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SFDR Regulatory Technical Standards — FAQs

14 April 2022

On 6 April 2022, the European Commission adopted the final Regulatory Technical Standards (RTS) supplementing the Sustainable Finance Disclosure Regulation (SFDR) and its Annexes. SFDR imposes significant ESG disclosure obligations on asset managers marketing funds in the EU. The RTS specify the mandatory website, pre-contractual and periodic reporting templates for financial market participants and in-scope financial products.

Provided there are no objections by the European Parliament and Council over the next three months, the RTS will be published in the Official Journal of the EU later in the year. Subject to no further delays, the RTS will then apply from 1 January 2023.

We answer below some of the most frequently asked questions posed in relation to SFDR based on the final RTS.

1. Are the final RTS published in April 2022 significantly different from the previous drafts?

   There are no substantial changes to the position that was set out in the February and October 2021 drafts. Financial market participants should now familiarise themselves with the mandatory reporting templates for pre-contractual and periodic disclosures as well as the Principal Adverse Sustainability Impacts (PASI) Statement in order to be in a position to make these disclosures from 1 January 2023.

2. Can I choose my SFDR product classification?

   The RTS explicitly state that the SFDR is "*not a labelling regime.*" It is the investment approach and/or other characteristics of a fund that will determine

SFDR product classification. A sponsor may elect to pursue a particular classification by structuring the environmental and/or social characteristics or objectives that the sponsor intends to promote to be consistent with that classification. Classification depends on a number of factors, including firmwide commitments, sustainability or responsible investment policies and the nature of the binding characteristics or objectives that flow through to the fund investments. Disclosures must then be made in accordance with the requirements of Article 8 or Article 9 depending on whether the claims made to EEA investors sit within Article 8 or Article 9.

3. What is an Article 8 characteristic?

The RTS do not provide any further clarity on what is an "environmental or social characteristic" qualifying a fund for Article 8 classification beyond what can already be drawn from guidance provided by the regulators. This guidance has allowed for a range of approaches to be adopted, including (i) environmental- or social-oriented thematic investment strategies, (ii) environmental- or social-oriented exclusions that materially reduce the investible universe, (iii) adoption of Principal Adverse Impact (PAI) diligence processes, and/or (iv) adoption and tracking of progress against environmental- or social-oriented targets or goals.

Whereas earlier drafts of the RTS specified that baseline environmental and social diligence would not place a fund in Article 8 territory, the latest guidance leaves open to interpretation whether, for example, the mere collection and tracking of performance against ESG KPIs, or certain ESG risk or opportunity management approaches, during the ownership period for fund products could constitute environmental or social characteristics. Further clarity on these issues may be provided when new minimum criteria for Article 8 products (which was flagged in ESMA's Sustainable Finance Roadmap) are introduced in due course.

4. How do periodic disclosure obligations impact my Article 8 characteristics or Article 9 objectives?

Helpful guidance about periodic disclosures has been retained in the RTS, and this should be front of mind when articulating Article 8 strategies. Qualitative and quantitative indicators will need to be reported to investors in annual reports demonstrating how the product meets the environmental or social characteristics that it promotes (for Article 8 funds) or the sustainable investment objective that it seeks to attain (for Article 9 funds). These indicators should be considered at the outset, alongside the design and investment strategy of the financial product.

5. Have the PAI indicators or the PASI Statement changed?

   Not materially. Importantly, the latest draft confirms that data on Scope 3 emissions should now be collected for the current reference period, i.e., the period from 1 January 2022.

   The final RTS have (i) clarified some of the definitions, (ii) added radioactive waste to the PAI for waste and (iii) clarified the calculation method for board gender diversity. The requirement to include information on actions taken or planned to avoid or reduce the PAI has been included in the disclosure template, which now signals that data collection with respect to PAI is not the end game – rather, plans, goals or targets to avoid or reduce PAI over time will be key. Significantly, the RTS no longer specify the need to set thresholds with respect to the PAI, something that was referenced in earlier guidance.

   The PASI Statement template is now final and will require a substantial mix of quantitative and qualitative data.

6. How often do I need to collect PAI data?

   Quarterly. There is a clear statement in the RTS that "*[t]he determination of principal adverse impacts should . . . be undertaken on at least four specific dates during such reference period and the average result should be disclosed on an annual basis.*" Those dates are 31 March, 30 June, 30 September and 31 December and a simple average of impacts calculated on each of those dates should be run to determine the figure to be reported for the corresponding reference period.

   Where information on the PAI is not readily available, financial market participants must include details of the best efforts used to obtain the information, including by seeking the information directly from investee companies, carrying out additional research, cooperating with third-party data providers or external experts or "*making reasonable assumptions.*"

7. If I don't consider PAI, do I still need to complete the PASI Statement?

   No. In this situation, a sponsor must make a negative disclosure prescribed in the RTS and provide an explanation of why the sponsor does not consider any adverse impacts and, where appropriate, set out information on whether the sponsor intends to consider such adverse impacts in the future by reference to the mandatory indicators.

8. When making “sustainable investments” can I use third-party data?

   Yes. Helpful guidance has been included confirming that where data on Taxonomy-alignment of economic activities is not available in public disclosures made pursuant to EU sustainability reporting rules, third-party data may be relied on. Where investees are not subject to EU sustainability reporting rules, publicly reported data or data that is obtained directly from the investee company or from a third party should be relied on, in each case provided the information is in the same format as required by EU sustainability reporting rules.

9. Does an Article 9 product still need to make 100% “sustainable investments”?

   Yes. The RTS confirm that Article 9 products should make sustainable investments only. There is some flexibility where other investments are required by sector-specific rules. However, in such cases a clear description needs to be included in disclosures to investors outlining the amount and purpose of those other investments so that it can be verified that such investments do not prevent the product from attaining its sustainable investment objective.

10. What does the diligence look like for “sustainable investments”?

    Article 9 products should have in place robust diligence with respect to “*good governance*” practices and whether the relevant target investments “*do no significant harm*” to environmental and social objectives. Disclosures to investors will need to include information on policies used to assess good governance practices of investee companies, including with respect to sound management structures, employee relations, remuneration of staff and tax compliance. No further guidance has been provided on what should be expected in relation to each of those areas.

    In relation to the “*do no significant harm*” principle, the RTS confirm that PAI diligence will need to be undertaken so that disclosures can explain how any adverse impacts have been taken into account. In addition, the RTS confirm that where “*sustainable investments*” are made, information will be required on the alignment of the investments with the “*minimum safeguards*” requirements under the Taxonomy Regulation, meaning diligence procedures should in principle consider alignment with the OECD Guidelines for Multinational Enterprises (OECD Guidelines) and UN Guiding Principles on Business and Human Rights (UNGP).

11. Can I contribute to an environmental objective without being Taxonomy aligned?

    Yes. The RTS confirm that a "sustainable investment" can contribute to an environmental objective that is not set out in the Taxonomy Regulation. However, as this regulatory regime evolves and potentially expands, we anticipate that both regulators and investors will expect greater alignment in the future.

12. How is human rights due diligence relevant to the SFDR requirements?

    The role of the UNGP and OECD Guidelines in regulatory compliance regimes continues to evolve. The RTS confirm the link between any product making "sustainable investments" and adherence to the UNGP and OECD Guidelines. Some financial market participants may need to make changes to their investment screening and diligence procedures and consider additional monitoring procedures during the investment period. As this regime develops, it is likely we will see the penetration of the UNGP and OECD Guidelines into the policies and diligence procedures of private enterprises.

13. What about exclusion strategies?

    The RTS expect that end investors should be provided with information to assess the effects of such exclusions on investment decisions, in particular the effect on the composition of the resulting portfolio. The RTS confirm that where exclusion strategies are applied, they should be binding on the investment strategy and included in disclosures on asset allocation and the sustainability indicators used to measure the effect of such strategies.

14. Are entity-level disclosures required for non-EU AIFMs?

    The RTS do not confirm this point. There has been uncertainty on this aspect for a number of months and differing views in the market. Our view is that EU regulators intend to make non-EU AIFMs subject to the SFDR entity-level disclosures[1] and official sources have now confirmed that entity-level disclosures must be made by non-EU AIFMs that are registered to offer financial products to EEA-based investors.

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1. For further information, please see our July 2021 *Alert.*↩

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