

# EU Sustainable Finance Disclosure Regulation— An Update

23 May 2022

The EU Regulation on sustainability-related disclosures in the financial services sector (the “[SFDR](#)”) came into effect in March 2021. Subsequently, the European Supervisory Authorities (the “ESAs”) produced on 6 April 2022 the final Regulatory Technical Standards (“[RTS](#)”), including the templates for disclosure by funds within Article 8 or Article 9 of SFDR. The RTS are subject to final approval by the European Parliament and Council. Since that date, the Commission and the European Supervisory Authorities have published documents which indicate that SFDR rule-making has not yet finished its initial phase.

The ESAs published on 13 May 2022 a [set of questions](#) that they have recently asked the European Commission (the “Commission”) in relation to interpretation of the SFDR and EU Taxonomy for sustainable activities. This is an important document: the ESAs have raised some key questions of interpretation that the industry as a whole has debated since the inception of SFDR, so the Commission’s answers will be crucial.

The questions include the following:

- Whether a firm can consider principal adverse impact (“PAI”) factors for only a subset of its funds and disclose that approach under Article 4 of SFDR, which covers a firm’s website disclosure on its consideration of PAI factors.
- The application of SFDR to a financial adviser, in particular where the adviser recommends investments that are not financial products in scope of SFDR, such as investments in securities and bonds.
- Whether Articles 6 and 7 of SFDR (that require firms to include sustainability-related information in all their financial products) apply to financial products that are no longer available to investors.
- If a fund in scope of Article 8 or 9 of SFDR does not invest in companies with good governance, whether it is able to continue to classify itself under Article 8 or 9 of SFDR.

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- If a fund in scope of Article 8 does not commit to invest in environmentally sustainable investments, whether such fund is obliged to disclose information on Taxonomy alignment and, if it then invests in environmentally sustainable investments, whether the fund is obliged to disclose information on Taxonomy alignment.

Separately, in relation to the RTS containing the disclosure and reporting templates, the Commission published two letters to the ESAs on 6 May 2022, each proposing amendments to the RTS. The [first](#) letter invites the ESAs to make specific changes to the RTS in light of the recently adopted Complementary Climate Delegated Regulation. The Complementary Climate Delegated Regulation sets out the specific conditions under which fossil gas- and nuclear energy-related activities are considered activities that contribute to climate change transition and hence qualify under the EU environmental Taxonomy. Hence, the Commission requires specific disclosure in pre-contractual documents and ongoing reporting of a fund's exposure to investments in fossil gas- and nuclear energy-related activities. We can expect changes to the RTS (and templates) in due course.

The [second](#) letter invites the ESAs to consider much broader changes to the RTS. The RTS include the list of PAI environmental and social indicators which firms within scope of Article 4 of the SFDR are required to measure and report. In open-ended language, the letter invites the ESAs to review the PAI regime by considering extending the list of PAI factors and refining the content of the factors by revising their definitions, methodologies, metrics and presentation. The letter suggests that more information be given in relation to “evidence that investments align with the standards” and that “implementation and application efforts” in relation to PAI factors take place. The breadth of the review is fairly unclear, but in principle could involve a wholesale review of the PAI regime. Separately, the Commission invites the ESAs to propose amendments to the Regulatory Technical Standards on information given in pre-contractual disclosure and periodic reporting on decarbonisation targets, including “intermediary targets and milestones”. There is also a reference to a possible review of the information given in pre-contractual disclosure and periodic reporting on alignment of the portfolio to the EU environmental Taxonomy.

Lastly, various delegated Directives and Regulations to the Alternative Investment Fund Managers Directive (“AIFMD”), Undertakings Collective Investment in Transferable Securities (“UCITS”) and the Markets in Financial Instruments Directive (“MiFID”) arising from SFDR first apply in August 2022.

A new MiFID Delegated Regulation on integration of sustainability factors and preferences into firms' organisational requirements and operating conditions requires a client's sustainability preferences to be taken into account in the suitability check. This

will apply where a firm regulated under MiFID provides investment advice or portfolio management to a client. Sustainability preferences means the client's preference to invest in financial instruments with a minimum proportion of environmentally sustainable investments (Taxonomy-aligned investments), with a minimum proportion of sustainable investments (the general concept under Article 2(17) of SFDR) or that take into account principal adverse impacts "where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client". As noted above, there is present uncertainty as to whether financial advisers are in scope of SFDR in relation to investments (such as bonds) that are not themselves in scope of SFDR. The Delegated Regulation also requires firms to take into account sustainability risks in overall organisational requirements, in risk management policies and in conflicts of interest (where a conflict may affect the sustainability preferences of a client). This applies from 2 August 2022. The European Securities and Markets Authority ("ESMA") recently published a consultation on guidelines on the suitability check, including draft guidance on how firms should include sustainability factors in the suitability check.

For Alternative Investment Fund Managers ("AIFMs"), a Delegated Regulation on sustainability risks and factors to be taken into account by AIFMs requires AIFMs to take into account sustainability risks (and principal adverse impacts, if they consider them) in the due diligence process and sustainability risks in the risk management policy and to update conflicts of interest policies for conflicts that may arise from the integration of sustainability risks. It also requires firms to take into account sustainability risks in overall organisational requirements, including responsibilities of the governing body. This applies from 1 August 2022.

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Please do not hesitate to contact us with any questions.

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