

CLIENT ALERT

# Recent Developments in EU Sustainable Finance Disclosure Regulation

July 12, 2022

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The Sustainable Finance Disclosure Regulation (the “**SFDR**”)<sup>1</sup> has been in effect since 10 March 2021. The SFDR applies to a wide range of financial market participants including EU and non-EU alternative investment fund managers (“**AIFMs**”) that market products such as funds in the EU (see our 2021 briefing on this topic [here](#)). Although the provisions of the SFDR relating to pre-contractual and website disclosures have been in place since March 2021, there was no guidance on interpretation, and the regulatory technical standards which contain more detailed requirements had not been finalised, providing uncertainty as to how AIFMs should approach compliance.

On 6 April 2022 the European Commission adopted regulatory technical standards (the “**SFDR RTS**”), which are scheduled to apply from 1 January 2023. The SFDR RTS set out how firms should seek to comply with aspects of the SFDR disclosure requirements, including by establishing template reporting requirements in relation to (i) principal adverse impacts of investment decisions on sustainability factors, and (ii) pre-contractual and website disclosures and periodic reports. The standards provided by the SFDR RTS are detailed and will require AIFMs to carry out extensive data gathering exercises in relation to Article 8 Funds and Article 9 Funds (as defined below). The method in which the disclosures are to be made, in particular the website disclosures, may also be difficult for AIFMs that are subject to conflicting rules (such as those applicable to U.S. fund managers) that prohibit the publication of information regarding the funds they manage.

<sup>1</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

The interpretation of the SFDR has been added to recently by (i) a Q&A from the European Commission (the “**EC**”) (available [here](#)), (ii) a supervisory briefing from the European Securities and Markets Authority (“**ESMA**”) (available [here](#)), (iii) a clarification statement (issued by ESMA) in relation to the SFDR RTS (available [here](#)) and (iv) a joint statement issued by the European Supervisory Authorities (the “**ESAs**”) clarifying the ESAs draft SFDR RTS (available [here](#)). This briefing summarises some aspects of the recent interpretative guidance likely to be of most interest to non-EU AIFMs marketing in the EU.

### Core obligations under SFDR

The SFDR is designed to promote transparency of sustainability risks. It seeks to achieve this by requiring financial market participants such as AIFMs to make certain disclosures. The SFDR imposes disclosure obligations in relation to the AIFM itself and separate requirements in relation to the marketing of a product such as a fund. The extent of the fund disclosure and reporting requirements depends upon the type of fund being marketed in the EU. These requirements are supplemented by the Taxonomy Regulation.<sup>2</sup>

The disclosure obligations include website disclosures at the AIFM (entity) level and website disclosures at a product level for Article 8 and Article 9 Funds. The pre-contractual disclosures and the periodic reporting requirements vary in relation to the classification of the fund’s status as a so-called Article 6, 8 or 9 Fund. This briefing does not detail the full obligations applicable to AIFMs marketing different types of funds to EU investors, but summarises the implications of recent guidance and RTS on these obligations.

As a recap, AIFMs that market funds which promote environmental or social characteristics (“**Article 8 Funds**”) are required to disclose: (i) certain additional pre-contractual information, (ii) information on their websites that includes the data specified in the SFDR RTS (as detailed further below in relation to principal adverse impacts (“**PAIs**”)), and (iii) the information specified in the SFDR RTS in periodic reports. AIFMs that market funds that have sustainable investment as their objective (“**Article 9 Funds**”) are required to disclose: (i) more detailed pre-contractual information, (ii) additional website disclosure in accordance with the SFDR RTS (as detailed further below in relation to PAIs), and (iii) the information specified in the SFDR RTS in periodic reports.

For Article 8 and Article 9 Funds, disclosures must be made using the templates prescribed by the SFDR RTS, which is scheduled to apply from 1 January 2023. Funds being marketed now which expect to continue marketing in 2023 should start preparing to comply with the SFDR reporting templates.

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<sup>2</sup> Regulation 2020/852/EU. Not covered in this briefing.

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

### Scope of application of SFDR – European Commission Q&A

The SFDR itself is unclear on the extent to which entity level disclosure rules apply to non-EU AIFMs, as opposed to the product level disclosure rules. The industry did not adopt a uniform interpretation of the SFDR's scope provisions on its publication. In particular, no consensus was reached on whether the term "alternative investment fund manager" as defined in Article 2(1)(e) of the SFDR was intended to capture non-EU AIFMs. Further, many non-EU AIFMs were concerned that some aspects of the SFDR (such as in relation to the website disclosures) if applied to them would conflict with regulations in other jurisdictions, such as the United States.

European Commission ("EC") guidance of 26 July 2021 stated that non-EU AIFMs marketing funds in the EU under national private placement regimes are subject to the SFDR. This response was not without ambiguity as the EC did not explicitly state that all aspects of the SFDR were to be applied to such non-EU AIFMs. In particular, it was not clear from the EC's response that the entity level requirements including the website disclosures relating to the manager rather than the fund are required to be made by non-EU AIFMs. Additional non-binding commentary was provided in response to industry requests in March 2022 from the Asset Management division of the EC confirming its view that the entity level requirements of the SFDR apply to non-EU AIFMs in addition to the product/fund level requirements.

Given that (i) only the European Court of Justice ("ECJ") may provide a legally binding interpretation of EU law, and (ii) only ESMA may issue binding guidance in relation to EU law, the response of the EC's Asset Management division is, whilst relevant, still not definitive on its own. Non-EU AIFMs are currently taking different approaches on whether they produce entity level website disclosures in line with SFDR. Many firms will in any case have statements on their websites regarding their approach to ESG, regardless of SFDR.

In addition, the EC has confirmed in the Q&A that the SFDR applies to funds that have not been marketed to new investors since 10 March 2021 (the date on which SFDR entered into force) but which are still in existence after that date. This means that, where the AIFM produces periodic reports for existing EU investors in Article 8 Funds and Article 9 Funds launched prior to 10 March 2021, such periodic reports must now include SFDR-compliant disclosures. For funds which closed prior to March 2021, an analysis must be undertaken to consider whether such funds could be classified as Article 8/9 Funds.

### Disclosure in relation to principal adverse impacts

As noted above, AIFMs are subject to a requirement to either disclose PAIs of their investment decisions on sustainability factors, or to explain why they do not consider PAIs. To date, firms have delayed the decision as to whether to disclose PAIs in anticipation of the SFDR RTS being finalised. Now that the SFDR RTS are effectively final, AIFMs that do choose to disclose PAIs will need to do so in accordance with the reporting templates set out in the SFDR RTS from 1 January 2023. The templates specify 18 separate sustainability indicators ranging from environmental indicators such as greenhouse gas emissions, carbon footprint, biodiversity and energy consumption of investee companies, through to social indicators

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

such as positions in companies with gender pay gaps and anti-bribery and corruption matters. We have summarised the data required to be collected by AIFMs in respect of PAIs in Appendix 1. Collecting this data is likely to be burdensome for firms and even if the AIFM is able to collect all of the required data, there is limited guidance in the SFDR RTS as to how the qualitative assessment of the fund's performance against the sustainability indicators is to be carried out. The SFDR RTS are also silent on the extent to which firms may rely on assumptions or qualifications when presenting the qualitative assessment of PAIs.

On 2 June 2022, the ESAs issued clarifications to address some of the difficulties of the SFDR RTS in respect of PAI disclosure. These clarifications relate principally to the calculation methodology for PAIs. The ESAs advised that where a fund's exposure to a PAI (such as greenhouse gas emissions) varies during the annual reference period, an average should be taken based on quarterly calculations of the exposure. There is also guidance to confirm that AIFMs must "look through" their holdings in investee companies if such investees are themselves holding companies, to determine the PAIs arising from the activities of the investee company's subsidiary operating companies. This potentially increases the regulatory burden for AIFMs disclosing PAIs.

### **ESMA clarification statement on scope of certain obligations relating to Article 8 and Article 9 Funds**

ESMA's clarification statement confirmed that AIFMs are required to assess all investee companies of their Article 8 Funds for compliance with good governance standards. AIFMs of Article 8 Funds are not permitted to restrict their assessment only to the portion of the portfolio that pursues environmental and social characteristics. The clarification statement also confirmed that it is mandatory for AIFMs of Article 9 Funds to use the PAI indicators when assessing whether an investment does significant harm to an environmental objective.

### **The presentation of data in website disclosures under the SFDR RTS**

AIFMs marketing Article 8 Funds and Article 9 Funds in the EU are required to ensure that they include on their websites information relating to these funds. Such information must be arranged in the manner specified in Articles 25 – 49 of the SFDR RTS, which impose specific headings for different sections of firms' web pages containing the relevant disclosure. The table in Appendix 2 summarises the required sections and content that must be made available on firms' websites, including by non-EU AIFMs marketing in the EU.

Non-EU AIFMs may be subject to conflicting laws in respect of disclosures relating to private funds in their home jurisdictions. Where such conflicts exist non-EU AIFMs may be required to geo-block or otherwise restrict EU investors from accessing areas of their websites that do not include the required SFDR disclosure and vice versa.

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

### The role of national regulators

In the supervisory briefing issued on 31 May 2022, ESMA set out the approach that regulators in EU member states should take to monitor and enforce compliance by AIFMs with the SFDR. The guidance is non-binding and does not require regulators to comply by any particular date. Although the guidance is intended to promote convergence of regulatory approaches in the EU, non-EU AIFMs that register funds for marketing in more than one EU member state will need to be prepared to take account of any difference in rules that may in the future emerge in each jurisdiction that they market in.

The briefing refers to a concept of “additional supervisory action” including intrusive measures such as analysis of AIFMs’ portfolios to ensure that the holdings reflect the sustainability strategies and characteristics presented by the AIFM in its disclosures to investors. AIFMs may be asked to explain to national regulators how their portfolios are consistent with the promoted strategy. Regulators are also given a role in reviewing the naming of funds, something which is not covered in the SFDR itself. The use of terms such as “ESG”, “green”, “social”, “ethical”, “impact” and similar terms in fund names should be restricted by national regulators only to certain funds. Such terms should only be allowed if their use is supported in a material way by evidence of the fund’s sustainability characteristics, themes or objectives, as these are reflected in the fund’s documentation. According to the supervisory briefing, national regulators should reject the use of terms relating to sustainability in funds’ names if the fund does not demonstrate binding sustainability characteristics, in particular if the fund’s documentation and portfolio analysis do not support its claim to promote sustainability objectives, the aim being to ensure that fund names are not misleading. As some draft directives published by national competent authorities (e.g. BaFin in Germany and the AMF in France) already indicate, this may lead to non-harmonised approaches across Europe with varying sustainability requirements attached to the use of certain expressions in fund names.

## Recent Developments in EU Sustainable Finance Disclosure Regulation

### Appendix 1 – Principal Adverse Impacts

The following table summarises the data on principal adverse impacts that AIFMs which consider the adverse impacts of investment decisions on sustainability factors will be required to disclose under Article 6 of the SFDR RTS. Some AIFMs will be required to disclose additional data, depending on their investment strategies.

In addition to the metrics on PAIs that AIFMs are required to collect, we have included the columns from the reporting template that specify the reporting period (the reporting year and the previous year) as well as those which require AIFMs to make qualitative assessments of their exposure to each PAI.

<i>Climate and other environment-related indicators</i>
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<b>Adverse sustainability indicator</b>	<b>Metric</b>	<b>Impact (year n)</b>	<b>Impact (year n-1)</b>	<b>Explanation</b>	<b>Actions taken, and actions planned and targets set for the next reference period</b>
Greenhouse Gas emissions	Scope 1, Scope 2, Scope 3 and Total GHG emissions				
Carbon footprint	Total carbon footprint				
GHG intensity of investee companies	GHG intensity of investee companies				
Exposure to companies active in the fossil fuel sector	Share of investments in companies active in the fossil fuel sector				

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Adverse sustainability indicator	Metric	Impact (year n)	Impact (year n-1)	Explanation	Actions taken, and actions planned and targets set for the next reference period
Share of non-renewable energy consumption and production	Share of non-renewable energy consumption and non-renewable energy production of investee companies from non-renewable energy sources compared to renewable energy sources, expressed as a percentage of total energy sources				
Energy consumption intensity per high impact climate sector	Energy consumption in GWh per million EUR of revenue of investee companies, per high impact climate sector				
Activities negatively affecting biodiversity-sensitive areas	Share of investments in investee companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas				

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Adverse sustainability indicator	Metric	Impact (year n)	Impact (year n-1)	Explanation	Actions taken, and actions planned and targets set for the next reference period
Emissions to water	Tonnes of emissions to water generated by investee companies per million EUR invested, expressed as a weighted average				
Hazardous waste and radioactive waste ratio	Tonnes of hazardous waste and radioactive waste generated by investee companies per million EUR invested, expressed as a weighted average				
<i>Indicators for social and employee, respect for human rights, anti-corruption and anti-bribery matters</i>					
Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises	Share of investments in investee companies that have been involved in violations of the UNGC principles or OECD Guidelines for Multinational Enterprises				

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Adverse sustainability indicator	Metric	Impact (year n)	Impact (year n-1)	Explanation	Actions taken, and actions planned and targets set for the next reference period
Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises	Share of investments in investee companies without policies to monitor compliance with principles or OECD Guidelines for Multinational Enterprises or grievance/complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises				
Unadjusted gender pay gap	Average unadjusted gender pay gap of investee companies				
Board gender diversity	Average ratio of female to male board members in investee companies, expressed as a percentage of all board members				

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Adverse sustainability indicator	Metric	Impact (year n)	Impact (year n-1)	Explanation	Actions taken, and actions planned and targets set for the next reference period
Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)	Share of investments in investee companies involved in the manufacture or selling of controversial weapons				
<i>Indicators applicable to investments in sovereigns and supranationals</i>					
GHG intensity	GHG intensity of investee countries				
Investee countries subject to social violations	Number of investee countries subject to social violations (absolute number and relative number divided by all investee countries), as referred to in international treaties and conventions, United Nations principles and, where applicable, national law				

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Adverse sustainability indicator	Metric	Impact (year n)	Impact (year n-1)	Explanation	Actions taken, and actions planned and targets set for the next reference period
<i>Indicators applicable to investment in real estate assets</i>					
Exposure to fossil fuels through real estate assets	Share of investments in real estate assets involved in the extraction, storage, transport or manufacture of fossil fuels				
Exposure to energy-inefficient real estate assets	Share of investments in energy-inefficient real estate assets				

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

### Appendix 2 – Website Disclosure

#### Article 8 Funds

Website Heading	Summary of Content
Summary	A summary of the information contained in the following sections, which must take up no more than two sides of A4 paper when printed.
No sustainable investment objective	The following statement must be inserted: “ <i>This financial product promotes environmental or social characteristics, but does not have as its objective sustainable investment</i> ”.
Environmental or social characteristics of the financial product	A description of the environmental or social characteristics that the financial product promotes.
Investment strategy	A description of (i) the investment strategy used to meet the environmental or social characteristics promoted by the financial product, and (ii) the policy to assess good governance practices of the investee companies, including with respect to sound management structures, employee relations, remuneration and staff and tax compliance.
Proportion of investments	The minimum proportion of sustainable investments that the AIFM will hold (disclosed in accordance with Annex II of the SFDR RTS).
Monitoring of environmental or social characteristics	A description of how the environmental or social characteristics of each fund are monitored throughout the lifecycle of the fund.

## Recent Developments in EU Sustainable Finance Disclosure Regulation

Website Heading	Summary of Content
Methodologies for environmental or social characteristics	A description of the methodologies used by the AIFM to measure how the social or environmental characteristics promoted by each of its Article 8 funds are met.
Data sources and processing	The policy used by the AIFM to assess the data sources used to attain each of the environmental or social characteristics promoted by the fund. This should include the measures used to ensure data quality, the methodology for processing data and the proportion of the data that are estimated.
Limitations to methodologies and data	A description of the limitations of the methodologies used to define the environmental or social characteristics of the fund and the data sources, as well as how such limitations do not affect how the environmental or social characteristics promoted by the fund are met.
Due diligence	A description of the due diligence carried out by the AIFM on the underlying assets of the fund.
Engagement policies	Disclosure in respect of the AIFM's approach to compliance with the requirement to promote shareholder engagement under Article 3g of Directive 2007/36. This is unlikely to apply to non-EU AIFMs.
Designated reference benchmark	Confirmation as to whether an index has been designated as a reference benchmark to meet the environmental or social characteristics promoted by the fund.

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

### Article 9 Funds

<b>Website Heading</b>	<b>Summary of Content</b>
Summary	A summary of the information contained in the following sections, which must take up no more than two sides of A4 paper when printed.
No significant harm to the sustainable investment objective	An explanation as to whether and why the investments of the fund do not significantly harm any of the sustainable investment objectives, taking into account the PAIs.
Sustainable investment objective of the financial product	A description of the sustainable investment objective of the financial product.
Investment strategy	A description of (i) the investment strategy used to attain the sustainable investment objective, and (ii) the policy to assess good governance practices of the investee companies, including with respect to sound management structures, employee relations, remuneration and staff and tax compliance.
Proportion of investments	The minimum proportion of sustainable investments that the AIFM will hold (disclosed in accordance with Annex II of the SFDR RTS).
Monitoring of the sustainable investment objective	The information from the section of Annex III of the SFDR RTS entitled “what is the asset allocation and the minimum share of sustainable investments?”

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

Website Heading	Summary of Content
Methodologies	The methodologies used to measure the attainment of the sustainable investment objective and how the sustainability indicators to measure the attainment of that sustainable investment objective are used.
Data sources and processing	The policy used by the AIFM to assess the data sources used to attain the sustainable investment objective. This should include the measures used to ensure data quality, the methodology for processing data and the proportion of the data that is estimated.
Limitations to methodologies and data	A description of the limitations of the methodologies used, as well as how such limitations do not affect the attainment of the sustainable investment objective.
Due diligence	A description of the due diligence carried out by the AIFM on the underlying assets of the fund.
Engagement policies	Disclosure in respect of the AIFM's approach to compliance with the requirement to promote shareholder engagement under Article 3g of Directive 2007/36. This is unlikely to apply to non-EU AIFMs.

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## Recent Developments in EU Sustainable Finance Disclosure Regulation

Website Heading	Summary of Content
Attainment of the sustainable investment objective	For funds that have sustainable investment as their objective and which have adopted an index as a reference benchmark, a description of how that index is aligned with the sustainable investment objective.  For funds that have a reduction in carbon emissions as their objective, a statement that the reference benchmark qualifies as an EU Climate Transition Benchmark or an EU Paris-aligned Benchmark.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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