



THE VOICE OF  
PRIVATE CAPITAL

VENTURE CAPITAL  
PRIVATE EQUITY  
INFRASTRUCTURE  
LONG TERM INVESTORS

---

# Invest Europe Member Policy Call

## SFDR Known Unknowns

---

Monday 15 February 2021

# Sustainable Finance Disclosure Regulation (SFDR) - Brief overview

## 1 type of manager

Any financial market participant

## 3 types of product/fund

Conventional AIFs

E&S Promoting Funds

Sustainable Investment Funds

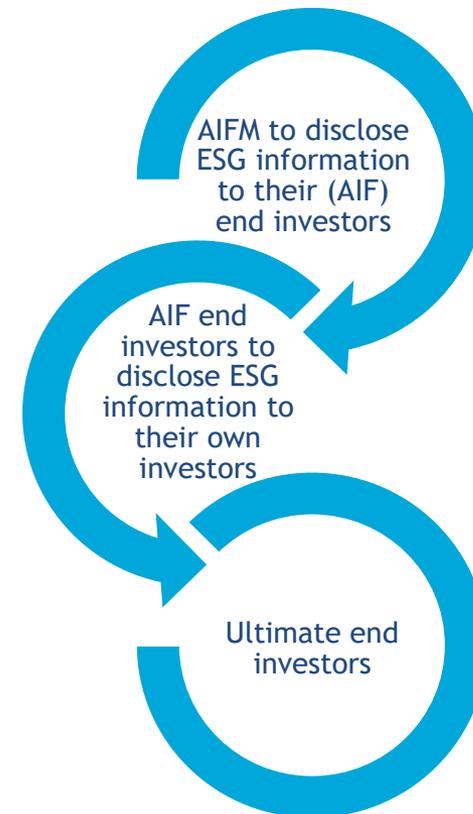
## 3 levels of requirements

Public (website) disclosure

Pre-contractual disclosure

Periodic disclosure (annual report)

Application date: 10 March 2021



---

# As a reminder...

---

## SFDR - Key Articles

- Article 4 “Transparency of **adverse sustainability impacts** at entity level”
- Article 6 “Transparency of the integration of sustainability risks”
- Article 7 “Transparency of **adverse sustainability impacts** at financial product level”
- Article 8 “Transparency of **the promotion of environmental or social characteristics** in pre-contractual disclosures”
- Article 9 “Transparency of **sustainable investments** in pre-contractual disclosures”
- Article 10 “Transparency of the promotion of environmental or social characteristics and of sustainable investments on **websites**”

---

# Please bear in mind...

---



- Invest Europe materials on SFDR do not constitute legal advice or provide legally binding guidance.
- We expect the European Commission to come up with *both* a response to the ESAs letter *and* broader guidance (e.g. in the form of FAQs) on the application of SFDR soon.
- The exact timing remains to be confirmed, as well as the extent to which the Commission will agree with our thinking and proposed implementation.
- Ultimately, the Commission's guidance will take precedence over Invest Europe's informal views on how the SFDR rules can be interpreted and applied.

---

# SFDR Known Unknowns

Consensus position



---

# Article 8 and legacy funds

---

*What is the relevance of Article 8 to funds which have closed prior to 10 March 2021 (legacy funds)? This is a live issue because there is no express grandfathering relief in SFDR for legacy funds.*

## Consensus view:

- Article 8 should not be applied retroactively to closed-end funds.
- SFDR is forward looking, applicable to products in market on or after 10 March 2021.

*Note: This approach involves accepting some legal risk, but could be acceptable, particularly in light of the difficulty associated with collecting relevant information in respect of legacy products.*

---

# Opting into PAIs

---

*Many asset managers will have the flexibility to choose whether to opt in or out of the PAI (Principal Adverse Impacts) regime. Their decision will likely balance effort/resourcing with IR and/or strategic priorities. This decision is made more complicated by the delay to the Level 2 rules (the recently published draft Regulatory Technical Standards developed by the ESAs), which means that a manager who opts in in 2021 may not know until very late in the day what the detail of opting in involves.*

## Consensus view:

- Tendency to **opt out** from day one, i.e. 10 March 2021, but to keep this decision under review in the short to medium term afterwards.

---

# Application to non-EU AIFMs

---

*SFDR does not distinguish between EU and non-EU firms (it only refers to, for example, “Financial Market Participants”). Non-EU AIFMs marketing AIFs into Europe will therefore need to take a position regarding whether SFDR will apply at firm level, fund level or both.*

## Consensus view:

- Only fund-level obligations (i.e. Article 6 and, as applicable, Articles 8 and/or 9) apply in the context of a non-EU AIFM marketing a fund into the EU pursuant to Article 42 AIFMD.
- It would be disproportionate and very hard to enforce firm-level obligations on these managers.

---

# Position of sub-threshold AIFMs

---

*SFDR does not distinguish between sub-threshold and fully-authorized AIFMs; each seems to be a financial market participant. The application of SFDR - at firm level, product level or neither - is very unclear.*

## Consensus view:

- The question of how SFDR applies to a sub-threshold AIFM (i.e. a small, registered AIFM) should be a question determined by **the law of the (home) Member State** of that AIFM.

---

# Periodic reporting obligations

---

*The SFDR periodic reporting obligations for products engaging Articles 8 or 9 apply from 1 January 2022. However, what this means in practice is unclear and there are several potential readings.*

## Consensus view:

- Preparedness to follow the reading - unless further guidance is published to the contrary - that the **reporting reference period** begins from 1 January 2022.
- It is at this point that firms will need to start capturing the data for the report, i.e. to report in 2023 regarding the 2022 reporting cycle.

*Note: This is a point of possible divergence from the position put forward in the draft RTS recently published by the ESAs.*

---

# Public disclosures

---

*Article 10 of SFDR requires certain financial market participants to make website disclosures in relation to Article 8 and Article 9 products.*

## Consensus view:

- This obligation should *not* apply in relation to products where information is *not* otherwise made available to the public.
- It would be inappropriate to make product-specific information available to the public generally, even with appropriate disclaimers, as this would seem contrary to the general policy objective of ensuring that only investors for whom a product is suitable are given information about that product.
- It is not necessary either because retail investors cannot typically invest in PE/VC products.
- Product-specific website disclosures should *only* be required where there is other information available about the product on a website.

---

# Article 8 scope

---

*There has not been any meaningful commentary on the scope of Article 8. What is the threshold for a product to be subject to Article 8? What is the meaning of “promotion” in the context of products promoting environmental or social characteristics?*

## Consensus view:

- Article 8 should only be engaged if the product promotes environmental and/or social characteristics in a way which suggests that certain investments would *not* be made by the product even if those investments otherwise meet the fund’s risk and return objectives.
- In order for a product to meet the Article 8 threshold, the manager would apply two conditions before a prospective investment could be approved for the fund:
  - that the investment satisfies the fund’s risk and return objectives (which in most cases will be at least market-level returns); and
  - meets a pre-defined environmental or social standard. Such a standard could cover (i) investments that would be avoided for certain negative externalities, and/or (ii) investments that have certain positive environmental and/or social characteristics.

---

## Article 8 scope (2)

---

- It would follow from reaching this position that, absent other active promotion of environmental or social characteristics, the following could form part of Article 6 disclosures, but **none would be sufficient to engage Article 8:**

- Firm or fund-level sustainability-related disclosures regarding investment processes if they are made only to comply with a legal obligation (e.g. a sustainability risk disclosure per Article 6 SFDR).
- Firm or fund-level sustainability-related disclosures explicitly or implicitly related to the firm's obligations to maximise risk-adjusted investment returns and not constraining investment decisions by reference to environmental or social considerations (i.e. no dual conditionality).
- The sponsoring firm's subscription to certain sustainability frameworks or standards, in particular where those frameworks focus on management of financially material sustainability risks and explicitly recognise that fiduciary risk-and-return related obligations to investors are paramount (for example, the Principles for Responsible Investment), or mandate reporting.

---

# Article 8 scope (3)

---

## Negative screens

- Article 8 should *not* be triggered merely because a product incorporates a norms-based or other exclusion screen (for example, a screen for thermal coal, tobacco or pornography), provided that the existence of such screen is not actively promoted as a positive feature as part of an attempt to “badge” or “sell” the product as sustainable.
- Similarly, a **merely confirmatory response** to one or more investors’ request or enquiry - i.e. where a financial market participant confirms to a particular investor, when asked, that its product is not going to do [X] - should not push the product into Article 8, provided that [X] has not previously been identified as part of the product’s strategy. This is particularly relevant in the context of side letter assurances which may be given on a ‘for-avoidance-of-doubt’ basis rather than as substantive commercial concessions.

---

# By comparison... Article 9

---

- Article 9 applies to a product which has **sustainable investment** (a term defined in Article 2(17) SFDR) as an objective.
- In the PE/VC industry, this will generally be identified readily in the fund's constitutional documents, for example in a summary of the principal legal terms, under the heading "investment objective". This sustainable investment objective could be (and often will be) accompanied by a binding obligation to target market rate returns (a so-called "**double bottom line**").
- An Article 9 product **need not invest exclusively** in sustainable investments. However, it would need to specifically target investments (at least for a material proportion of the fund) which make a measurable "contribution to" an environmental and/or social objective.

---

# Draft Level 2 RTS

A closer look



---

# Summary

---

- Final ESA report includes revised draft [Regulatory Technical Standards \(RTS\)](#) ready for adoption, proposed to apply from [1 January 2022](#) (except Scope 3 GHG emissions: 1 January 2023).
- RTS covers:
  - Article 4 Principal Adverse Impact (PAI) website statements and indicators
  - Article 8 (“light green”) / Article 9 (“dark green”): fund pre-contractual reporting requirements, including templates
  - Article 10 website disclosures for Article 8/9 funds
  - Article 11 periodic disclosures for Article 8/9 funds, including templates
  - “do no significant harm” definition for Article 2(17) (“sustainable investment”) - also relevant to certain Article 8 funds (“mid-green”)

---

# PAI statement (Article 4)

---

- 14 (+ 2) “mandatory” (i.e. report always required) and many more “optional” (i.e. report required if “principal”) indicators.
- Different indicators for (i) companies; (ii) governments; and (iii) real estate.
- **Measurement** required on at least 4 specific dates per period (report is the average measurement).
- **Narrative reporting** also stressed: new requirement to disclose actions taken and actions planned, or targets set, to avoid or reduce PAIs identified.
- **Historical comparison** for at least 5 years (reduced from 10).
- First RTS-compliant reports in **2023**, covering period from January 2022 (or later, if the firm opts in after January but before December) to December 2022.
- Statement for those opting out is prescribed but similar to previous proposal.
- New (and concerning) proposed requirement to produce disclosures in English AND the official **language** of the EU Member States where the firm’s products are marketed.

---

# Mandatory indicators - environmental matters

---

## ENVIRONMENTAL MATTERS

1. Greenhouse gas emissions (Scope 1, 2 and (from 1/1/2023) Scope 3)
2. Carbon footprint
3. GHG intensity of investee companies
4. Exposure to companies active in the fossil fuel sector
5. Share of non-renewable energy
6. Energy consumption intensity per high impact climate sector
7. Activities negatively affecting biodiversity-sensitive areas
8. Emissions to water
9. Hazardous waste ratio

---

# Mandatory indicators - social matters etc.

---

## SOCIAL AND EMPLOYEE, RESPECT FOR HUMAN RIGHTS, ANTI-CORRUPTION AND ANTI-BRIBERY MATTERS

10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises
11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises
12. Unadjusted gender pay gap
13. Board gender diversity
14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)

---

# “Green” funds (Article 8 / 9): pre-contractual disclosures

---

- Revised templates published (effective January 2022) - see page 83.
- ESAs regret that they cannot produce different templates for different products (“The ESAs strongly believe that this is a sub-optimal situation leaving the disclosures unfit for purpose for both types of documents.”).
- Funds have to measure **DNSH** against [relevant] PAI indicators for “sustainable investments” where they have made / committed to make them (i.e. n/a to Article 8 funds which have not committed to make a sustainable investment).
- Such funds must also measure portfolio companies against OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.
- Also need to include details of the policy to assess good governance “including with respect to sound management structures, employee relations, remuneration of staff and tax compliance”.

---

# “Green” funds: website disclosures

---

- Two-page summary required and website position specified.
- Those committing to make “sustainable investments” must explain DNSH tests (with reference to PAI indicators).
- Obligation to produce disclosures in English AND the official language of the EU Member States where the firm’s products are marketed.

---

# “Green” funds: periodic disclosures

---

- **Templates** published - see page 90.
- **Historical comparison** for 5 years required.
- **Top 15 investments** must be listed (or fewer if 50% of portfolio is in less than 15 investments).
- **DNSH disclosures** for those making “sustainable investments”.
- Reports required in **2022**.

---

# Initial observations

Recitals



---

# Funds-of-funds

---

## Recital (4)

“... where the investee company is a holding company, collective investment undertaking or special purpose vehicle, financial market participants that have sufficient information about the adverse impacts of the investment decisions of those companies should look through to the individual underlying investments of those companies and consider the total adverse impacts arising from them. Where they do not have such information, they cannot be considered to take into account the principal adverse impacts of their investment decisions on sustainability factors.”

---

# Lack of data

---

## Recital (8)

“Financial market participants should identify principal adverse impacts on sustainability factors through all reasonable means available. For example, they may employ external market research providers, internal financial analysts and specialists in the area of sustainable investments, undertake specifically commissioned studies, use publicly available information or shared information from peer networks or collaborative initiatives. Financial market participants may also engage directly with the management of investee companies to better understand the risk of adverse impacts on sustainability factors. Direct engagement may be particularly necessary in situations where there is an insufficient level of data available.”

---

# Article 8/9 fund: definition

---

- ESAs asked the Commission about this, but appear to have also tried to answer the question (and not necessarily in a helpful way!)
  - Recital (18)

“Among financial products, a difference is to be made between financial products that **exclusively** pursue sustainable investments and all other financial products that promote environmental or social characteristics.”
  - Recital (19)

“One of the ways in which financial products can promote environmental or social characteristics is to take into account principal adverse impacts of investment decisions.”
  - Recital (22)

“To ensure comparability, where a financial product promotes environmental or social characteristics in a pre-contractual or periodic document, in its product name or in any marketing communication about its investment strategy, financial product standards, labels it adheres to or applicable conditions for automatic enrolment, the financial product should include the pre-contractual and periodic disclosures set out in this Regulation.”
-

---

# DNSH potentially relevant to all “green” products

---

- Recital (33)

“... financial market participants that make available either a financial product that promotes environmental or social characteristics or a financial product that has sustainable investment as its objective should provide information relating to the ‘do not significantly harm’ principle.”

- This is only mandatory for Article 8 funds that make a commitment to make at least some “sustainable investments”.

---

# Article 10 website disclosures - public?

---

- Recital (35)

“The website product disclosure should provide additional details regarding the investment strategy of the financial product, such as the policy to assess good governance of investee companies, as well as methodologies to measure the attainment of the environmental or social characteristics or objectives of the financial product, provided that such information is consistent with the pre-contractual information. Moreover, financial market participants should include on their website a clear, succinct and understandable summary of the information provided as part of the periodic reporting. When doing so, financial market participants should comply with national and Union law governing the protection of confidentiality of information, including the protection of undisclosed know-how and business information and the processing of personal data.” [emphasis added]

---

# Article 10 website disclosures - public?

---

- See related commentary in the Accompanying Documents section of the report:  
“... Industry respondents also noted that some products are tailor-made private funds and portfolios managed on discretionary basis set up under bilateral agreements protected by confidentiality. Public website disclosures of products for institutional investors that are not publicly distributed should not be included in the website disclosures or should be made in a password-protected area of the website, otherwise it would be problematic in view of the general confidentiality of contractual agreements with institutional investors, applicable to both tailored funds and individual mandates, to disclose the relevant details in the public domain of the website.

.....

With regard to tailor-made products, the ESAs note that they cannot change the SFDR product scope which makes no differentiation between whether a product is “private” or “public” or whether a product is intended for a single client, according to the products listed in Article 2(12) SFDR. Furthermore, the public website disclosure requirement in Article 10 SFDR makes no provision for password protected disclosure, which by definition is not “public” then. The ESAs have provided a reminder in Recital 36 RTS, however, that website disclosures should respect EU and national rules on confidentiality of information.”

---

---

# Taxonomy aligned products: double reporting

---

In the responses to the consultation, the ESAs say the following:

“Furthermore, the ESAs intend to avoid double reporting for EU taxonomy aligned products, which will be further elaborated in the forthcoming taxonomy product RTS consultation paper.”



THE VOICE OF  
PRIVATE CAPITAL  
VENTURE CAPITAL  
PRIVATE EQUITY  
INFRASTRUCTURE  
LONG TERM INVESTORS

---

Thank you

Any questions?

---