

New guidance on the practical application of SFDR published by ESAs - update of Q&As

On 25 July 2024, the ESAs published a new consolidated version of their Q&As on Regulation (EU) 2019/2088 (SFDR) and Commission Delegated Regulation (EU) 2022/1288 (SFDR Delegated Regulation) by including a total of 15 new questions. The main additions are found in the following sections: Section I (Scope issues), Section IV (PAI disclosures) and Section V (Financial product disclosures).

You can find the new version of Q&As using the following link:

https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf

Some of the new questions provide detailed guidance on specific issues and are therefore worth taking a closer look at. In the following, we would like provide a summary of some key points of such additional guidance:

Section I - Scope issues:

Requirement to put in place websites for Article 10 SFDR website disclosures by registered AIFMs (Question 4)

Financial market participants (including registered AIFMs) must ensure that the relevant information is made available on a website in accordance with Article 10 SFDR. The websites can be provided at the level of a product-specific website or group website on condition that they correspond to the website of the registered AIFM. In case there is no website, the registered AIFM should establish a website in order to comply with Article 10 SFDR.

Any such information pursuant to Article 10 of the SFDR must be easily accessible to investors and should be kept up to date while revisions or changes to such information should be clearly explained.

Clarification with respect to sustainability risks (Question 5)

Should sustainability risks be considered irrelevant for a specific product financial market, participants will still need to comply with other sustainability risk integration rules arising from other regulations such as Article 18(5) of Commission Delegated Regulation (EU) No 231/2013 and Article 23(5) of Commission Directive 2010/43/EU.

Section IV – PAI disclosures:

Questions 26 to 29 provide for further guidance on the treatment and calculation of some of the principal adverse impact indicators (e.g., in respect of the necessity of a look-through approach, the exchange rate to be used and aggregation of data). In particular, where an AIFM or a UCITS management company aggregates the adverse impact of the funds under management or, should these funds be fund of funds, there ought to be a look-through approach with respect to the investee companies that cause greenhouse gas (GHG) emissions.

Section V – Financial product disclosures:

Questions 20 to 28 provide a series of clarifications with respect to disclosure as regards topics such as the EU taxonomy alignment, the application of the look-through approach on underlying investments in article 2 (17) SFDR contexts, the treatment of efficient portfolio management techniques, financial products tracking PABs or CTBs, website disclosures under article 10 SFDR etc.

Below we will briefly focus on some of the more important aspects of these clarifications.

Question 20

As regards the calculation and reporting rules for EU Taxonomy alignment at financial product level to be reported in the various pre-contractual and periodic Annexes of the SFDR Delegated Regulation, ESMA clarifies that the turnover should be the default key performance indicator (KPI) to be used for disclosing the minimum extent of the Taxonomy-alignment in pre-contractual documents. In contrast, the periodic reporting on actual level of the Taxonomy alignment has to be done on all three KPIs (turnover, capital expenditure and operating expenditure).

Question 21

A concrete example of how sustainable investments can be measured both at economic activity or investment level is provided.

Question 22

It is clarified that the financial market participant must make sure that the underlying investments of the other SFDR financial products comply with its own application of Article 2(17) SFDR in cases in which a financial product invests in other financial products that make sustainable investments with potentially differing applications of Article 2(17) SFDR (look-through approach).

In other words, this means that a financial market participant must ensure through its own due diligence procedures that the underlying investments comply with the relevant sustainable investment text. Consequently, it is not possible to rely on an alternative application of Article 2(17) SFDR for the purpose of calculating the percentage of sustainable investments if investments are made in target funds.

Question 23

The ESAs stress that a delegation of the portfolio management does not have any impact on the responsibility of the financial market participant to ensure compliance of the investments made by its delegate with the requirements of article 2 (17) SFDR. In line with Question 22 the ESAs take the view

that the delegating financial market participant must ensure that any investments considered sustainable investments conform to its own application of article 2 (17) SFDR.

This means for example that if the financial product makes investments in investee companies or underlying financial products pursuant to a delegation arrangement which does not comply with the delegating financial market participant's application of sustainable investments, that specific investment cannot be considered a sustainable investment for the delegating financial market participant's financial product.

Given that the above is not exactly common market practice in Luxembourg it cannot be excluded that the obligation for such a financial market participant to impose its own sustainable investment application on delegates and to also monitor due compliance of it might create issues for AIFMs and UCITS management companies (in particular third party-party management companies) having delegated the portfolio management to third-party investment managers.

Question 24

Clarifications are provided with respect to the treatment of efficient portfolio management (EPM) techniques and money market funds (MMFs) for Article 9 funds. In particular, EPM techniques can only fall into the non-sustainable section of article 9 funds should they be applied for hedging or liquidity purposes. Furthermore, MMFs cannot be regarded automatically as liquidity with their classification depending on the type of MMF they represent.

Question 25

The ESAs do not grant an exemption for financial products tracking passively PABs or CTBs, these products have to comply with the SFDR disclosures.

Question 26

The ESAs clarify that, in order to fulfil the requirements in Article 10(1) lit. (c) to (d) SFDR, there is no need to publish the actual documents referred to in Articles 6(3) and 11(2) SFDR.

However, the ESAs emphasize that it is their supervisory expectation that the obligation to publish the information referred in Article 10(1) lit. (c) to (d) SFDR should be fulfilled by publishing the templates in Annexes II to V of the SFDR Delegated Regulation.

Question 27

A confirmation is provided that good governance checks are not required in respect of SPVs or holding companies used for investments in real assets like cars or real estate.

Question 28

The ESAs confirm that Article 9(3) SFDR can be applied to financial products tracking PABs and CTBs as well as to financial products using an active investment strategy applying the exact same requirements as those applicable to PABs and CTBs as laid down in Commission Delegated Regulation (EU) 2020/1818.

Should you have any questions on the new updated ESAs Q&As or generally on SFDR, please feel free to contact our Ashurst investment funds team.

The information provided is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to.

Readers should take legal advice before applying it to specific issues or transactions.