

EU Guidance Clarifies SFDR Extraterritorial Application and Scope of Article 8

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The European Securities and Markets Authority (ESMA) published on 23 July 2021 the guidance provided by the European Commission (EC) in response to a number of questions posed by the European Supervisory Authorities (ESAs) in January 2021. The questions sought to clarify key areas of ambiguity regarding the scope and application of the Sustainable Finance Disclosure Regulation¹ (SFDR), including its extraterritorial application. Akin Gump has previously discussed the SFDR in alerts accessible [here](#).

This alert focuses on the guidance as it relates to the application of the SFDR to non-EU managers, and to the definition of an Article 8 “light green” fund.

Other questions the EC has clarified include the application of the SFDR to registered (or sub-threshold) AIFMs; the calculation basis for the 500-employee threshold for parent undertakings of a large group; requirements for Article 9 products; and the application of the disclosure requirements to segregated accounts or other non-pooled financial products managed on a discretionary basis. We will discuss the guidance relating to the above separately.

Application of SFDR to Non-EU Managers

The EC has clarified that, on the basis that the definition of a financial market participant includes the term ‘alternative investment fund manager’ (AIFM) and as the term encompasses both EU and non-EU AIFMs, the scope includes non-EU AIFMs within the scope of the Alternative Investment Fund Managers Directive 2011/61 (AIFMD).

In practice, as non-EU AIFMs fall within the scope of the AIFMD as a result of Article 42 of the AIFMD, i.e. registration for marketing in the EU pursuant to the national private placement regimes, the requirements under the SFDR will apply to non-EU managers who have registered their funds to be marketed in the EU. As the guidance contemplates the application of the SFDR generally, “including the financial product related provisions”, it seems that also the manager-level disclosures must be complied with.

Contact Information

For further information or advice, please contact one of the partners named below or your usual contact at Akin Gump.

Ezra Zahabi
Partner
ezra.zahabi@akingump.com
London
+44 20.7661.5367

Helen Marshall
Partner
helen.marshall@akingump.com
London
+44 20.7661.5378

The contribution of [Philip Woodruff](#) is gratefully acknowledged.

The guidance leaves open whether the manager-level disclosures must cover all products and strategies or only those that are being marketed in the EU.

Guidance Regarding Article 8 Products

A financial product, such as an interest in an investment fund, falls within the scope of Article 8 if it promotes environmental or social characteristics or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices. The ESAs questions included questions regarding the following issues (paraphrased below), to which the EC's guidance has provided some clarification.

Does including words like “sustainable”, “sustainability” or “ESG” in the name of a product cause it to be considered a product that ‘promotes environmental or social characteristics’ within the meaning of Article 8 of SFDR?

In short, it seems the guidance concludes that including references to sustainability in the name of the product amounts to “promotion”. Accordingly, a product that incorporates “sustainability” or similar terms in its name is likely to be considered an Article 8 product.

‘Promotion’ in this context is not limited to marketing communications but could also include use of product names or designations. On that basis, it would seem that the naming of a product could be sufficient for it to come within the scope of Article 8. The general approach seems to be that, where a fund labels itself as having ‘sustainable’ characteristics it will need to comply with the disclosure requirements set out in Article 8 regardless of how accurate that description might be or how successful it is at meeting its ambition.

The guidance confirms that the transparency required under Article 8 seeks to address potential greenwashing practices. The disclosures relating to Article 8 funds should therefore be meaningful in allowing the investors to understand the aims of the product, how the product will integrate the relevant environmental or social considerations and its performance over time against its stated environmental or social ambitions.

Do references in the promotional (or other) documents relating to the product to taking into account a sustainability factor or sustainability risk in the investment decision making process cause a product to be deemed a product within the scope of Article 8?

The guidance confirms that disclosure for the purposes of Articles 6 and 7 of the SFDR describing how the product integrates sustainability risk is not, without more, sufficient to cause a product to fall within the scope of Article 8 of SFDR. However, financial market participants will still need to be careful if disclosing principal adverse impacts under Article 4 that they are not inadvertently promoting environmental or social characteristics if they intend to fall outside of Article 8.

Is an Article 8 product required to invest a minimum share of its investments to attain its designated “environmental or social characteristics”?

The guidance confirms that the SFDR does not prescribe portfolio composition or minimum sustainable investment thresholds or targets, or investment strategies, methodologies or tools. However, as confirmed above, merely taking into consideration sustainability risk is not sufficient for a product to be considered an

Article 8 product. An Article 8 fund will likely be required in some way to evidence in the periodic reports showing its performance what it has done to attain the social or environmental characteristics promoted.

Does an intrinsic characteristic of the product, such as a sectoral exclusion (e.g. tobacco) that is not actively advertised suffice for a product to qualify as “promoting” environmental or social characteristics within the scope of Article 8?

In addition, would complying with a national legal obligation applicable to the financial market participant (e.g. a ban on investment in cluster munitions) bring the product within the scope of Article 8?

While the guidance does not provide an unambiguous answer to these questions, it recaps that an Article 8 product includes a product which “*complies with certain environmental, social or sustainability requirements or restrictions laid down by law, including international conventions, or voluntary codes, and these characteristics are “promoted” in the investment policy.*”

The guidance further states that promotion within the meaning of Article 8 of the SFDR encompasses, for example, “**direct or indirect claims, information, reporting, disclosures as well as an impression that investments pursued by the given financial product also consider environmental or social characteristics in terms of investment policies, goals, targets or objectives or a general ambition in, but not limited to, pre-contractual and periodic documents or marketing communications, advertisements, product categorisation, description of investment strategies or asset allocation, information on the adherence to sustainability-related financial product standards and labels, use of product names or designations, memoranda or issuing documents, factsheets, specifications about conditions for automatic enrolment or compliance with sectoral exclusions or statutory requirements...**”

Accordingly, it seems the case that where the fund documents include a description regarding compliance with minimum standards and legal requirements this is capable of amounting to promotion. It is unclear whether any reference to such compliance would cause a product to fall within the scope of Article 8, or whether this would be the case only if the reference in some way amounted to a direct or an indirect claim or gave an impression that the fund had some measure of environmental, social and governance (ESG) focus.

Presumably, the same approach also applies where a fund pursues legal obligations such as the ban on cluster munitions. This could be sufficient to make a fund come within the scope of Article 8 if there is also ‘promotion’ but the exact parameters of what makes product disclosures ‘promotion’ is still not very clear.

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¹ 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 (See [here](#)).