

## ESG: European Regulators Seek Clarification on the Application of the Sustainable Finance Disclosure Regulation

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European financial supervisory authorities have requested the European Commission to clarify key areas of ambiguity regarding the scope and application of the Sustainable Finance Disclosure Regulation<sup>1</sup> (SFDR), including its extraterritorial application.

The Joint Committee of the European Supervisory Authorities (ESAs) responsible for drafting the regulatory technical standards under the SFDR has written to the European Commission seeking clarity on “several important areas of uncertainty in the interpretation of SFDR.”<sup>2</sup>

The ESAs also seek clarification about whether the SFDR applies to non-EU Alternative Investment Fund Managers (AIFM) when marketing under the national private placement regime of Article 42 of the Alternative Investment Fund Managers Directive<sup>3</sup> (AIFMD) in the EU. Specifically, the ESAs have sought clarity about whether “SFDR applies to non-EU AIFMs, for example when they market a sustainable EU Alternative Investment Fund under a National Private Placement Regime.” The ESAs state that clarity is being sought from the European Commission for the following reasons:

“SFDR applies to financial market participants and financial advisers. Article 2(1)(e) SFDR defines ‘an alternative investment fund manager (AIFM)’ as one of the financial market participants to which SFDR applies. An ‘AIFM’ is further defined in Article 2(4) SFDR with reference to Article 4(1)(b) of Directive 2011/61/EU (the Alternative Investment Fund Managers Directive (AIFMD)). Therefore, SFDR applies to AIFMs in general by virtue of the reference to Article 4(1)(b).”

In our previous [ESG alert of 25 November 2020](#), we discussed the potential extraterritorial reach of the SFDR due to the broad drafting and certain guidance provided by the European Commission in the context of the Taxonomy Regulation.

The ESAs have also stated that, although “many of these interpretative uncertainties of SFDR may be clarified in due course, the ESAs have identified certain priority

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questions pertaining to the SFDR that would benefit from a more urgent clarification to facilitate an orderly application of SFDR from 10 March 2021.”

The five priority areas identified by the ESAs are:

1. The application of SFDR to non-EU AIFMs and registered AIFMs
2. Application of the 500-employee threshold for principal adverse impact reporting on parent undertakings of a large group
3. The meaning of “promotion” in the context of products promoting environmental or social characteristics
4. The application of Article 9 of SFDR
5. The application of SFDR product rules to portfolios and dedicated funds.

We set out in [Annex 1](#) to this client alert the full list of questions put to the European Commission by the ESAs.

<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 (See [here](#)).

<sup>2</sup> Letter from Steven Maijoor to the European Commission on Priority Issues Relating to SFDR Application, 7 January 2021 (See [here](#)).

<sup>3</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (See [here](#)).

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## (1) The application of SFDR to non-EU AIFMs and registered AIFMs

- Does SFDR apply to registered (sometimes referred to as “sub-threshold”) AIFMs referred to in Article 3(2) AIFMD?
- Does SFDR apply to non-EU AIFMs, for example when they market a sustainable EU Alternative Investment Fund under a National Private Placement Regime?

## (2) Application of the 500-employee threshold for principal adverse impact reporting on parent undertakings of a large group

- Must the calculation of the 500-employee threshold to the parent undertaking of a large group be applied to both EU and non-EU entities of the group without distinction as to the place of establishment of the group and/or subsidiary?
- Does the due diligence statement include impacts of the parent undertaking only or must it include the impacts of the group at a consolidated level?

## (3) The meaning of “promotion” in the context of products promoting environmental or social characteristics

- Can the name of a product, which may include words like “sustainable”, “sustainability”, or “ESG” be considered to qualify a product to be promoting an environmental or social characteristic or to be having sustainable investment as its objective?
- While a financial product to which Article 8 applies does not need to explicitly promote itself as targeting sustainable investments (within the meaning of Article 2(17) SFDR), would a reference to taking into account a sustainability factor or sustainability risk in the investment decision be sufficient for Article 8 to apply? If the answer is yes, how can financial market participants that disclose mandatory information according to Article 6(1) or Article 7(1) SFDR ensure that this is not automatically considered as “promoting environmental or social characteristics”?
- Must a product to which Article 8 applies invest a minimum share of its investments to attain its designated environmental or social characteristic in order to be considered to be promoting environmental or social characteristics?
- In the absence of active advertising of an environmental or social characteristic of the product, would an intrinsic characteristic of the product,

such as a sectoral exclusion (e.g. tobacco) which is not advertised, also qualify as “promotion”?

- In addition, would complying with a national legal obligation, which applies to the financial market participant, such as a ban on investment in cluster munitions, also bring the product into the scope of Article 8?

#### **(4) The application of Article 9 of SFDR**

- Must a product to which Article 9(1), (2) or (3) SFDR applies only invest in sustainable investments as defined in Article 2(17) SFDR? If not, is a minimum share of sustainable investments required (or would there be a maximum limit to the share of “other” investments)?
- Where an EU Climate Transition Benchmark (“EU CTB”) or EU Paris-aligned Benchmark (“EU PAB”) exists, is it necessary for a product to track an EU PAB or an EU CTB on a passive basis for Article 9(3) SFDR to apply to it?
- If the questions above are answered in the affirmative and if the minimum standards of an EU PAB or an EU CTB do not require the index components to be sustainable investments, can the product fall within the scope of Article 9(3) SFDR?

#### **(5) The application of SFDR product rules to portfolios and dedicated funds**

- For portfolios, or other types of tailored financial products managed in accordance with mandates given by clients on a discretionary client-by-client basis, do the disclosure requirements in SFDR apply at the level of the portfolio only or can they apply at the level of standardised portfolio solutions?
- If the disclosure requirements of SFDR apply at the portfolio level, how is it possible to maintain confidentiality obligations to the client in view of the disclosures required, especially the website disclosures required by Article 10 SFDR?

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