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ESAs publish Q&A on the SFDR RTS

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Commission Delegated Regulation (EU) 2022/1288, setting out the regulatory technical standards (**RTS**)[1] to be used by financial market participants (**FMPs**) when disclosing sustainability-related information under the Sustainable Finance Disclosures Regulation (**SFDR**),[2] was published on 25 July 2022 in the Official Journal of the EU (**OJ**). The RTS will apply from 1 January 2023.[3]

On 17 November 2022 – less than six weeks before the SFDR RTS 'go live' date – the European Supervisory Authorities (**ESAs**)[4] published a "Questions and Answers"[5] on the RTS (**Q&A**). The Q&A is very detailed, comprising 60 questions over 34 pages and including worked examples, tables of guidance and decision trees.

The Q&A covers many topics – not all of which relate to the RTS, despite the title of the Q&A – under the following broad Sections:

1. Current value of all investments in principal adverse impact (PAI) and taxonomy-aligned disclosures.
2. PAI disclosures.

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5. Taxonomy-aligned investment disclosures.
6. Financial advisers and execution-only FMPs.

This is not the first time that SFDR questions and answers have been published[6] and previous questions and answers are cross-referenced in the latest publication. However, while the Q&A is meant to provide clarification, some of the responses are opaque and may not add the clarity desired.

Some items to note for asset managers addressed in Sections (1), (2), (3) and (5) of the Q&A

To highlight just a few of the Q&A that may be of interest:

- In response to a question relating to the treatment of short positions (question 3 of **Section (1)**), the ESAs have stated, amongst other things, that long and short positions should be netted in accordance with the Short Selling Regulation (**SSR**).[7]
  In more detail, the question asks how short positions should be included within the PAI indicators. As part of its wider response, in addition to saying that the methodology in the SSR for calculating short positions should be applied, the ESAs add that that the principal adverse impacts of long and short positions should be netted at the level of the individual counterpart (investee undertaking, sovereign, supranational, real estate asset), but without going below zero.
- Question 20 of **Section (2)** asks whether information on integration of sustainability risks at the level of the relevant FMP in the decision-making process applies to all investments or only investments that are affected by other

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- On the same theme as the question above, **Section (2)** question 21 asks whether the PAI disclosures under Article 4 of SFDR (that relates to transparency of entity-level adverse sustainability impacts) should relate to only those financial products in scope of SFDR or all types in instruments invested in by the FMP. The ESAs' response is that FMPs have to consider *all* investment decisions for disclosures under Article 4(1)(a), 4(3) or 4(4) of SFDR.

- **Section (3)** is of particular interest:
    - With regards to Climate Transition Benchmarks (**CTB**), there is a question as to whether it is sufficient to qualify as making sustainable investments simply by investing in line with a CTB that meets the CTB requirements that apply pre 31 December 2022. The question arises because the pre 31 December 2022 requirements for a CTB do not require the investments in the index themselves to be "sustainable investments" within the meaning of Article 2(17) of SFDR.[8]
    - In more detail, the ESAs make the point that, when completing the RTS disclosures, filling out the section in the template on sustainable investment in line with the Benchmarks Regulation requirements for CTBs before 31 December 2022 is not strict enough to satisfy the requirements for a "sustainable investment" according to Article 2(17) of SFDR. From 1 January 2023, CTBs need to comply with the new provisions in Regulation (EU) 2020/1818[9] which requires administrators of CTBs to exclude certain companies in specific sectors from the CTB. The ESAs highlight that

aligned benchmarks or CTBs as reference benchmarks after 31 December 2022 satisfy the requirements for "sustainable investments" pursuant to Article 2(17) of SFDR (question 2).

- The ESAs have confirmed that it is for FMPs to determine how investment companies follow good governance practices. The ESAs point out that SFDR is a disclosure regulation and that while the RTS provide details as to how FMPs should disclose that an Article 8 financial product invests in companies that respect the requirement to follow good governance practices, the SFDR and the RTS do not prescribe the reference metrics (question 3).
- The ESAs have made it clear that whether a financial product is considered Article 8 or Article 9 and whether it needs to comply with disclosure and reporting obligations does not differ as between a financial product that is a fund and a financial product that is a managed account/discretionary mandate (question 5).
- The SFDR and Taxonomy Regulation are silent as to what is a "substantial contribution" for socially sustainable investments. The question is asked whether FMPs can determine their own substantial contribution criteria for socially sustainable investments. The ESAs' view is yes, FMPs can create their own framework for their financial products. However, the ESAs add that FMPs cannot interpret "sustainable investment" set out in Article 2(17) of SFDR differently for the different financial products they make available. "Sustainable investment" must

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- The ESAs have clarified in their response to question 8 of Section (5) that where new financial products are disclosing the minimum portion of their taxonomy-aligned investments, the disclosure should be understood as the expected investments determined by analysing the investable universe of the financial product.

Conclusion

The ESAs' Q&A provides some additional information and guidance but there are many questions still outstanding that FMPs are trying to deal with in the run up to 1 January 2023. In addition, the EU Commission has stated[10] that it intends to publish a set of Q&As on the SFDR early in 2023, which may address concerns relating to the application of fundamental concepts in the SFDR, legal and reputational risks, and greenwashing. In the same speech, the EU Commission stated that it plans to publish over 200 FAQs intended to support businesses with reporting obligations under the Taxonomy Regulation. Providing information this close to the RTS coming into force and with further information to come shortly after may not be seen by all as a welcome development.

This update was authored by Angelo Lercara, Mikhaelle Schiappacasse, Katie Carter and Philippa List.

Footnotes

1) Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’, specifying the content,

and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment
objectives in pre-contractual documents, on websites and in periodic reports is available here.

2) Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector, as amended by Regulation (EU) 2020/852 on the establishment of
a framework to facilitate sustainable investment (Taxonomy Regulation).

3) For more information, see our OnPoint "RTS under the SFDR published in the Official Journal", available here.

4) The ESAs are the European Securities and Markets Authority (**ESMA**), the European Banking Authority (**EBA**) and the European Insurance and Occupational Pensions Authority (**EIOPA**).

5) The November 2022 "Q&A" are available here.

6) For example on 26 July 2021, the EU Commission published its
long-awaited questions and answers which attempted to respond to the ESAs' specific questions. To access the EU Commission's response please click here. A
technical amendment was issued by the EU Commission in November 2021, which is available here.

7) Regulation (EU) No 236/2012.

8) Article 2(17) of SFDR defines 'sustainable investment' as an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a

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integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

9) Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.

10) This statement was made in a speech given by Mairead McGuinness, European Commissioner for Financial Services, Financial Stability and Capital Markets Union, on 5 December 2022. The speech is available here.

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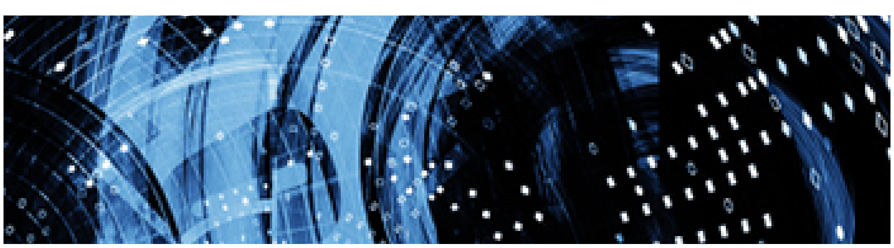

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