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### Starting shot for the implementation race – Initial thoughts on the SFDR RTS adopted on 6 April 2022

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The wait is finally over: yesterday, the EU Commission adopted the [Regulatory Technical Standards](#) (“**RTS**”) for the [Sustainable Finance Disclosure Regulation](#) (“**SFDR**”). Below we have set out our initial thoughts on this text which will be a central working document for the full implementation of SFDR by the financial services industry. Based in part on our experience in several client pilot projects to implement previous draft versions of the RTS, in particular the disclosure templates, we address some of the main open issues and questions currently vexing the financial services industry.

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#### Why are the RTS relevant for the financial services industry?

SFDR is a cornerstone of the EU Commission’s ambitious Sustainable Finance Strategy. It applies to so-called “Financial Market Participants” (“**FMPs**”), notably fund and asset managers, insurers, pension funds, banks and investment firms, which offer “**Financial Products**” subject to SFDR. Financial Products include funds, investment-based insurance products (“**IBIPs**”) and certain pension products and also extends to the portfolio management of segregated accounts. Under the SFDR, FMPs must make pre-contractual, periodic and website disclosures on sustainability risks and factors and on certain environmental and social aspects of their Financial Products.

The RTS complement the provisions of SFDR applying from 10 March 2021 by providing detailed guidance on disclosures relating to principal adverse impacts on sustainability factors (“**PAI**”) at FMP level and pre-contractual, periodic and website disclosures of Financial Products promoting environmental or social characteristics (so-called “**Art. 8 SFDR Products**”) or having sustainable investment as their objective (so-called “**Art. 9 SFDR Products**”).

While the text of the RTS is now final, they are not yet formally in force since the EU Council and the EU Parliament are granted a 3 months scrutiny period (extendable by another 3 months) in which they can approve or reject the RTS as a whole. Since the RTS are technical and have been subject to a long consultation and redrafting process since February 2021, it is not expected that Council or Parliament will object. If no objection is made, the RTS will apply from 1 January 2023.

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### **What is the structure of the RTS?**

The RTS are composed of the [RTS text](#) and five separate annexes (available [here](#)) which contain the standardised disclosure templates which FMPs must use to make the disclosures under Art. 4 SFDR and Art. 8 to 11 SFDR (“**Templates**”). In five chapters, the RTS text deals with general disclosure rules (Chapter I), PAI reporting at FMP level (Chapter II), pre-contractual disclosures for Art. 8 SFDR Products and Art. 9 SFDR Products (Chapter III), website disclosures for such products (Chapter IV) and periodic disclosures for such products (Chapter V). Different from the previous draft RTS, the requirements for pre-contractual and periodic disclosure of Art. 8 SFDR Products and Art. 9 SFDR Products are now set out directly in the respective Templates and, aside from the more complex Taxonomy disclosures (see below), there are no additional provisions in the text of the RTS repeating the content of the Templates. This will facilitate working with the Templates because FMPs will no longer have to scrutinize both RTS text and Templates which in some instances contained diverging guidance.

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### **What to do on PAI disclosures at FMP level?**

While the first detailed disclosure on PAI for FMPs complying with Art. 4 SFDR based on the RTS is only due by 30 June 2023, FMPs are already working on collecting the relevant data in 2022 to report on it in 2023. [Annex I](#) to the RTS contains pre-defined mandatory and voluntary PAI indicators which FMPs must integrate into their data collection processes, down to the ultimate asset. Good news is that at first glance there are no substantial changes on the PAI indicators which would have caused FMPs to revisit their data collection processes. Bad news is that the EU Commission has not decided to drop some of the many mandatory PAI indicators for investee companies (equity and debt) which are particularly challenging for investments in private companies. The RTS again confirm that data needs to be collected at least on a quarterly basis, meaning that the first data collection point for 2022 on 31 March 2022 has already passed. FMPs which have not yet started the respective data collection projects will therefore need to move very quickly.

A lot of discussions in the market have centered around the standards applicable to PAI indicator data collection. In line with previous versions of the RTS, FMPs must apply “best efforts” to obtain this data for all investments from available sources, including investee companies, own research, third data providers or reasonable assumptions of the FMPs. Due to the lack of easily available and comparable data, many FMPs are not yet in a position to obtain PAI indicator data on all of their investments. This has led to the question whether such FMPs can be considered to comply with Art. 4 SFDR. While the ESAs clearly stated in the recitals to the [previous RTS version](#) that FMPs not having such information cannot be considered to take into account PAI, this wording has now been removed and replaced by a requirement that disclosures must be “comprehensive”. This may be a sign that the EU Commission acknowledges FMPs’ difficulties in collecting PAI indicator data. Some may consider, however, that FMPs will anyway still have put significant effort into obtaining the data, including recourse to proxies and assumptions. The collection of PAI indicator data is also one of the main elements of the “Do No Significant Harm (DNSH)” analysis for sustainable investments and it may be difficult to qualify investments as “sustainable investments” if no data on PAI indicators (not even proxies or assumptions) is available.

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## How will Taxonomy disclosures be integrated into SFDR?

One of the main challenges FMPs had to tackle from the beginning of this year were the disclosures on the share of investments made in “Taxonomy-aligned investments”. The current divergence of practices in the market has even led the European Supervisory Authorities (“**ESAs**”) to comment on this specifically in their recent update of the Joint Supervisory Statement on SFDR. Unfortunately, the RTS do not really contribute to solving the open issues or facilitating the challenge:

- First of all, FMPs will have to learn new vocabulary: the easily understandable term “Taxonomy-aligned investments” has been replaced by the much longer “investments in environmentally sustainable economic activities”. This is in line with the wording in the [Taxonomy Regulation](#) and the divergence in the draft RTS has led to some questions in the market. However, the concept has not been followed through for the Templates which are now using both the old and the new term, potentially causing even more confusion for customers/investors.
- FMPs are still required to disclose the share of their investments in environmentally sustainable economic activities on the basis of all three Taxonomy KPIs (turnover, CapEx and OpEx). While the pre-contractual disclosure can be based on one single KPI (usually turnover) only, the period disclosures will have to be more detailed, using all three KPIs. This is due to the methodology used in the [Art. 8 Taxonomy Delegated Act](#). Some of the environmentally sustainable economic activities will only show when using CapEx or OpEx as relevant KPI (e.g. expenditures to improve energy efficiency of buildings).
- One of the things vexing the market has been whether Art. 8 SFDR Products promoting environmental characteristics but not committing to make sustainable investments must also do the full Taxonomy disclosures. While the wording of Art. 6 Taxonomy Regulation seems to imply this, the ESAs have in the past mentioned on several occasions that such Art. 8 SFDR products would not have to disclose on Taxonomy. This issue has not been resolved by the RTS. The RTS and the

Templates merely refer to Art. 6 Taxonomy Regulation. However, the Taxonomy disclosures in the Templates are part of the section dealing with sustainable investments, which according to the Template guidance notice should only be filled out by Art. 8 SFDR Products making sustainable investments. For periodic disclosures of Art. 8 SFDR Products there is a clear statement in the RTS that Taxonomy only needs to be included if the Art. 8 SFDR Product had committed to making sustainable investments contributing to an environmental objective. This has however not been picked up in the respective Template. So, FMPs can only hope that the EU Commission will soon answer to the many industry letters raising this issue.

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## **Must FMPs again update their websites?**

FMPs have already been obliged under the SFDR to make certain disclosures on their websites. These included disclosures on the FMPs (notably sustainability risk policies, consideration of PAI and remuneration policies) as well as on Art. 8 SFDR Products and Art. 9 SFDR Products. The RTS now provide significantly more detailed website disclosures for PAI consideration and for Art. 8 SFDR Products and Art. 9 SFDR Products. In relation to PAI consideration, the detailed Template in Annex I will have to be used from 1 January 2023, including the collected PAI indicator data as well as actions taken, actions planned and targets to address and mitigate the respective impacts.

There are no Templates for the website disclosure of Art. 8 SFDR Products and Art. 9 SFDR Products, but the RTS require that FMPs disclose according to specific sections and contain guidance on the content of each of these sections. These website disclosures are designed to complement the pre-contractual and periodic disclosures and must contain additional information on the continuous monitoring of sustainability indicators during the product lifecycle, methodologies, data sources and processing, possible limitations to methodologies and data as well as a description of the investment due diligence and the FMPs engagement policies.

Another important feature of the new website disclosure requirements relates to language. The summary sections for the PAI consideration and for the product-related website disclosures need to be provided in multiple languages, including:

- In an official language of the FMP's or Financial Product's home member state;
- If different, in an additional language customary in the sphere of international finance (usually English); and
- If the FMP offers Financial Products in other EU member states or the respective Financial Product is marketed in other EU member states, in an official language of all of these host member states.

I.e., for a Luxembourg fund with English documentation marketed in Germany, France and Spain, the summaries need to be provided in English, German, French and Spanish – a lot of work for translators going forward.

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## What are the next steps for FMPs?

FMPs will need to quickly familiarise themselves with the RTS and the Templates and start to implement them at FMP and product level. While some FMPs have already taken first steps to use the Templates (in particular in Luxembourg, where the [Luxembourg regulator CSSF urged FMPs to already use the Templates for their disclosures](#)), others are still at the starting point of the implementation. This is made even more complicated by language issues: currently, both the RTS and the Templates are only available in English. It is not clear, when the EU Commission will provide official versions in the EU languages. From our experience we know that it takes some time to move from generic, qualitative SFDR level 1 disclosures to the more detailed qualitative and quantitative level 2 disclosures in the RTS and the Templates. Even well-prepared FMPs will take some time to align content and form and avoid triggers for greenwashing allegations and misunderstandings. This is even more true for the PAI consideration which requires extensive data collection already this year to be able to make disclosures in 2023. In any case, FMPs are well advised to start (or continue) RTS implementation now and not wait until 1 January 2023 approaches. While RTS disclosures are central, they are only one of the many tasks resulting from the EU Sustainable Finance Strategy in 2022, from integration of sustainability risks and factors into the regulatory governance to sustainability preferences in customer conversations. For an overview see our [2022 EU Sustainable Finance Placemat](#). FMPs will only be able to tackle this package if they start early.

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