

Sustainable Finance update (asset management) – 1) European Commission answers ESAs' questions on the interpretation of SFDR and 2) ESAs publish a consultation paper on the review of the SFDR RTS

1. European Commission answers to ESAs' questions on the interpretation of SFDR

On 5 April 2023, the European Commission published its [response](#) to eight questions on the interpretation of SFDR that were submitted by the ESAs to the Commission on 9 September 2022. The Commission has also revised and amended its [previous Q&A](#) in order to ensure consistency. Below, we have set out the key points of the Commission response.

Definition of "sustainable investments"

The Commission helpfully clarifies that the definition of "sustainable investment" pursuant to Article 2 (17) SFDR does *"not prescribe any specific approach to determine the contribution of an investment to environmental or social objectives. Financial market participants must disclose the methodology they have applied to carry out their assessment of sustainable investments [...]"* Moreover, as regards the reference to "economic activities" in Article 2 (17) SFDR, the Commission made it clear that under Article 2 (17) SFDR, financial products (such as UCITS and AIFs) make investments that do not specify the use of proceeds, such as investments in the general equity or debt of investee companies and that the *"notion of sustainable investment can therefore also be measured at the level of a company and not only at the level of a specific activity"*.

Regarding the question how the "contribution" of an economic activity to an environmental or social objective should be measured, the Commission responded that *"SFDR does not set out minimum requirements that qualify concepts such as contribution, do no significant harm, or good governance, i.e. the key parameters of a 'sustainable investment'. Financial market participants must carry out their own assessment for each investment and disclose*

their underlying assumptions. This policy choice gives financial market participants an increased responsibility towards the investment community and means that they should exercise caution when measuring the key parameters of a 'sustainable investment'.

The above answers from the Commission provide, for the time being, helpful certainty to the industry as they make it clear that there are no minimum requirements to determine a sustainable investment under Article 2 (17) SFDR and more particularly that no minimum revenue threshold, in respect of investee companies' revenues linked to sustainable activities, needs to be applied in order for an entire investment to be considered sustainable but that financial market participants must make their own assessment and disclose the methodology used to carry out that assessment. The Commission does however remind financial market participants that this increased responsibility towards the investment community means that caution should be exercised when measuring the key parameters of a sustainable investment.

According to the Commission, relying on a transition plan aimed at ensuring that the investment will not significantly harm any environmental or social objective in the future would not be sufficient in order to qualify the investment as sustainable.

Article 9 (3) SFDR – objective of carbon emissions reduction

The Commission clarifies that Article 9 (3) SFDR is “neutral in terms of product design” and that financial products with a carbon emissions reduction objective can fall in its scope whether they are actively or passively managed.

In addition, the Commission helpfully recalls that SFDR is a transparency regulation and that SFDR does not prescribe the use of a Paris-aligned Benchmark nor a Climate Transition Benchmark but where none is passively tracked then a detailed explanation is required on how the continued effort of attaining the carbon emissions reduction can be ensured.

The Commission also confirms our understanding that funds that passively track a Paris-aligned Benchmark or a Climate Transition Benchmark are deemed to have sustainable investments and are not required to comply with the second paragraph of Article 9 (3) SFDR, i.e. they are not required to disclose a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.

Article 8 – promotion of carbon emissions reduction

The Commission also makes it clear that Article 8 SFDR funds are able to promote carbon emissions reductions as part of their promoted environmental characteristics without falling within Article 9 (3) SFDR, provided that investors are not misled in believing that this aspect is part of the fund's objective and therefore that the fund has a sustainable investment objective pursuant to Article 9 (3) SFDR.

The “consideration” of PAIs

The Commission provides guidance on the meaning of the “consideration” of principal adverse impacts (“PAIs”) pursuant to Article 7 (1) SFDR (“...a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors”) by stating that the description related to the adverse impacts should include both a description of the adverse impacts and the procedures put in place to mitigate them.

2. ESAs' consultation on SFDR RTS review

On 12 April 2023, the ESAs published a [joint consultation paper](#) on the review of the SFDR RTS regarding PAIs and financial product disclosures. The ESAs' proposed changes would result in new regulatory technical standards that would amend the exiting [SFDR RTS](#).

The consultation is based on the Commission's [mandate](#), which requested the ESAs to propose amendments to the SFDR RTS in order, amongst other, to streamline and further develop the regulatory framework (the "**Mandate**").

It is noteworthy that the ESAs are consulting on a number of substantial changes to the SFDR RTS (including the pre-contractual and periodic templates to be used) which go beyond the Mandate.

The proposed changes as part of the Mandate can be summarised as follows:

- Extension of the list of universal social indicators for PAIs;
- Refinement of the content of a number of the other indicators for adverse impacts and their respective definitions, applicable methodologies, metrics and presentation and;
- Introduction of disclosures on decarbonisation on GHG emissions reduction targets.

In addition to what was explicitly requested by the Commission as part of the Mandate, the ESAs are also considering the following changes:

- DNSH disclosure design options;
- Simplification of the templates; and
- Other technical adjustments.

Next steps:

The consultation is open until 4 July 2023 after which the ESAs will present their proposals to the Commission.

For any further information please contact us or visit our website at [**www.elvingerhoss.lu**](http://www.elvingerhoss.lu).

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