



Matheson



SFDR Factsheet:
New ESG Disclosure
Requirements

January 2021

The European Commission (“**Commission**”) launched its **Sustainable Finance Action Plan** in March 2018, including three legislative proposals aimed at: creating an EU sustainability taxonomy; requiring disclosures relating to environmental, social and governance (“**ESG**”) factors; and the creation of low carbon and positive carbon impact benchmarks. This note focuses on the **Sustainable Finance Disclosure Regulation**, known as the SFDR or the Disclosure Regulation.

WHAT DOES THE DISCLOSURE REGULATION AIM TO DO?

The Disclosure Regulation requires AIFMs and UCITS management companies (amongst others, but for the purposes of this note, we focus on investment funds and their managers)¹ to consider and disclose in a consistent and harmonised manner how ESG factors are adopted in their decision making processes. It aims to harmonise disclosure standards among EU member states to facilitate the comparability of different financial products and services. Many of the provisions of the Disclosure Regulation apply to all asset managers, whether or not they have an express ESG or sustainability focus. The Disclosure Regulation applies different requirements and implementation timeframes in respect of disclosures:

- on websites;
- in prospectuses; and
- in periodic reports.

WHEN WILL THE DISCLOSURE REGULATION APPLY?

The main provisions of the Disclosure Regulation will apply from **10 March 2021**. The requirements relating to disclosures in the periodic reports of ESG-focused products are stated to apply from **1 January 2022**.

WHEN WILL THE TECHNICAL STANDARDS BE AVAILABLE?

The European Supervisory Authorities (“**ESAs**”) are mandated under various provisions of the Disclosure Regulation to provide further detail on the exact level of information to be disclosed in level 2 technical standards. In April 2020, the ESAs published a joint **consultation paper** setting out their proposals, including

1. The Disclosure Regulation applies to “financial market participants” which includes MiFID firms providing the service of portfolio management, AIFMs and UCITS managers. It applies to AIFs, UCITS and portfolio management services / managed accounts. The Disclosure Regulation also applies rules to financial advisers, which are not addressed in this note.

some draft templates (with further templates in respect of pre-contractual and periodic disclosures to be provided at a later date) and draft regulatory technical standards (“**RTS**”). The ESAs are required under their mandate to submit their final advice on RTS to the Commission by the end of December 2020 (although the ESAs have indicated that they will not submit the advice until January 2021) and it is expected that the final RTS will be issued in early 2021.

On 20 October 2020, the Commission confirmed in a **letter** to the ESAs that all application dates are being maintained as laid down by the SFDR with effect from 2021, notwithstanding that the timetable for responding to the ESAs’ joint consultation on ESG disclosures will not permit RTS to be developed by the ESAs by the original target date of 30 December 2020. The level 2 technical standards will not apply from 10 March 2021 but will become applicable “*at a later stage*”. Fund managers will be required to comply with the high level and principle based requirements of the Disclosure Regulation from 10 March 2021.

WHAT ARE “ARTICLE 8 FUNDS”?

While the Disclosure Regulation contains requirements that will apply to all asset managers, even those which do not have an express ESG or sustainability focus, it also provides for further disclosures to be made by what are often referred to as “Article 8 funds” and “Article 9 funds”.

Article 8 funds (sometimes referred to as “light green funds”) are funds which promote, among other characteristics, environmental and social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices. There is no definition of “promote”, “promoting” or “promotion” in the Disclosure Regulation. It is unlikely that the ESAs will issue further guidance on this as they have stated² that the interpretation of promotion is a level one matter ie, it can only be addressed in the primary, or level 1, regulation and not in delegated acts or guidance to be developed by the ESAs and therefore can only be addressed by the Commission.

The recitals to the Disclosure Regulation suggest that the legislation, by providing for differing requirements for Article 8 and Article 9 funds, aims to differentiate between sustainable products with varying “*degrees of ambition*”.

WHAT ARE “ARTICLE 9 FUNDS”?

Article 9 funds (sometimes referred to as “dark green funds”) are funds that have sustainable investment as their objective. Sustainable investments are defined in the Disclosure Regulation as any of the following:

- investments in economic activity that contributes to an environmental objective;
- investments in economic activity that contributes to a social objective and in particular an investment that contributes to tackling inequality, an investment fostering social cohesion, social integration or labour relations; and
- investments 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.

2. ESAs’ Public Hearing on Joint ESAs’ Consultation Paper on ESG Disclosures 2 July 2020



HOW DOES THE DISCLOSURE REGULATION INTERACT WITH THE TAXONOMY REGULATION?

The **Taxonomy Regulation** also forms part of the Commission’s Action Plan and is intended to provide a common language for firms and investors to identify which economic activities are “environmentally sustainable”. In contrast with the Disclosure Regulation, it does not address social objectives. The Taxonomy Regulation sets out criteria for determining if an activity is environmentally sustainable, including whether the activity contributes to, or does not significantly harm, one or more specified environmental objectives:

- Climate change mitigation
- Climate change adaptation
- Sustainable use and protection of water and marine resources
- Transition to a circular economy (including waste prevention and recycling)
- Pollution prevention and control
- Protection of healthy ecosystems

The Taxonomy Regulation provides for further disclosures which need to be made in addition to those set out in the Disclosure Regulation. As the Disclosure Regulation and the Taxonomy Regulation were agreed upon and published at different times, there are some inconsistencies between the two regulations and sustainable investments under the Disclosure Regulation are not defined by reference to the Taxonomy Regulation. Therefore, it may be possible to have an Article 9 fund which is not highly aligned with the Taxonomy Regulation where, for example, the Article 9 fund has a predominantly social objective.

The disclosure requirements will impact at both the manager level and the product level. We have summarised in the tables below the key disclosure requirements that will apply:

- generally at manager level;
- in respect of any funds made available by the manager, whether or not the fund has an ESG or sustainability focus; and
- in respect only of funds that have an express ESG focus.

COMMENT

Before the required disclosures can be made under the Disclosure Regulation, managers must make a number of business decisions and conduct an exercise to categorise their funds in order to establish what rules apply to them. There is a considerable amount of work to be undertaken to do this and to update policies and documentation in advance of the 10 March 2021 deadline.

In order to deal with the large volume of updates that must be filed by the March deadline, on 4 November 2020, the Central Bank confirmed that there will be a fast-track process for filing updates. Funds and their Managers will be expected to self-certify compliance with the requirements of the level 1 Disclosure Regulation requirements. The Central Bank will not conduct a review of these level 1 disclosures prior to the 10 March deadline. The Central Bank will review disclosures in full prior to the implementation of the level 2 technical standards (the general market sense is that the level 2 technical standards will apply from 1 January 2022).

Your usual Matheson contact will be happy to discuss with you the steps to be taken to prepare for the application of these new detailed disclosure requirements.

MANAGER LEVEL REQUIREMENTS

	Requirement	Type of Disclosure	Level 1 Provision	Level 2 Provision	Timing
1	<p>Sustainability Risk Policy</p> <p>The manager must formulate a policy on the integration of sustainability risks in its investment decision-making process.</p>	Website	Article 3(1) Article 3(2)	N / A ³	10 March 2021
		Pre-contractual (product level disclosure of the manager's policy)	Article 6(1)(a) Article 6(2)(a)	N / A	10 March 2021
2	<p>Principal Adverse Impact Statement</p> <p>Managers must decide:</p> <p>(a) to implement a due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors; or</p> <p>(b) provide an explanation as to why the manager does not consider such adverse impacts.</p> <p>While the decision as to whether to comply with (a) or (b) is generally at the discretion of the manager, from 30 June 2021 large managers (ie, managers with more than 500 employees) will be required to implement the due diligence policy.</p>				
	2a	<p>Where a manager is complying with (a) above, it must publish a statement on the due diligence policy – the Principal Adverse Impact Statement or PAIS. The PAIS must include information on the identification and prioritisation of principal adverse impacts, summaries of engagement policies, adherence to responsible business codes and other internationally recognised standards for due diligence and reporting and, where relevant, the degree of alignment with the objectives of the Paris Agreement.</p> <p>The draft RTS require the PAIS to include detailed disclosures on both qualitative and quantitative grounds and provide a prescribed format for the PAIS. The quantitative disclosure requires managers to disclose against 50 separate granular ESG metrics or indicators (32 mandatory and 18 optional). Managers must disclose against at least one of the optional climate indicators and at least one of the optional social indicators, meaning that managers will be required to disclose against 34 indicators in total.</p>	Website	Article 4(1)(a) Article 4(2)	Articles 4 to 11 Draft RTS
2b	<p>Where a manager is complying with (b) above, the manager must publish its reasons for not considering principal adverse impacts of investment decisions on sustainability factors, including an explanation on whether and when the firm intends to consider such impacts.</p> <p>The draft RTS require the explanation to be published in a separate section of the manager's website entitled "No consideration of sustainability adverse impacts". That section must start with a prominent statement that the manager does not consider the adverse impacts on its investment decisions on sustainability factors.</p>	Website	Article 4(1)(b)	Article 11 Draft RTS	10 March 2021
3	<p>Remuneration Policy</p> <p>Existing remuneration policies must be updated to include information on how the policy is consistent with the integration of sustainability risks.</p>	Website	Article 5(1)	N / A	10 March 2021

FUND LEVEL – REQUIREMENTS APPLICABLE TO ALL FUNDS

	Requirement	Type of Disclosure	Level 1 Provision	Level 2 Provision	Timing
4	<p>Integration of Sustainability Risks in Investment Decisions</p> <p>Managers must decide whether to:</p> <p>(a) assess the likely impacts of sustainability risks on the returns of each fund; or</p> <p>(b) provide an explanation for why the manager does not consider sustainability risks to be relevant to a particular fund.</p>				
4a	Where a manager is complying with (a) above, the manager must publish a description of the manner in which sustainability risks are integrated into investment decisions and the results of the assessment of the likely impact of sustainability risks on the return of the fund. The recitals to the Disclosure Regulation confirm that this may be either a qualitative or quantitative disclosure.	Pre-contractual	Article 6(1)(b)	N / A	10 March 2021
4b	Where a manager is complying with (b) above, the manager must publish clear and concise reasons why sustainability risks are not relevant for returns of the financial product.	Pre-contractual	Article 6(1)(b)	N / A	10 March 2021
5	<p>Principal Adverse Impacts</p> <p>(a) Where a manager has implemented a due diligence policy with respect to the principal adverse impacts of its investment decisions on sustainability factors (see row 2 above relating to Manager Level Requirements), the manager must decide whether and how each fund considers principal adverse impacts on sustainability factors at product level.</p> <p>(b) Where a manager has not implemented a sustainability due diligence policy, it must explain for each fund the reasons why it does not consider such adverse impacts.</p>				
5a	Where a manager is implementing a sustainability due diligence policy, there must be disclosure as to whether and how each fund considers the principal adverse impacts on sustainability factors.	Pre-contractual	Article 7(1)(a)	N / A	30 December 2022
		Periodic	Article 7(a)(b)	N / A	30 December 2022
5b	Where a manager does not implement a sustainability due diligence policy, the manager must disclose for each fund an express negative statement that the manager does not consider adverse impacts, and the reasons for not doing so.	Pre-contractual	Article 7(2)	N / A	10 March 2021
6	<p>Marketing Communications</p> <p>Managers must review all marketing materials for all in-scope funds to ensure that those marketing materials do not contradict any information disclosed under the Disclosure Regulation.</p>	Marketing materials	Article 13(1)	The ESAs are mandated to prepare implementing technical standards to determine the standard presentation of information.	10 March 2021
7	<p>The Taxonomy Regulation requires that, where a fund is not an Article 8 fund or Article 9 fund, pre-contractual and periodic disclosures must include the following statement:</p> <p>“The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.”</p>	Pre-contractual Periodic	Article 7 Taxonomy Regulation	N / A	1 January 2022 (for climate change mitigation and climate change adaptation) 1 January 2023 (for the remaining four environmental objectives)

FUND LEVEL – REQUIREMENTS APPLICABLE TO FUNDS WITH AN ESG FOCUS

Requirement	Type of Disclosure	Level 1 Provision	Level 2 Provision	Timing	
Article 8 Funds - Promoting Environmental or Social Characteristics					
8	<p>The manager must publish:</p> <ul style="list-style-type: none"> ▪ a description of the environmental or social characteristic; ▪ information on the methodologies used to assess, measure and monitor the environmental or social characteristics; ▪ information on how those characteristics are met; and ▪ if an index has been designated, information on whether and how this index is consistent with those characteristics. <p>The draft RTS require the disclosures to be set out in a section of the manager’s website titled “Sustainability-related disclosures” and in the same part of the website as the other information relation to the fund, including marketing communications.</p>	Website	Article 10(1)	Articles 33 and 34 Draft RTS	10 March 2021
9	<p>In addition to the pre-contractual disclosures applicable to all funds noted above, the fund must disclose:</p> <ul style="list-style-type: none"> ▪ information on how environmental or social characteristics are met; ▪ if an index has been designated, information on whether and how this index is consistent with those characteristics; and ▪ if an index has been designated, where the methodology used for the calculation of the index is to be found. <p>The draft RTS require the disclosures to follow the template to be set out in Annex II (not yet published).</p>	Pre-contractual	Article 8(1) Article 8(2)	Articles 14 to 22 Draft RTS	10 March 2021
10	<p>The Taxonomy Regulation inserts a new article 8(2a) in the Disclosure Regulation, which requires that pre-contractual disclosures include:</p> <ul style="list-style-type: none"> ▪ information on the environmental objective or objectives listed under the Taxonomy Regulation to which the underlying investment contributes; and ▪ a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable. <p>The Taxonomy Regulation also requires that the following statement be included in pre-contractual disclosures (and periodic reports) of Article 8 funds:</p> <p>“The “do no significant harm” principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.”</p>	Pre-contractual	Article 8(2a)	Level 2 measures mandated – not yet published	1 January 2022 (for climate change mitigation and climate change adaptation) 1 January 2023 (for the remaining four environmental objectives)
11	<p>The manager must disclose in periodic reports a description of the extent to which environmental and social characteristics are met.</p> <p>The draft RTS require this disclosure to follow the template set out in Annex IV (yet to be published).</p>	Periodic	Article 11(1)(a)	Articles 36 to 42, Article 51 Draft RTS	1 January 2022
12	<p>The Taxonomy Regulation inserts a new article 11(1)(d) in the Disclosure Regulation. Where an Article 8 fund promotes one of the six environmental characteristics set out in the Taxonomy Regulation, periodic disclosures must include:</p> <ul style="list-style-type: none"> ▪ information on the environmental objective or objectives to which the underlying investment contributes; and ▪ a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable. 	Periodic	Article 11(1)(d)	Level 2 measures mandated – not yet published	1 January 2022 (for climate change mitigation and climate change adaptation) 1 January 2023 (for the remaining four

FUND LEVEL – REQUIREMENTS APPLICABLE TO FUNDS WITH AN ESG FOCUS

	Requirement	Type of Disclosure	Level 1 Provision	Level 2 Provision	Timing
Article 9 Funds - Funds with Sustainable Investment Objective					
13	<p>The manager must publish:</p> <ul style="list-style-type: none"> a description of the sustainable investment objective; information on the methodologies used to assess, measure and monitor the impact of the sustainable investments; if no index has been designated as a reference benchmark, an explanation on how the objective is to be attained; and if an index has been designated, information on how the index is aligned with the objective and an explanation as to why and how the designated index aligned with the objective differs from a broad market index. <p>The draft RTS require the disclosures to be set out in a section of the manager’s website titled “Sustainability-related disclosures” and in the same part of the website as the other information relation to the financial product, including marketing communications.</p>	Website	Article 10(1)	Article 33, Article 35 Draft RTS	10 March 2021
14	<p>In addition to the pre-contractual disclosures applicable to all funds noted above, a fund with a sustainable investment objective, where an index has been designated as a reference benchmark, must disclose information on how the index is aligned with the objective and an explanation as to why and how the designated index aligned with the objective differs from a broad market index. The disclosure must include an indication of where the methodology used for the calculation of the index is to be found.</p> <p>Where no index has been designated as a reference benchmark, an explanation on how the objective is to be attained.</p> <p>The draft RTS require the information to be disclosed to follow the template to be set out in Annex III (yet to be published).</p>	Pre-contractual	Article 9(1) Article 9(2) Article 9(4)	Articles 23 to 32 Draft RTS	10 March 2021
15	<p>The Taxonomy Regulation inserts a new article 9(4a) in the Disclosure Regulation, which requires that pre-contractual disclosures include:</p> <ul style="list-style-type: none"> information on the environmental objective or objectives listed under the Taxonomy Regulation to which the underlying investment contributes; and a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable. 	Pre-contractual	Article 9(4a)	Level 2 measures mandated – not yet published	1 January 2022 (for climate change mitigation and climate change adaptation) 1 January 2023 (for the remaining four environmental objectives)
16	<p>The periodic reports must disclose:</p> <ul style="list-style-type: none"> the overall sustainability-related impact of the fund by means of relevant sustainability indicators; or where an index has been designated, a comparison between the overall sustainability-related impact of the fund with the impacts of the designated index and of a broad market index through sustainability indicators. <p>The draft RTS requires this information to follow the template to be set out in Annex V (yet to be published).</p>	Periodic	Article 11(1)(b)	Articles 43 to 51 Draft RTS	1 January 2022
17	<p>The Taxonomy Regulation inserts a new article 11(1)(c) in the Disclosure Regulation, which requires that pre-contractual disclosures include:</p> <ul style="list-style-type: none"> information on the environmental objective(s) set out in the Taxonomy Regulation to which the underlying investment contributes; and a description of how and to what extent the underlying investments qualify as “environmentally sustainable” for the purposes of the taxonomy, and also the proportion of investments that are environmentally sustainable. 	Periodic	Article 11(1)(c)	Level 2 measures are mandated – not yet published	1 January 2022 (for climate change mitigation and climate change adaptation) 1 January 2023 (for the remaining four environmental objectives)



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