

Matheson



SFDR Factsheet:
The Principal Adverse
Impact Statement



DISCLOSURE REGULATION LEVEL 1 REQUIREMENTS

The PAIS must include at least the following:

- information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators;
- a description of the principal adverse sustainability impacts and of any actions taken or, where relevant, planned;
- brief summaries of engagement policies in accordance with the Shareholder Rights Directive, where applicable; and
- a reference to their adherence to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement.²

LEVEL 2 TECHNICAL STANDARDS

By 30 December 2020, the European Supervisory Authorities (“ESAs”) were required to develop draft regulatory technical standards (“RTS”) on the content, methodologies and presentation of information referred to in Article 4 of the Disclosure Regulation in respect of the sustainability indicators in relation to adverse impacts on the climate and other environment-related adverse impacts. The relevant deadline for similar RTS covering sustainability indicators in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters is 30 December 2021.

In April 2020, the ESAs published a joint [consultation paper](#) setting out their proposals, including 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 were required under their mandate to submit their final advice on RTS to the Commission by the end of December 2020 (although the ESAs indicated in October 2020 that they would not submit the advice until January 2021) and it is expected that the final RTS will be issued in early / mid 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. Fund managers will be required to comply with the high level and principle based requirements of the Disclosure Regulation from 10 March 2021 but the RTS will become applicable “*at a later stage*”.

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, and in particular the requirements relating to the principal adverse impact statement (“**PAIS**”).

WHAT IS THE PAIS?

Article 4 of the Disclosure Regulation requires financial market participants (“**FMPs**”)¹ to publish and maintain on their websites, where they consider principal adverse impacts of investment decisions on sustainability factors, a statement on the due diligence policies with respect to those impacts, taking due account of the size, nature and scale of their activities and the types of financial products that they make available. Where an FMP does not consider the adverse impacts of investment decisions on sustainability factors, the FMP must publish and maintain on its website clear reasons for why it does not do so, including where relevant information as to whether and when they intend to consider such adverse impacts. This requirement applies from **10 March 2021**.

The PAIS is intended to show investors and prospective investors how investment decisions made by a FMP have or may have adverse impacts on sustainability factors relating to environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Common indicators and a mandatory reporting template will have to be used by FMPs for the PAIS, reflecting policymakers’ intention to encourage investors to compare the sustainability of different investment approaches to enable them to make more informed investment decisions and in turn redirect capital flows towards sustainable investment.

As noted above, the requirement applies on a comply or explain basis (unless the FMP has an average of 500 employees or is the parent undertaking of a large group which has an average of 500 employees, in which case the FMP must comply from **30 June 2021**).

¹ The Disclosure Regulation applies to “financial market participants” which includes MiFID firms providing the service of portfolio management, AIFMs and UCITS management companies and self-managed funds, among other entities such as financial advisers which are not covered by this note.

² The Paris Agreement is a legally binding international treaty on climate change, which was adopted by 196 parties at COP (Conference of the Parties) 21 in Paris on 12 December 2015 and entered into force on 4 November 2016.



WHAT ARE “ARTICLE 8 FUNDS”?

The draft RTS provide a single draft framework for adverse impact disclosure by FMPs. The draft RTS include a mandatory reporting template for the PAIS³ (the “**Mandatory Reporting Template**”) and a set of indicators for both climate and environment-related adverse impacts and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters, including:

- a core set of mandatory indicators (32 in total) that will always lead to principal adverse impacts, irrespective of the result of the assessment by the FMP, for example, greenhouse gas emissions measured by carbon footprint, using the formula outlined in Annex I of the RTS and including details of the impact year-on-year;
- additional indicators (18 in total) for environmental and social factors, to be used to identify, assess and prioritise additional principal adverse impacts (using specific qualitative or quantitative factors and metrics), for example, emissions, measured in tonnes of air pollutants equivalent per million EUR invested; and
- a statement to be published where adverse impacts of investment decisions are not considered by FMPs.

The description of principal adverse impacts must include the 32 minimum principal adverse impacts on sustainability factors set out in Table 1 of Annex I, plus at least one additional principal adverse impact on a climate or other environment-related sustainability factor that qualifies as principal as set out in Table 2 of Annex I, plus at least one additional principal adverse impact on social, employee, human rights, anti-corruption or anti-bribery sustainability factor that qualifies as principal as set out in Table 3 of Annex I (ie, the PAIS must include at least 34 indicators in total).

The draft RTS sets out details of the website disclosure which should include the PAIS, published in the format set out in the Mandatory Reporting Template and made up of the following sections:

³ Table 1, Annex I, Draft RTS



| SECTION | DRAFT RTS | DESCRIPTION |
|---|------------|---|
| Summary | Article 5 | Including the name of the FMP, the fact that principal adverse impacts are considered, the reference period and a summary of the PAIS comprising a maximum of two pages in length. |
| Description of principal adverse sustainability impacts | Article 6 | Including the minimum principal adverse impacts set out in Table 1 of Annex I of the RTS, one additional environmental and social indicator from each of Table 2 and 3 of Annex I of the RTS and any other adverse impact that qualifies as principal, as well as a historical comparison with previous reference periods. |
| Description of policies to identify and prioritise principal adverse sustainability impacts | Article 7 | Including the date of approval of the policies, the allocation of responsibility for the implementation of the policies within organisational strategies and procedures, a description of the methodologies of assessment of each principal adverse impact, any associated margin of error and a description of data sources used. If information relating to any of the indicators is not readily available, details of best efforts used to obtain information directly from investee companies or otherwise to assess the adverse impacts has to be disclosed. |
| Description of actions to address principal adverse sustainability impacts | Article 8 | Including details of the actions taken during the reference period and planned by the FMP for the next reference period to avoid or reduce the principal adverse impacts identified and an explanation of the reduction in principal adverse impacts achieved by the actions taken during the reference period. |
| Engagement policies | Article 9 | Including summaries of relevant shareholder engagement policies and an explanation of the reduction in principal adverse impacts achieved of the actions taken during the reference period. |
| References to international standards | Article 10 | Including a description of the adherence of the FMP to responsible business conduct codes and internationally recognised standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement, including at least forward-looking climate scenarios. The description must specify the adverse indicators used in the assessment to measure that adherence or alignment. |



RELATED PROSPECTUS DISCLOSURES

Article 7 of the Disclosure Regulation requires that, by **30 December 2022**, where an FMP prepares a PAIS in accordance with Article 4, the prospectus for the relevant financial product must disclose:

- a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors; and
- a statement that information on principal adverse impacts on sustainability factors is available in the relevant periodic report of the financial product.

Where an FMP does not consider principal adverse impacts in accordance with Article 4, the prospectus disclosures for the relevant financial product must include a statement that the FMP does not consider principal adverse impacts and the reasons why it does not do so. This requirement applies from **10 March 2021**.

COMMENT

In light of the Commission's confirmation that the RTS will not apply from 10 March 2021, and that FMPs will be required to comply with the high level and principle based requirements of the Disclosure Regulation from that date, there is a lack of clarity as to what the PAIS to be published on FMPs' website will look like in the absence of finalised RTS. Some FMPs (excluding those large FMPs who must comply with the PAIS requirement by 30 June 2021, as referred to above) may adopt the approach permitted under Article 4 of the Disclosure Regulation of publishing on their websites clear reasons why they do not consider principal adverse impacts, including where relevant information as to whether and when they intend to consider such adverse impacts, pending the application of the RTS.

Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this update.

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