Mr John Berrigan
Director General
Directorate-General Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de Spa 2
1000 Brussels
Belgium

JC 2021 02

7 January 2021

Ref: Priority issues relating to SFDR application

Dear Mr Berrigan,

I am writing to you as Chair of the Joint Committee of the European Supervisory Authorities (ESAs). During the course of the work on the draft regulatory technical standards under Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector[1] (SFDR), as amended by Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment[2] (Taxonomy Regulation), the ESAs have encountered several important areas of uncertainty in the interpretation of SFDR.

These areas of uncertainty have been voiced by stakeholders during the consultation process relating to the draft regulatory technical standards[3], including during the public hearing organised by the ESAs on 2 July 2020. The consultation closed on 1 September 2020 and the ESAs are currently finalising the draft regulatory technical standards within the Joint Committee of the ESAs.

While many of these interpretative uncertainties of SFDR may be clarified in due course, the ESAs have identified certain priority questions pertaining to the SFRD that would benefit from a more urgent clarification to facilitate an orderly application of SFDR from 10 March 2021.

These priority areas of SFDR are summarised in the Annex covering:

- the application of SFDR to non-EU Alternative Investment Fund Managers (AIFMs) and registered AIFMs;
- application of the 500-employee threshold for principal adverse impact reporting on parent undertakings of a large group;

[1] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1).
[2] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088 (OJ L 198, 22.6.2020, p. 13).
[3] ESG disclosures: Draft regulatory technical standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a, Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088, 23 April 2020 (JC 2020 16).

- the meaning of “promotion” in the context of products promoting environmental or social characteristics;
- the application of Article 9 of SFDR; and
- the application of SFDR product rules to portfolios and dedicated funds.

The ESAs greatly appreciate your attention to this matter and look forward to hearing from you, taking into account the required application of the SFDR by 10 March 2021.

Yours sincerely,

Steven Maijoor

Chair of the ESA’s Joint Committee

cc: Irene Tinagli, Chair of the Committee on European and Monetary Affairs, European Parliament

João Leão, President of the ECOFIN Council, Council of the European Union

Jeppe Tranholm-Mikkelsen, Secretary-General of the Council of the European Union

Annex – SFDR priority questions received by the ESAs

Application of SFDR to non-EU AIFMs and registered AIFMs

SFDR applies to financial market participants and financial advisers. Article 2(1)(e) SFDR defines 'an alternative investment fund manager (AIFM)' as one of the financial market participants to which SFDR applies. An 'AIFM' is further defined in Article 2(4) SFDR with reference to Article 4(1)(b) of Directive 2011/61/EU4 (the Alternative Investment Fund Managers Directive (AIFMD)). Therefore, SFDR applies to AIFMs in general by virtue of the reference to Article 4(1)(b).

- Does SFDR apply to registered (sometimes referred to as sub-threshold) AIFMs referred to in Article 3(2) AIFMD?

- Does SFDR apply to non-EU AIFMs, for example when they market a sustainable EU Alternative Investment Fund under a National Private Placement Regime?

Application of the 500-employee threshold for principal adverse impact reporting at entity level to parent undertakings of a large group

Article 4(4) SFDR requires, from 30 June 2021, "*financial market participants which are parent undertakings of a large group as referred to in Article 3(7) of Directive 2013/34/EU*[5] *exceeding on the balance sheet date of the group, on a consolidated basis, the criterion of the average number of 500 employees during the financial year shall publish and maintain on their websites a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors*".

- Must the calculation of the 500-employee threshold to the parent undertaking of a large group be applied to both EU and non-EU entities of the group without distinction as to the place of establishment of the group and/or subsidiary?

- Does the due diligence statement include impacts of the parent undertaking only or must it include the impacts of the group at a consolidated level?

Meaning of "promotion" in the context of products promoting environmental or social characteristics

Article 8 SFDR aims to enhance transparency on products "promoting environmental or social characteristics" in pre-contractual disclosures. It applies: "*Where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics*" (paragraph 1 thereof).

[4] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (OJ L 174, 1.7.2011, p. 1).
[5] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

In general, clarification on the level of ambition of the characteristics through the provision of examples of different scenarios that are within, and outside, the scope of Article 8 SFDR would assist the orderly application of SFDR.

More specifically, the following questions arise:

- Can the name of a product, which may include words like “sustainable”, “sustainability”, or “ESG” be considered to qualify a product to be promoting an environmental or social characteristic or to be having sustainable investment as its objective?

- While a financial product to which Article 8 applies does not need to explicitly promote itself as targeting sustainable investments (within the meaning of Article 2(17) SFDR), would a reference to taking into account a sustainability factor or sustainability risk in the investment decision be sufficient for Article 8 to apply? If the answer is yes, how can financial market participants that disclose mandatory information according to Article 6(1) or Article 7(1) SFDR ensure that this is not automatically considered as “promoting environmental or social characteristics”.

- Must a product to which Article 8 applies invest a minimum share of its investments to attain its designated environmental or social characteristic in order to be considered to be promoting environmental or social characteristics?

- In the absence of active advertising of an environmental or social characteristic of the product, would an intrinsic characteristic of the product, such as a sectoral exclusion (e.g. tobacco) which is not advertised, also qualify as “promotion”?

- In addition, would complying with a national legal obligation, which applies to the financial market participant, such as a ban on investment in cluster munitions, also bring the product into the scope of Article 8?

Application of Article 9 SFDR

Article 9(1) and (2) SFDR apply: “*Where a financial product has sustainable investment as its objective*”.

In addition, Article 9(3) requires:

> *Where a financial product has a reduction in carbon emissions as its objective, the information to be disclosed pursuant to Article 6(1) and (3) shall include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement.*
>
> *By way of derogation from paragraph 2 of this Article, where no EU Climate Transition Benchmark or EU Paris-aligned Benchmark in accordance with Regulation (EU) 2016/1011 of the European Parliament and of the Council (1) is available, the information referred to in Article 6 shall include 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.*

- Must a product to which Article 9(1), (2) or (3) SFDR applies only invest in sustainable investments as defined in Article 2(17) SFDR? If not, is a minimum share of sustainable investments required (or would there be a maximum limit to the share of "other" investments)?

- Where an EU Climate Transition Benchmark (EU CTB) or EU Paris-aligned Benchmark (EU PAB) exists, is it necessary for a product to track an EU PAB or an EU CTB on a passive basis for Article 9(3) SFDR to apply to it?

- If the questions above are answered in the affirmative and if the minimum standards of an EU PAB or an EU CTB do not require the index components to be sustainable investments, can the product fall within the scope of Article 9(3) SFDR?

Application of SFDR product rules to MIFID portfolios and other tailored products

As above, SFDR applies to financial market participants and financial advisers. In particular, in respect of investment firms as defined in point (l) of Article 4(1) of Directive 2014/65/EU[6], Article 2(1)(e) SFDR defines 'an investment firm which provides portfolio management' as one of the financial market participants to which it applies and Article 2(11)(d) SFDR defines 'an investment firm which provides investment advice' as one of the financial advisers to which it applies.

- For portfolios, or other types of tailored financial products managed in accordance with mandates given by clients on a discretionary client-by-client basis, do the disclosure requirements in SFDR apply at the level of the portfolio only or can they apply at the level of standardised portfolio solutions?
- If the disclosure requirements of SFDR apply at the portfolio level, how is it possible to maintain confidentiality obligations to the client in view of the disclosures required, especially the website disclosures required by Article 10 SFDR?

[6] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349).