

MEMO# 32651

July 31, 2020

29 July Meeting with ESMA on Disclosure Regulation RTS Consultation

[32651]

July 31, 2020 TO: EU ESG Disclosure Regulation Working Group RE: 29 July Meeting with ESMA on Disclosure Regulation RTS Consultation

We spoke with Patrik Karlsson at ESMA on 29 July about the ESAs' consultation on the regulatory technical standards (RTS) for the sustainable finance Disclosure Regulation (SFDR). The conversation was extremely helpful and raised some issues that we will incorporate into the draft RTS consultation response letter, which we plan to send to you on Monday morning (with two weeks for your review).

Below are some items of note from our conversation:

Manager-level Disclosure ("Principal Adverse Impact [PAI] Statement")

- **Clarified the three deadlines for PAI Statement disclosure (SFDR Art 4).**
 - **Initial deadline** – An asset manager (AM) must publish certain pieces of the PAI Statement website disclosure on the day on which it first starts considering (i.e., tracking) principal adverse impacts. The disclosure date can at the earliest be 10 March 2010. AMs subject to the mandatory disclosure obligation (over 500 employees, per SFDR Art 4(3)) must do this initial disclosure by **30 June 2021**. This initial disclosure is limited to the following elements of the PAI Statement:
 - RTS Art 5 – Summary
 - RTS Art 7 – Description of policies to identify and prioritise principal adverse sustainability impacts
 - RTS Art 9 – Only the summaries of engagement policies, not the explanation of the reduction in principal adverse impacts achieved.
 - RTS Art 10 – References to international standards
 - **Second deadline – 30 June 2022** disclosure of the PAI Statement (for AMs subject to mandatory disclosure), including all of the information covering the reference period of [whenever the AM did its initial PAI Statement disclosure] to Dec 2021. This disclosure includes the elements listed above, plus the following:
 - RTS Art 6 – PAI indicators over the reference period (but not the historical comparison)
 - RTS Art 8 – Description of actions and engagement policies to address

- principal adverse sustainability impacts over the reference period
 - RTS Art 9 – Explanation of the reduction in principal adverse impacts achieved by actions taken during the reference period
 - **Third deadline – 30 June 2023** disclosure of the PAI Statement (for AMs subject to mandatory disclosure), including all of the information covering the reference period of January 2022 to December 2022. This disclosure includes the elements listed above, plus the following:
 - RTS Art 6 – Historical comparison comparing the last two reference periods
- **Proportionality and the line between “comply” and “explain.”** Looking to better incorporate SFDR’s Art 4 proportionality language into the PAI indicator disclosure requirements and welcome feedback on this. Currently one size fits all methodology that is very strict. 32 (mandatory) + 2 (optional) indicators always lead to PAI and have to be considered PAI. They welcome feedback on whether this is proportional.
 - Noted that it should be possible to interpret RTS Art 7.2 as providing proportionality/leeway. [RTS Art 7.2 says if indicators are not available, then must provide details on best efforts used to obtain info from companies and, if not available from companies, best efforts used to assess adverse impacts.] It’s therefore possible to “comply” even if not able to obtain good data but would need to explain why.
- **Calculation methodology for indicators.** The purpose of the requirement to calculate indicators over a reference period is to avoid potential window dressing. They recognize there are a lot of good questions on how an AM would actually do this (e.g., how to account for purchases/sales, different asset classes). They would welcome suggestions on how to simplify the disclosure (e.g., point in time) while avoiding window dressing.
- **Thresholds for adverse impact.** Thresholds are a good idea in theory but very hard to come up with something that will work in practice, especially given the PAI indicators’ link to DNSH disclosures for Art. 8 and 9 products. Did not sound likely that they will pursue developing thresholds.
- **Incorporation of indicators into the investment process.** [Note: this came up in the hearing as well.] Confirmed the SFDR is primarily about ex ante disclosure of PAI, while the European Commission’s (EC) forthcoming UCITS/AIFMD Delegated Acts (DAs) are behavioral (i.e., due diligence provision that AMs who disclose PAI must also incorporate consideration of PAI into investment process).
- **Art 7 product-level PAI disclosure.** We mentioned some of the confusion we’ve heard from industry around the link between Art 4 (entity-level PAI disclosure) and Art 7 (product-level PAI disclosure). Confirmed that Art 4 does not require any sub PAI Statements for products. Any lack of clarity with respect to the link between Art 4 and 7 needs to be answered by the EC though.

Product-level Disclosure

- **Timing.** Very aware of timing and implementation challenges, but ESAs don’t have any leeway on level 1 deadlines and any changes would need to come from the EC. With respect to periodic reports, there’s an open question on the 1 Jan 2022 compliance date – whether the first reporting period begins on 1 Jan 2022 or whether the disclosure applies to annual reports issued from 1 Jan 2022. EC has to advise on that particular issue, and the ESAs will try to clarify in the final report to the extent possible.

- **Definition of Art 8 products.** They would like feedback on Recital 21 (which quasi-defines Art 8 products), on whether it is helpful and/or how to improve it. Level 1 constraints on further defining Art 8 products. [Note that Art 8 is a product category for disclosure purposes, not for distribution purposes. The EC is expected to finalize the MiFID II DAs soon,^[1] which will amend MiFID II suitability and target market requirements to likely require an Art 8 fund to have some element of “sustainable investments” (or the asset manager would need to “comply” with the SFDR Art 4 and 7 PAI disclosure requirements) in order to be distributed as an ESG/sustainable fund.]
- **Art 8 and sustainable investments.** Art. 8 product disclosure of any “sustainable investments” (RTS Arts 15, 16) will be necessary, even though an Art 8 product does not have an objective of sustainable investments. Noted the link to the MiFID II DAs (which is not final yet and on which the ESAs did not have any input).
- **“Do no significant harm” (DNSH).** The DNSH disclosure (RTS Arts 16, 25) applies only to any “sustainable investments” in an Art 8 or 9 product. [“Sustainable investments” are investments that contribute to an E or S objective and that “do not significantly harm” other objectives.] Must take into account the PAI indicators, but the methodology is left to the AM’s discretion. May ultimately link to the Taxonomy technical screening criteria.
 - Noted that SFDR Art 2(17) definition of “sustainable investments” is drafted open-ended without a set of E or S objectives, rather have to show haven’t done ANY significant harm to ANY E or S objective.
 - RTS Arts 16 and 25 require disclosure of how investments that significantly harm the sustainable investment objectives are excluded. In the hearing, the ESAs said that there should be a process in place for excluding investments that could do significant harm to E or S objectives and the methodology of that process should be disclosed. He mentioned on the call though that they may decide to require more specific excluded investments disclosure in the periodic report. [This is something it may be useful for us to comment on.]

Hope this is helpful, and please let us know if you have any questions.

Linda M. French
Assistant Chief Counsel, ICI Global

Anna Driggs
Director and Associate Chief Counsel
ICI Global

endnotes

^[1] Our response to the EC’s consultation on the draft MiFID II DAs is *available at* <https://www.iciglobal.org/iciglobal/pubs/memos/memo32584>.

should not be considered a substitute for, legal advice.