



## Are you sure SFDR doesn't apply to you?

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February 2021

The clock is ticking... 10th March is almost upon us so, first things first...

### What is SFDR and Who or What is Subject to SFDR?

The Sustainable Finance Disclosure Regulation (“SFDR”) is the latest Environmental, Social and Governance (“ESG”) regulation in the European Union. It is part of a package of initiatives and legislation to move Europe toward several Sustainability goals.

SFDR relates to sustainability related disclosures in the financial services sector. It requires financial sector firms to consider two main issues:

1. disclosure of the principal adverse sustainability impacts (doing harm); and
2. quantification of the beneficial investment results

SFDR applies to nearly all firms in the financial sector: AIFM, UCITS, MiFID as well as Solvency II and IDD firm as well as the products they manage or promote.

### Does SFDR apply to UK firms?

SFDR has not been adopted into UK law post-Brexit, **however**, there are a number of ways in which SFDR could be relevant for UK firms, either as a requirement or on a practical level. Here are **9** of the circumstances under which SFDR could become applicable to UK firms:

- A UK fund manager marketing funds into the EU under national private placement regimes (NPPRs)
- A UK AIFM is now a non-EU (or third country) AIFM and if it is registered to market into an EU Member State under NPPRs, it will be subject to the SFDR
- A UK fund manager acting as the delegated investment manager to an EU firm which is subject to SFDR will need to comply where the EU firm imposes the obligations to comply with the SFDR on the UK firm
- UK firms may come under client or investor pressure to comply with SFDR and therefore decide to opt in
- A global group that has UK and EU-based entities may decide to implement SFDR as a global standard (i.e. the group may decide to impose SFDR as the highest common denominator standard
- A UK firm may see SFDR as a “gold standard” for ESG disclosure requirements and decide to adopt it on a voluntary basis
- Some UK firms may adopt SFDR to gain a competitive advantage
- A UK firm operating funds with an EU structure where it is responsible for compliance with SFDR may also adopt it for the whole of its structure or group
- An EU firm that is subject to SFDR in relation to the fund, has a UK firm as the operator and so the UK firm takes the lead on SFDR implementation as an operator

## How might a UK firm assess whether SFDR applies? Here are some questions to ask?

- Are you planning to market any funds into the EU after 10 March 2021 under NPPRS?
- Are you operating or sponsoring any EU fund structures? (If so, liaise with the fund Board and any third parties involved about the responsibilities for SFDR and document the conclusion.)
- Are you providing fund management or advisory services to EU clients that are financial market participants? If so, anticipate having SFDR requirements imposed on you.
- Is your firm part of a group containing an EU firm? Has the group / firm reviewed group policies and decided whether to impose SFDR to the UK firm on a voluntary basis?
- Has there been any pressure to comply with SFDR from clients or investors? (Check with your investor or client's relations teams and again record the conclusion.)
- Is there a commercial or competitive advantage in complying with SFDR on a voluntary basis?

## The UK's Current Approach to Sustainable Investment Regulation and Timeline

### The UK Approach?

In **November 2020**, UK Chancellor Rishi Sunak outlined the UK's roadmap to developing and implementing more robust environmental disclosure standards but on a different timescale to the EU's SFDR. The UK concern, given the urgency of the climate threat, is that a voluntary approach to climate related financial disclosures is not sufficient.

The UK has decided that it will, instead, be the first country in the world to make disclosures that are aligned with the Task Force on Climate related Financial Disclosures (TCFD) fully mandatory by **2025**. In adopting this approach the UK will be going **beyond** the "comply or explain" approach adopted under SFDR.

The FCA intends to consult on these new requirements in the first half of 2021 and aims to finalize the rules by the end of 2021.

Implementation is likely to be phased, starting with the largest firms in 2022 and introducing requirements for smaller firms in 2023.

### The Timeline?

SFDR becomes effective on **10 March 2021**.

The reporting on specific data gathered by funds and portfolio managers becomes effective by **30 June 2021** and year end 2021.

There are also detailed requirements in the Regulatory Technical Standards ("RTS") (*see below*) which, once they are approved and adopted by the European Commission, should apply from **1 January 2022**. *Therefore, although the RTS is informative for the purposes of complying with the 10 March deadline, the requirements of the RTS will not be binding until they are formally adopted.*

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## What do you need to do by 10 March 2021

See over...SFDR requires certain disclosures to be made on websites and in pre-contractual documents e.g. Private Placement Memoranda.

Financial services firms, referred to in SFDR as “financial market participants”, have to make a decision to:

- either to comply with the principal adverse sustainability impacts (“PASI” or “PAS”) of the investment (see below); or
- explain why not and include this in pre-contractual disclosures.

### What are the new disclosures?

The website disclosures cover policies on Remuneration, Risk Management, Portfolio Management and disclose relevant components of these.

The financial product decisions need to be made as to the product’s categorisation as either:

- a sustainable investment (Article 9 of SFDR);
- a partially sustainable investment (Article 8 of SFDR); or
- neither, in which case disclosure is on the sustainability risks and possible impact to financial returns.

### How to approach these decisions?

The decisions as to whether to comply or not require both short term and longer-term strategic consideration.

Industry estimates, surveys and research indicate that investment flows into ESG investments will exceed those into non-sustainable investments in the coming years. *(Please contact us if you would like more information on the industry position.)*

We can all anticipate that this will be a developing area for some time to come. Furthermore, as there is considerable interaction between market participants and the financial products they advise on and market, the strategic position taken now is likely to have far-reaching effects for the firm.

On a more practical level it is difficult to see how a firm that has decided not to adopt measurement and disclosure of the principal adverse sustainability impacts (PASI) could (or should) advise on an Article 9 product. Moreover, if the data is not available at product level it will prove difficult for a firm to quantify the PASI.

## Next Steps

**For UK firms:** consider the points above and consider whether any group, client or commercial reasons mean that the firm needs to comply with SFDR?

**For all firms to which SFDR is applicable:** the European Supervisory Authorities (“ESAs”) in early **February 2021** published the final draft of the **RTS**. These set out the detailed disclosure requirements for the PASI statements. The final draft also sets out the disclosure requirements for Article 84 and Article 95 (for funds or portfolios), together with the related mandatory disclosure templates.

The revised **RTS** do take account of the feedback received to the ESAs’ Consultation Paper of 23 April 2020 on the first draft of the RTS. The final draft also incorporates the mandatory disclosure templates - following the feedback received by the ESAs to their online survey and consumer testing exercise.

The RTS (including templates) can be found [here.](#)

If you are not already well advanced with this project, there's no time to lose as **10 March 2021 is almost upon us**. Please do get in touch if you need assistance on any of the matters discussed in this briefing note.

## We can help you...

- understand the implications of SFDR for your firm
- consider the strategic impacts of SFDR on your business to determine, if it is not mandatory for your firm, whether you should voluntarily comply
- by undertaking a gap-analysis between your existing documents and th SFDR requirements to identify whether any up-upgrades are required to existing disclosure documents to ensure compliance (whether voluntarily or mandated)
- by providing you with the tools to undertake any analysis for yourselves
- by assisting with up-dating your product development processes to include SFDR considerations
- enhance your policies and procedures - working with your legal, compliance, product and operational teams as required.

Contact us as below – we're happy to discuss any aspect of this article:

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