

SFDR – regulatory technical standards (RTS) published

Top 10 talking points (April 2022)

The European Commission published on 6 April 2022 its much-anticipated and much-delayed Regulatory Technical Standards (RTS) under SFDR. While we've seen various previous drafts of the RTS in the last two years, this latest publication represents the RTS in effectively final form.

For many asset managers, the first question on seeing the final RTS is “*what's new?*”. And that's what we cover in this briefing note: what's changed, what's remaining the same, and what is still unclear, compared to the previous draft versions of the RTS.

What are the key takeaways?

- In substance, the April 2022 RTS are largely un-changed as from the February 2021 and October 2021 prior drafts. Superficially at least, the RTS appear heavily amended, but on closer scrutiny these are merely drafting and stylistic changes, and improvements to the legal architecture of the regulation.
- **PAI regime:** it will remain mandatory to use a prescribed disclosure template for the annual manager-level PAI report. The harm indicators, and the narrative disclosures, are not materially changed.
- **Article 8 / 9 disclosures:** the April 2022 RTS retain the prior approach of pre-contractual and periodic disclosures being made through mandatory templates, substantively unchanged from prior drafts.
- **Not a labelling regime:** The Commission emphasises once again that SFDR article 8/9 are anti-greenwashing disclosure rules, not a positive labelling regime. This is an unfortunate case of shutting the stable door after the horse has bolted, as the market perception is that these are labels.

Which key questions remain unanswered?

- **PAI regime:** the April 2022 RTS do not expressly answer the question of whether any products can be excluded from the manager's entity-level report. In the absence of such clarification, we remain of the view that all products must be included. Similarly, the RTS do not provide any details on product-level PAI reports (although this was not required by SFDR in any event). There is also no further guidance on how to treat short positions.
- **Definition of article 8/9 products:** the RTS do not include any formal definition of article 8 and 9 products, beyond the indirect references in the recitals. Importantly, the RTS do not set any minimum thresholds for qualifying as article 8 products, and do not clarify uncertainties around article 9(3).
- **Definition of sustainable investment:** the RTS do not define this in any further detail, and there is no further guidance on the open question of what “contributes to” an E/S objective means.

This briefing note sets out the Top 10 things which asset managers should know about the April 2022 RTS, as compared to the previous draft versions.

1. What's the status and purpose of the draft RTS?

On 6 April 2022, the European Commission published its proposed Level 2 [Regulatory Technical Standards \(RTS\)](#) under both the EU Sustainable Finance Disclosures Regulation (**SFDR**) and the EU Taxonomy Regulation (the **Taxonomy**). The RTS were accompanied by [five draft annexes](#), which provide mandatory disclosure templates.

What do the RTS cover?

The RTS provide additional technical detail on the content, methodology and presentation of certain existing disclosure requirements under SFDR and the Taxonomy Regulation. The RTS are a consolidated set of technical standards.

Regulation	Disclosure requirement	Action
SFDR	<ul style="list-style-type: none">due diligence policies with respect to the consideration of principal adverse impacts (PAI) on sustainability factors	Update existing principles-based disclosures, which have been in place since 10 March 2021
	<ul style="list-style-type: none">disclosures for a financial product which either promotes environmental or social characteristics (an article 8 product) or has sustainable investment as its objective (an article 9 product)	
Taxonomy	<ul style="list-style-type: none">further disclosure obligations for article 8 / 9 products which promote environmental sustainability	Update existing principles-based disclosures, which have been in place since 1 January 2022

Firms which are subject to these existing requirements will need to ensure that their existing principles-based disclosures are updated to reflect the detailed requirements of the RTS, ahead of the RTS coming into force.

When will the RTS come into force?

The Commission is proposing that the RTS will come into effect from **1 January 2023**.

Note that the draft version published today is **not the final version of the RTS**. The Commission's draft still must be reviewed by the European Parliament and the Council of the EU. Those bodies could, in theory, make changes to the RTS (although further substantive changes are not expected).

Please note that the requirement to gather data for PAI quantitative disclosures effectively applies retrospectively, for calendar year 2022 – see question 8 below, for more details.

Have there been prior versions of the RTS?

There have been multiple prior drafts of the RTS and related consultations, going back to the first half of 2020. Three significant draft versions have received much attention in the market:

- [April 2020](#) consultation paper, which included a widely-criticised Draft RTS and which was generally very poorly received by the industry
- [February 2021](#) final report, which addressed some (but not all) of the concerns in the industry around the RTS. The February 2021 version of the RTS was the most recent detailed discussion of PAI disclosures
- [October 2021](#) final report, which introduced the Taxonomy disclosures, and refined some of the disclosure proposals for article 8 / 9 products.

(Please refer to our [ESG – notes for clients webpage](#), to access our detailed briefing notes on each of the April 2020, February 2021 and October 2021 versions of the RTS.)

The purpose of this briefing note is generally to compare the April 2022 RTS published by the Commission, as against the February 2021 and October 2021 final reports. **This note assumes a general familiarity with the prior drafts of the RTS and assumes that the reader's immediate interest is how the proposals have evolved, and what are the remaining areas of uncertainty.**

We will shortly publish a broader general summary of the requirements under the RTS, and the actions that in-scope firms should take ahead of the 1 January 2023 deadline.

2. Is SFDR a product labelling regime?

No (at least not in the Commission's eyes!). The explanatory memorandum that accompanies the RTS reinforces the comments made in the 2021 Q&A, clarifying that article 8 / 9 SFDR should **not be seen as a labelling regime**.

SFDR article 8/9 is simply a **disclosure regime** that is triggered upon a financial product making certain claims about its sustainability ambitions.

This responds to market practice in the industry that article 8/9 should be viewed as an **aspirational badge or label**. There is a growing tension between market perceptions that article 8/9 should be seen as a "gold standard" for ESG funds, which is at odds with the Commission's perception that article 8/9 are disclosures triggered by claims made about a product.

3. Do the RTS change how to define an article 8 or an article 9 product?

The RTS do **not make any substantive changes** to the definition of an article 8 or 9 product.

There are several key points to note:

- The RTS do **not impose any minimum standards** to qualify as an article 8 product. In particular, there are no minimum requirements for the proportion of a portfolio which must be aligned with E/S characteristics, and there are no minimum requirements to make sustainable investments within an article 8 product.
- The April 2022 RTS retain the recital (now numbered as Recital (16)) which confirms that an **exclusion strategy** is a sufficient basis to trigger article 8 status, although emphasising the greenwashing risks.
- The RTS do not provide any further clarity on the **definition of an article 9(3) product**, nor how to address some of the open questions around what to do if the reference index contains positions which would not be sustainable investments.

4. Do the RTS deal with the meaning of "sustainable investment" under SFDR?

No, the RTS do not provide any further (much called for) guidance on the definition of a "**sustainable investment**". Beyond the basic definition in Article 2(17) SFDR, there is little guidance for the industry on how this should be interpreted, and this remains an area of uncertainty.

It remains to be seen whether the European Supervisory Authorities will produce further Q&A on this topic in advance of 1 January 2023.

5. Pre-contractual disclosure for article 8 / 9 products – what's changed?

The prior draft versions of the RTS adopted the approach of requiring the article 8 and article 9 pre-contractual information to be contained in a **mandatory disclosure template**, which must be annexed to the offering documents for the product (such as the prospectus for a fund). The October 2021 draft RTS also adopted the approach of including a **parallel set of drafting "instructions"** as operative provisions in the RTS, along with drafting notes in the disclosure template.

Comparing the [April 2022 RTS](#) to the prior versions:

What remains the same or similar?	What's changed?
<ul style="list-style-type: none"> The April 2022 RTS retain the same fundamental approach of requiring the pre-contractual disclosures to be contained in a mandatory disclosure template, which will be annexed to the offering documents. Please see Annex II to the RTS which sets out the pre-contractual disclosures for an article 8 product, and Annex III which includes the disclosures for an article 9 product. With the exception of a couple of points noted opposite, the Annex II and Annex III disclosure templates are not substantively changed. The core disclosure requirements are broadly the same as previously proposed. Firms which have already done meaningful work to prepare for disclosure will likely welcome this approach. The April 2022 RTS retain the approach that an article 8 product must disclose: (i) whether it commits to having a minimum percentage of sustainable investments, and (ii) if so, whether or not it invests with an environmental objective in environmentally sustainable economic activities under the Taxonomy. (This feeds into the status of article 8 products under the revised suitability assessments under MiFID2.) 	<ul style="list-style-type: none"> Fortunately, the April 2022 RTS simplify the approach compared to the October 2021 draft, and have largely deleted the drafting instructions from the operative provisions of the RTS. This is to be welcomed, as the interaction between the operative provisions and the drafting notes in the templates was unclear and, in some cases, inconsistent. The April 2022 RTS clarify what is required for disclosure of asset allocation. (It had been unclear following the October 2021 draft as to which elements required an express quantitative figure or minimum commitment.) The drafting notes in the Annex II and Annex III templates have been expanded and are now largely self-explanatory, and in most cases without a need to cross-refer to operative clauses. Again, this approach is likely to be welcomed by firms. The marginal explanatory notes (which are mandatory to include in the client-facing template) in both templates have in some cases been clarified. This will not have an impact on firms.

6. Taxonomy disclosure for article 8 / 9 products – what's changed?

By way of background, under Article 5 and 6 of the Taxonomy, article 8 / 9 products which invest in sustainable investments with an environmental objective must disclose how and to what extent the investments are in economic activities that qualify as environmentally sustainable under the Taxonomy.

The October 2021 final report proposed that these Taxonomy disclosures would be achieved through a mixture of narrative and quantitative disclosure. The quantitative disclosures would show the minimum taxonomy alignment of aggregated investments (both including and excluding sovereign exposures). The reference to “minimum” alignment caused some confusion in the market, as it was unclear if the RTS was requiring firms to set a minimum commitment, or simply report on portfolio alignment.

Comparing the [April 2022 RTS](#) to the prior versions:

What remains the same or similar?	What's changed?
<ul style="list-style-type: none"> The April 2022 RTS retain the basic structural approach of Taxonomy disclosures being 	<ul style="list-style-type: none"> The disclosure in the pie charts has now been clarified to refer to the degree to which the

What remains the same or similar?	What's changed?
<p>achieved through a mixture of narrative and quantitative disclosures.</p> <ul style="list-style-type: none"> • This includes retaining the approach of making the quantitative disclosures through two pie charts, both including and excluding sovereign exposures. • For the quantitative disclosures, the April 2022 RTS retain the requirement to use the same KPIs for all non-financial undertakings, and the same KPI for the same types of financial undertakings. The April 2022 RTS also retain the approach of using turnover as the default KPI for non-financial undertakings, with the option of using capex or opex only if this would be more representative based on the features of the financial product. • The methodology for calculating taxonomy alignment is also substantively unchanged. • The narrative disclosures on Taxonomy alignment are substantively unchanged between the October 2021 final report and the April 2022 RTS. 	<p><i>aggregated investments are investments in environmentally sustainable economic activities.</i></p> <ul style="list-style-type: none"> • This removes the ambiguity noted above around whether firms must set targets (now clearly not necessary for this disclosure).

7. Website disclosure for article 8 / 9 products – what's changed?

The prior versions of the RTS did not provide mandatory templates for the website disclosures but did prescribe the format, content and manner of the disclosures on a firm's website. The website disclosures are intended to expand on topics disclosed in a concise way in pre-contractual documents and to provide further information relevant to those end investors.

Comparing the **April 2022 RTS** to the prior versions:

What remains the same or similar?	What's changed?
<ul style="list-style-type: none"> • The April 2022 RTS retain the same section headings for the website disclosures for article 8 products and article 9 products. • The requirements for the naming of the website section and the clear identification of the financial product on the website remain. • With the exception of a couple of points noted opposite, the website disclosure requirements are not substantively changed. 	<ul style="list-style-type: none"> • Prior versions of the RTS contained a recital stating that firms should comply with confidentiality and data protection law when making the website disclosures. That clarification in the recitals has not transferred to the April 2022 RTS. While we did not believe that this recital allowed website disclosures to be made on private or password-protected websites, some firms did rely on this recital to modify the public disclosures to ensure confidentiality requirements or private placement rules were adhered to (for example, by anonymising or redacting data).

	<ul style="list-style-type: none"> • The removal of this recital is unfortunate for firms who may have been relying on it in designing their website disclosures, although we believe there is still room to modify website disclosures accordingly, provided the baseline information is publicly disclosed. • The April 2022 RTS clarifies that the translation requirement for the summary section of the website disclosure is triggered where the product is "made available" in a host Member State, not just where it is "marketed" in a host Member State. This is a potentially broader concept than "marketed", which could have suggested active promotion only.
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8. Periodic disclosure for article 8 / 9 products – what’s changed?

As with the pre-contractual disclosure requirements, the prior draft versions of the RTS provided for a mandatory disclosure template to be annexed to the periodic reporting documents for the product (such as the annual report for a fund).

Comparing the **April 2022 RTS** to the prior versions:

What remains the same or similar?	What’s changed?
<ul style="list-style-type: none"> • The April 2022 RTS retain the same fundamental approach of requiring the pre-contractual disclosures to be contained in a mandatory disclosure template, which will be annexed to the periodic reporting documents. • Please see Annex IV to the RTS which sets out the periodic disclosures for an article 8 product, and Annex V which includes the disclosures for an article 9 product. • With the exception of a couple of points noted opposite, the Annex IV and Annex V disclosure templates are not substantively changed. The core disclosure requirements are broadly the same as previously proposed. 	<ul style="list-style-type: none"> • Fortunately, the April 2022 RTS simplify the approach compared to the October 2021 draft, and have largely deleted the drafting instructions from the operative provisions of the RTS. The drafting notes have been clarified, and the marginal notes improved. These changes will all likely be welcomed by firms. • The concept of fossil fuel sector has been expanded to cover the exploration, mining, extraction, production, processing, storage, refining or distribution, including transportation, storage and trade of fossil fuels. This will be relevant for Article 8 products which will make specific disclosures as to the proportion of investments in this sector. • The April 2022 RTS has clarified that the "other" investments (i.e., non-sustainable investments) that an article 9 product can make are those investments used for hedging or which relate to cash held as ancillary liquidity. Prior draft versions of the RTS had also referred to article 9 products holding "investments for which there is insufficient data" but this has been removed from

the April 2022 RTS. This aligns with the approach taken by the Commission in its Q&A from July 2021.

9. PAI regime – has anything changed with the disclosure requirements?

Although superficially there seem to be a lot of changes to the relevant recitals and articles of the April 2022 RTS, most of those changes are for clarification purposes and do **not substantively change the content**, compared to the proposals in the February 2021 final report.

Firms should also note that, per the ESAs’ recent [supervisory statement](#), if they are considering PAI they should be making “**non-reference period**” disclosures in accordance with the RTS from **1 January 2023**. This means that firms should update their “firm-level” PAI disclosures to adapt to the prescribed format in Table 1 of Annex I and include the additional detail required under the RTS by that date.

Comparing the **April 2022 RTS** to the prior versions:

What remains the same or similar?	What’s changed?
<ul style="list-style-type: none"> The April 2022 RTS still retain the approach that the PAI report is published in the ‘Sustainability-related disclosures’ section on the website of an in-scope firm by using the format of the template set out in Table 1 of Annex I. The relevant sub-sections to be covered by the PAI report remain unchanged as set out at the end of Table 1 of Annex I. Even if the wording of the recitals concerning PAI was amended, the look through approach in the recitals has been maintained in the April 2022 RTS. 	<ul style="list-style-type: none"> The April 2022 RTS clearly differentiate between disclosures for financial market participants and financial advisers by including new sub-sections. On a point of timing, we emphasise that the first PAI report containing quantitative data must be published by June 2023. This will need to contain PAI data for calendar year 2022, as at the four quarter-end dates for this year. In-scope firms should therefore be collecting this data during 2022, even though the RTS is not yet in force. The first data collection date was 31 March 2022, at the end of Q1, which has already passed. The April 2022 RTS clarifies that the translation requirement for the summary section of the website disclosure is triggered where the product is "made available" in a host Member State, not just where it is "marketed" in a host Member State. This is a potentially broader concept than "marketed", which could have suggested active promotion only. In recital 9 of April 2022 RTS, it is expressly stated that the carbon footprint metrics are not yet fully developed and, therefore, financial market participants should base relevant PAI entity-level disclosures on forward-looking climate scenarios.

It’s worth noting that the April 2022 RTS do not expressly answer the question of whether any **products can be excluded** from the manager’s entity-level report. In the absence of such clarification, we remain of the view that all products must be included.

10. PAI regime – has anything changed with the PAI indicators and metrics?

The February 2021 final report proposed an approach under which firms must make their PAI disclosures annually, using a mandatory template. The template contained extensive quantitative data reporting requirements, against a set of mandatory and optional indicators of harm. It also contained extensive narrative disclosure requirements around a firm’s policies and procedures.

Comparing the [April 2022 RTS](#) to the prior versions:

What remains the same or similar?	What’s changed?
<ul style="list-style-type: none">• The April 2022 RTS retain the basic structural approach of PAI indicators and metrics, with no substantive changes to the prior approach.• The definitions in Annex 1 are substantively unchanged.• The number and content of the PAI indicators in Table 1 to 3 of Annex I remain the same. However, the title of PAI indicator 8 in Table 2 slightly changed.• The formulae in Annex 1 are unchanged.	<ul style="list-style-type: none">• In-scope firms must, by reference to each PAI indicator included in Table 1 of Annex 1 to the April 2022 RTS, state what actions they have planned and the targets they will set for the next reference period in addition to disclosure on the actions they have already taken.• The scope of the adverse sustainability indicator 9 was amended. In addition to the hazardous waste ration generated by investee companies, this sustainability indicator now also includes ‘radioactive waste ratio’ generated by such companies.

It’s worth noting that the April 2022 RTS do not provide any details on [product-level PAI reports](#) (although this was not required by SFDR in any event). There is also no further guidance on how to treat [short positions](#).

HOW SIMMONS & SIMMONS CAN HELP

Simmons & Simmons would be pleased to assist with legal advice and project support on the RTS.

[Simmons & Simmons resources](#)

For more information, please see our [Sustainable Finance and ESG website](#).

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