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Private Investment Funds and ESG: European Commission Delays Finalization of the SFDR's Regulatory Technical Standards

This client alert, part of a series focused on ESG regulatory developments, provides an overview of the upcoming EU regulatory changes. It should be read together with our ESG Lexicon, available [here](#), which provides definitions of any terms not defined herein.

Key Takeaways

- *The European Commission has announced that it is delaying the applicability date of certain requirements of Regulation 2019/2088 on sustainability-related disclosures for the financial services sector (the “SFDR”).*
- *The SFDR contains principles-based requirements (“Level 1 requirements”) that will be supplemented by regulatory technical standards (“RTSs”), which will set out the “Level 2 requirements.” The first draft RTSs were released in April 2020 and were set to be finalized by the end of 2020. The European Commission has said that high level and principles-based requirements will still apply as of March 10, 2021, as planned, but the Level 2 requirements will be delayed until a later date, possibly January 2022 or later.*
- *U.S. fund managers that market funds in the European Union or establish an EU fund still need to prepare to comply with Level 1 requirements as early as March 2021 and will need to monitor developments related to the forthcoming RTSs in order to comply with subsequent Level 2 requirements.*

Overview

As discussed further in our prior alert (available [here](#)), the SFDR (available [here](#)) will require alternative investment fund managers (“AIFMs”), including U.S. fund managers that market funds in the European Union or establish an EU fund, and alternative investment funds (“AIFs”) to make new disclosures related to (i) how sustainability is addressed in the investment decision-making process and (ii) “financial products” characterized as sustainable investments or that promote environmental and/or social characteristics. The text of the SFDR lays out the principles-based, Level 1 requirements that will apply as of March 10, 2021 and calls for Level 2 requirements to be finalized through RTSs by the end of 2020. The European Supervisory Authorities (“ESAs”) published draft RTSs earlier this year, consistent with this timeline. However, in a recent letter sent to two trade associations in Italy and Germany, the European

Commission indicated that finalization of the RTSs and the deadline for compliance with the corresponding Level 2 requirements will be delayed. This letter (which is unofficial) indicates that Level 2 requirements are now not expected to become effective until January 2022 or later. It should be stressed that the delay in finalizing and implementing Level 2 requirements does not affect the SFDR's Level 1 requirements, many of which take effect as of March 10, 2021.

Delays in the Applicability of the Regulatory Technical Standards Disclosure Requirements

In April 2020, the ESAs set out draft RTSs (available [here](#)) in respect of the content, methodologies and presentation of the information required in relation to “principal adverse sustainability impacts” and in respect of AIFs that promote environmental and/or social characteristics or that have sustainable investment as their objective. The final RTSs will supplement the SFDR and were originally due by the end of 2020. In its letter to the two trade associations, the European Commission stated, “[i]n order to provide financial market participants and financial advisers as well as supervisors with time for implementation, the Regulatory Technical Standards will become applicable at a later stage.” The final RTSs will now be released at a later date, and the related Level 2 requirements are not likely to apply until at least January 2022. Annex A indicates which articles of the SFDR include references to supplementary RTSs, and therefore relate to pending Level 2 requirements with delayed effective dates.

Principles-based Disclosure Requirements Remain Applicable as of March 10, 2021

High-level, principles-based disclosure requirements (the Level 1 requirements) are delineated within the text of the SFDR itself and do not require RTSs to supplement them. These requirements will continue to apply as of their original effective dates, most of which are March 10, 2021. Provisions of the SFDR relating the integration of sustainability risks in the investment decision-making process (Articles 3, 5 and 6), for example, will continue to apply as of March 10, 2021.

Looking Ahead

U.S. fund managers that market funds in the European Union or establish an EU fund not only need to prepare for the SFDR's principles-based Level 1 requirements that become effective as early as March 10, 2021, they also need to monitor developments related to the finalization of the RTSs in order to prepare for forthcoming Level 2 requirements. While the newly announced delay provides some short-term relief from compliance, AIFM- and AIF-level disclosures will likely need to be updated once again in 2022, which puts further pressure on legal and compliance teams.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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Annex A**Key Provisions of the SFDR and RTS Considerations**

Provision	Form of Disclosure	Subject of Disclosure	Information Required	Requires Level 2 RTSs	Effective Date
Art. 3	Website	Sustainability risk policies at AIFM level	Policies on the integration of sustainability risks in its investment decision-making process	No	March 10, 2021
Art. 4(1)	Website	Adverse sustainability impacts at AIFM level	Where the AIFM considers principal adverse impacts of investment decisions on sustainability factors, a statement on due diligence policies with respect to those impacts; ^(a) where it does not consider such adverse impacts, clear reasons for why it does not do so (including whether and when it intends to)	Yes	March 10, 2021*
Art. 5	Website	Remuneration policies in relation to the integration of sustainability risks	Include in AIFM remuneration policies information on how those policies are consistent with the integration of sustainability risks	No	March 10, 2021

Provision	Form of Disclosure	Subject of Disclosure	Information Required	Requires Level 2 RTSs	Effective Date
Art. 10	Website	AIFs that promote environmental and/or social characteristics (Art. 8 AIFs), or have sustainable investments as their objective (Art. 9 AIFs)	<ul style="list-style-type: none"> ▪ A description of the environmental and/or social characteristics or the sustainable investment objective; ▪ Information on the methodologies used to assess, measure and monitor the environmental and/or social characteristics or the impact of the sustainable investments selected for the AIF;^(b) and ▪ The information covered by pre-contractual disclosures and periodic reports referred to in Arts. 8, 9 and 11 	Yes	March 10, 2021*
Art. 4(3)	Website	Adverse sustainability impacts at entity level	FMP (with more than, on average, 500 employees or parent thereof): due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors	Yes	June 30, 2021*
Art. 6(1)	Pre-contractual disclosures	Integration of sustainability risks	<p>The manner in which sustainability risks are integrated into AIFM investment decisions and results of assessments of likely impacts of sustainability risks on the returns of AIFs made available</p> <p>Where the AIFM deems risks not to be relevant, the descriptions are to include a clear and concise explanation of the reasons therefor</p>	No	March 10, 2021
Art. 8	Pre-contractual disclosures	AIFs that promote environmental and/or social characteristics	Information about how the environmental and/or social characteristics of the AIF are met; if an index has been designated as a reference benchmark, information on whether and how	Yes	March 10, 2021*

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			this index is consistent with those characteristics, as well as whether the methodology used for the calculation of the index can be found		
Art. 9(1)	Pre-contractual disclosures – gloss on Art. 6(1) and (3) disclosures	AIFs with sustainable investments as their objective, with an index as a reference benchmark	How the designated index is aligned with the AIF's sustainable investment objective and an explanation as to why and how the designated index aligned with that objective differs from a broad market index	Yes	March 10, 2021*
Art. 9(2)	Pre-contractual disclosures – gloss on Art. 6(1) and (3) disclosures	AIFs with sustainable investments as their objective, with no index as a reference benchmark	How the sustainable investment objective is to be attained	Yes	March 10, 2021*
Art. 9 (3)	Pre-contractual disclosures – gloss on Art. 6(1) and (3) disclosures	AIFs with the reduction of carbon emissions as their objective	The objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement	Yes	March 10, 2021*
Art. 11	Periodic reports	AIFs that promote environmental and/or social characteristics (Art. 8 products)	The extent to which environmental and/or social characteristics are met	Yes	January 1, 2022*
Art. 11	Periodic reports	AIFs that have sustainable investments (including the reduction of carbon	The overall sustainability-related impact of the AIF by means of relevant sustainability indicators; or where an index has been designated as a reference benchmark, a comparison	Yes	January 1, 2022*

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		emissions) as their objective (Art. 9 products)	between the overall sustainability-related impact of the AIF with the impacts of the designated index and of a broad market index through sustainability indicators		
Art. 7	Pre-contractual disclosures	Adverse sustainability impacts at AIF level	Whether and, if so, how the particular AIF considers principal adverse impacts on sustainability factors or, if they do not consider these to be relevant, a statement that the AIFM does not consider the impacts and the reasons therefor	Yes	December 30, 2022*

* Compliance with high-level and principle-based requirements outlined in the SFDR continue to apply as of the listed date, while the Level 2 RTS requirements are pending finalization and will apply on a later date. For provisions with 2022 effective dates, it remains to be seen whether the Level 2 requirements would also apply at later dates.

- (a) Disclosure shall include: information about policies on the identification and prioritization of principal adverse sustainability impacts and indicators; a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned; brief summaries of engagement policies in accordance with Article 3g of Directive 2007/36/EC, where applicable; and a reference to adherence to responsible business conduct codes and internationally recognized standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement.
- (b) Disclosures shall include: data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental and/or social characteristics or the overall sustainable impact of the AIF.