



## Asset Management & Investment Funds Update

April 2022

### SFDR Level 2 Published

#### Commission adopts long-awaited SFDR Level 2 measures

On 6 April 2022, a significant step towards finalising the long-awaited SFDR compliance standards was taken with the Commission's adoption of Level 2 delegated measures based on the two sets of regulatory technical standards (RTS) published by the European Supervisory Authorities (ESAs) in February and October 2021 (SFDR Level 2). It is now up to EU co-legislators to review SFDR Level 2 within the allotted three-month scrutiny period (which they may shorten or extend by an additional three months). If no objections are raised during scrutiny, SFDR Level 2 will enter into force and apply from the scheduled effective date of 1 January 2023.

#### SFDR Level 2 versus ESA RTS

Crucially for those in-scope UCITS managers and AIFMs which have progressed compliance plans, SFDR Level 2 does not deviate in any material respect from the ESA RTS published last year and the pre-contractual, periodic report and principal adverse sustainability impact (PAI) disclosure templates appended to SFDR Level 2 effectively mirror those in ESA RTS annexes. Following the Commission's legal review of the ESA RTS, and to ensure consistency, quality and avoid duplication, certain of the ESA RTS provisions have been adapted or deleted. As a result, SFDR Level 2 differs in form but not in substance from the ESA RTS and consists of five chapters: Chapter I on general provisions, Chapter II on reporting entity-level PAIs, Chapter III on pre-contractual disclosures for funds in scope of SFDR Articles 8 and 9, Chapter IV on website disclosures for funds in scope of SFDR Articles 8 and 9, and Chapter V on financial report disclosures for funds in scope of SFDR Articles 8 and 9.

#### No clarification of outstanding implementation challenges

While the absence of any material changes to the ESA RTS is undoubtedly welcome, it also means that SFDR Level 2 does not answer any of the myriad open questions on SFDR compliance and implementation. For example, there is no clarification of the thresholds to be met for an investment to qualify as sustainable under SFDR nor any clarification of the requirements for funds in scope of Article 9(3) SFDR. There is also no change to the previously indicated, and significantly challenging, timelines for Level 2 product-level financial report disclosures (required to be included in reports published after the January 2023 SFDR Level 2 effective date) and publication of the first quantitative PAI statement (required by 30 June 2023). The requirement to perform two 'do no significant harm' assessments on Taxonomy-aligned investments under both SFDR and the Taxonomy and the necessity to perform Taxonomy alignment calculations absent necessary investee company data are also carried over from the ESA RTS despite the ESA's specifically highlighting these issues in their cover letter to the Commission enclosing the October 2021 RTS. In the absence of legislative clarifications of these issues, it is hoped that ESMA's promised guidance and Q&As "on a number of stakeholder questions...with regard to implementation and timing of SFDR e.g., on scope, definitions,

*interactions between different pieces of legislation*" will have the intended effect of bringing "greater clarity" for those in scope of SFDR Level 2 and, ideally, in advance of the 1 January 2023 compliance deadline.

### SFDR "not a labelling regime"

Notably, the Commission took the opportunity in the Level 2 explanatory statement to reiterate that SFDR is a disclosures framework for financial products with stated levels of sustainability ambitions and "not a labelling regime". While legislators and regulators have not always been consistent on this point (both the ESAs and the Commission have referred to so-called Article 8 and 9 products), concerns have been raised that fund managers are extensively using Article 8 and 9 designations in the marketing of funds in scope of the regime's product-level disclosure rules. The ESMA Chair, in recent comments, noted this increasing use of "the disclosures categories as product classifications" and that this has led to Article 8 funds being "called out for less ambitious environmental or social characteristics". In ESMA's view this creates a potential investor protection issue which may need to be addressed through the application of "appropriate criteria to ensure that investors who are looking for sustainability features in their financial products are offered products matching their preferences." It appears, therefore, that SFDR Level 2 will not be the final piece of this regime's puzzle and Level 1 amendments could quickly follow the entry into force of the delegated measures.

### Next steps

While SFDR Level 2 is not yet in force, the Commission's adoption of the ESA RTS without substantive amendments indicates that further amendments to these compliance standards are unlikely. As such, in-scope UCITS managers and AIFMs may be confident in progressing compliance plans based on the Commission's adopted Level 2 measures and indeed, given the scheduled compliance deadline of 1 January 2023, would be well advised to do so.

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