

# Small AIFMs & the SFDR

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**The deadline for alternative investment fund managers (AIFMs) to implement Regulation (EU) 2019/2088, as amended (the "SFDR") for their alternative investment funds (AIFs) is approaching fast and is set on the 10th of March 2021. In this respect, this contribution explains the uncertainties with respect to the application of the SFDR to "small AIFMs", i.e. AIFMs registered pursuant to Directive 2011/61/EU, as amended (the "AIFMD"), and their AIFs.**



On 27 November 2019, the SFDR on sustainability-related disclosures in the financial services sector came into force and the regulation will apply as from 10 March 2020 onwards. The regulation forms part of a number of initiatives adopted by the European Commission as part of its Action Plan on Sustainable Finance adopted in March 2018.

Apart from the SFDR, these include:

- a regulation amending the benchmark regulation in relation to low carbon benchmarks and positive carbon impact benchmarks;
- Regulation (EU) 2020/852 (the "Taxonomy Regulation") on the establishment of a framework to facilitate sustainable investment; and
- delegated regulations amending MiFID II Delegated Regulation 2017/565 (LVL 2 MiFID II) and Commission Delegated Regulation (EU) 231/2013 (LVL 2 AIFMD) to integrate ESG considerations and preferences into investment advice and portfolio management; and to incorporate sustainability risks.

The SFDR seeks to harmonize existing provisions on disclosures to investors in relation to sustainability-related disclosures by imposing requirements to a wide range of cross-sectoral financial market participants (e.g. UCITS management companies and investment firms) and financial advisers (e.g. investment firms and credit institutions) in relation to financial products (e.g. AIFs and undertakings for collective investment undertakings (UCITS)). Due to the cross-sectoral approach of the SFDR, the regulation ensures a «level playing field».

This contribution seeks to answer the contribution whether small managers also fall within the scope of the SFDR. To that end, it first assesses the scope of the SFDR with respect to AIFMs and

AIFs. It then provides a high-level overview of the SFDR obligations for AIFMs and AIFs they manage. Furthermore, the contribution continues by discussing what SFDR obligations potentially apply to small AIFMs and then concludes.

## Scope SFDR – Small AIFMs & AIFs

To ensure cross-sectoral consistency throughout European sectoral laws, the SFDR is applicable to a wide range of financial market participants, including, amongst others:

- AIFMs and management companies for undertakings for collective investment in transferable securities (UCITS ManCo); and
- managers of qualifying venture capital (EuVECA) and social entrepreneurship funds (EuSEF) that are registered as small AIFM in accordance with Article 14 Regulation (EU) No 345/2013, as amended (EuVECAR) and Article 15 Regulation (EU) No 346/2013, as amended (EuSEFR).

All types of fund managers, including AIFMs and UCITS ManCos, are thus required to comply with the SFDR. The question that arises is whether small managers also fall within the scope of the SFDR. That question has been raised several times so far, but has not been answered yet.

The definition of "financial market participant" under Article 2(1) SFDR includes all AIFMs. Furthermore, the SFDR clarifies that AIFM means "an AIFM as defined in the AIFMD. Reading the AIFMD, an AIFM means "a legal person whose regular business is managing one or more AIFs". This definition in the AIFMD concerns the *activity* of managing AIFs, regardless of whether an AIFM is registered or authorized pursuant to the AIFMD. In other words, small AIFMs fall, in principle, within the scope of the SFDR.

Despite this, however, the list of "financial market participants" also explicitly clarifies that small AIFMs managing EuVECAs and EuSEFs fall within the scope of the SFDR. These two types of AIFs can be managed by both authorized and registered AIFMs.

From the viewpoint of the European legislator, an *a contrario* reasoning could, thus, lead to the conclusion that small AIFMs are "out-of-scope", as it would otherwise not have been necessary to explicitly include these two types of small AIFMs within the definition of the SFDR's financial market participants definition.

## SFDR Obligations – A brief Overview

The SFDR imposes both obligations on the "entity level", i.e. "fund manager level", and on the "product level" (i.e. fund level).

On the fund manager level, the SFDR requires, amongst others, to:

- Integrate sustainability risks in the investment process;
- To consider significant adverse effects of investment decisions on sustainability factors in the due diligence process, or explain why the manager does not comply with this (for managers with less than 500 employees on a group consolidated basis);
- Explain in their remuneration policy how the policy is consistent with the integration of sustainability risks.

Fund managers are required to publish their efforts in this respect on their website.

On the product level, fund managers are for every AIF and UCITS, amongst others, required to include in the prospectus or private placement memorandum (PPM) how sustainability risks are integrated and their likely effects on the returns, or provide an explanation why sustainability risks are not relevant. Various additional duties apply if the AIFs and/or UCITS that they manage are labelled as "promoting environmental or social characteristics" ("Light Green Product") or as a "sustainable investment" ("Dark Green Product") under Article 8 and 9 SFDR.

In particular, these additional information obligations relate to not only mandatory disclosure related to his products in the prospectus and PPM, but also with respect to additional information obligations with publication on the website and in the annual report.

## Do SFDR Obligations apply to Small AIFMs and their AIFs?

Legally speaking, Small AIFMs fall within the scope of the AIFMD. The question is, however, whether small AIFMs also have to "materially comply" with obligations under the SFDR.

Under Article 3 SFDR, AIFMs are required to integrate sustainability risks in their investment decision-making process and to publish this on their website. No mention or indication is contained that explicitly excludes the applicability of the SFDR to small AIFMs. The same holds true for the requirements related to the remuneration policy under Article 5 SFDR. In this respect, however, it should be noted that the AIFMD does not require small AIFMs to comply with the AIFMD remuneration (policy) rules. Furthermore, Article 4 SFDR applies to AIFMs on a "comply-or-explain" basis. Only "big" fund managers that em-

ploy on a consolidated basis more than 500 employees are required to publish on their website a:

- Principal adverse impact statement, including the impact of investment decisions on sustainability factors; and
- A statement of due diligence policies.

"Small" fund managers may, however, choose to not comply with these obligations. Instead, they are required to publish on the website of the fund manager why they do not comply with these obligations.

On the product level, the question whether the SFDR applies to AIFs managed by small AIFMs seems to be clearer. All disclosures to be made for "standard", "Light Green Products" and "Dark Green Products" relate to "pre-contractual disclosures" and "periodic disclosures". Under the SFDR, "pre-contractual disclosures" are referred to as Article 23 AIFMD disclosure, whereas for "periodic disclosures" reference is being made to Article 22 AIFMD. Small AIFMs are in Luxembourg both not required to publish a PPM within the meaning of Article 23 AIFMD nor an annual report within the meaning of Article 22 AIFMD.

For small AIFMs managing EuSEFs and EuVECAs, the SFDR refers explicitly to the offering document that is to be published in accordance with Article 13(1) EuVECAR and Article 14(1) EuSEFR and to the annual report to be published under Article 12 EuVECAR and Article 13 EuSEFR. This seems to confirm that, at least, SFDR obligations with respect to the PPM and annual report do not apply to small AIFMs that manage AIFs that do not qualify as an EuSEF or EuVECA. It can, however, not be entirely excluded that the "entity level" obligations will be deemed to be applicable by regulators to small AIFMs and their AIFs.

From a proportionality principle, the compliance with the SFDR requires quite some resources. In my view, the SFDR should, therefore, not mandatorily apply to small AIFMs and their AIFs. Investor demand may, however, require them to voluntarily comply with its standards.

## Conclusion

Technically speaking, small AIFMs that manage AIFs fall under the material scope of the SFDR. This contribution, however, highlighted that it seemed to have been the intention of the European legislator not to include small AIFMs within the scope of the SFDR. Until, however, the European or national legislator clarifies these aspects, however, small AIFMs remain in uncertainty as to whether the SFDR will (partly) apply to them.

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