

What is the Impact on Fund Managers?

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The European Commission confirmed in its letter of 20 October 2020 that the level 2 measures under Regulation (EU) 2019/2088 on the sustainability-related disclosures in the financial services sector, as amended (the «SFDR») will be delayed from 10 March 2021 to a date to be determined.

The European Commission (the «EC») has confirmed in a letter (the «Letter») to the European Supervisory Authorities (the «ESAs») dated 20 October 2020 that the regulatory technical standards (the «LVL 2 RTS») which implement the SFDR will be delayed.

The EC in its letter has not specified what the new foreseen compliance date for the LVL 2 RTS will be. It is, however, expected by the market that it will likely be January 2022. The EC in its Letter, however, clarifies that it will still be necessary for financial market participants (including fund managers) and financial advisers to comply with the (principles) set out in the (Level 1) SFDR, as from 10 March 2021.

This contribution analyzes the impact of the delay of the adoption of the LVL 2 RTS, as well as its implications for fund managers when complying with the SFDR, without the LVL 2 RTS in place. To provide some context to the delay and its implications analyzed in this contribution, first a brief overview of the legislative developments with respect to the SFDR will be discussed.

Legislative Developments – SFDR

The SFDR that was officially published on 27 November 2019 lays down the general framework with principles on sustainability related disclosures in the financial services sector that fund managers and financial advisers need to comply with. Certain provisions of the SFDR, however, contain requirements that need to be complemented by regulatory technical standards («RTS») to be adopted by the LVL 2 RTS. The EC is required to develop these RTS with the help of the (Joint Committee of the) ESAs. Originally, the SFDR required the ESAs to develop and submit the LVL 2 RTS to the EC by 30 December 2020. These would then have to be implemented by

fund managers and financial advisers on 10 March 2021.

For this purpose, the ESAs launched a consultation on 23 April 2020 that closed on 1 September 2020. Furthermore, they launched on 21 September 2020 a survey how the information to be disclosed pursuant to Article 8(3), Article 9(5) and Article 11(4) of the SFDR (i.e. pre-contractual and periodic disclosures) should be presented by fund managers and financial advisers. This consultation period ran until 16 October 2020.

Due to the unprecedented economic and market stress caused by the Covid-19 crisis, it became, however, apparent that the final version of the LVL 2 RTS would not be ready to be sent to the EC by 30 December 2020. Based upon the industry pushback received by the ESAs on the draft LVL 2 RTS and justified by the need to guarantee sufficient stakeholder involvement in the process under the current difficult circumstances, the ESAs are currently revising some of the proposals. The delay allows now more time to the ESAs, fund managers and financial advisers to adopt and implement the LVL 2 RTS.

Compliance with the SFDR - Guidance in the EC's Letter

Delay LVL 2 RTS

The EC's Letter confirms that the LVL 2 RTS will be applicable in a later stage. In this respect, it the Letter notes that «In order to provide financial market participants and financial advisers adequate time for implementation, the regulatory technical standards will become applicable at a later stage.»

The LVL 2 RTS specify, amongst others, the detailed requirements on the content and presentation of disclosed information and transparency requirements on both the «entity level» (e.g. policies/procedures at the level of fund managers) and the «product level» (e.g. private placement memorandums/prospectuses and annual reports of funds). With respect to this, the Letter, however, emphasizes that, in terms of substance, the application of the SFDR is not conditional on the formal adoption and entry into force or application of the RTS. The Letter is, therefore, not to be understood as a delay of the entire SFDR disclosure regime. Instead, the EC confirms that the (Level 1) SFDR will come into effect on 10 March 2021.

The EC's Explanation regarding SFDR Compliance

The EC requires the SFDR to be implemented by 10 March 2021 even though the LVL 2 RTS will not yet be adopted by that time. To that end, the Letter provides some guidance how fund managers and financial advisers may implement the SFDR with view to the LVL 2 RTS delay. The guidance of the EC in its Letter distinguishes between SFDR provisions that do not require LVL 2 RTS implementation measures and those provisions that do require LVL 2 RTS implementation measures.

No LVL 2 RTS required

With respect to the integration of sustainability risks in the investment decision-making process (Articles 3, 5 and 6 SFDR), fund managers must, as from 10 March 2021 onwards, already consider sustainability risk in their internal processes. They are ought to do this «in accordance with the applicable sectoral legislation in place».

LVL 2 RTS required

With respect to the guidance of the EC in its letter, a distinction is made between those requirements in the LVL 2 RTS applying at «the entity level» (i.e. fund managers and financial advisers) and those applying at the «financial product level» (i.e. the relevant funds).

At the «entity level», Article 4 SFDR concerns website disclosures to be made by fund managers of adverse sustainability impacts. With respect to this, the Letter indicates that «numerous financial market participants already now comply with the non-financial reporting requirements under or adhere to international standards and might consider using that information.»

In this respect, the Letter states that «there are no impediments to financial market participants and financial advisers complying with the Level 1 requirements laid down in the Regulation.»

The deadlines for compliance stated in the SFDR remain, thus, to be applicable. For «small» fund managers having less than 500 employees that are subject to the «comply-or-explain» requirements the compliance date is 10 March 2021. For the «big» fund managers that are subject to the mandatory disclosure statement laid down in Article 4(3) or (4) SFDR, the deadline remains 30 June 2021.

At the «financial product level», Articles 8, 9, 10 and 11 SFDR lay down the disclosures to be made with respect to financial products (i.e. funds). These disclosures touch upon the private placement memorandums/prospectuses, the websites and the annual reports of relevant funds managed by fund

managers (the «Product Documentation»). With respect to the financial product disclosures, the EC Letter indicates that fund managers «must already describe in the product documentation how the level of sustainability are achieved».

The EC Letter, therefore, indicates that fund managers should by 10 March 2021 already comply with the disclosure principles set out in Articles 8 and 9 SFDR.

The Practical Implications for Fund Managers implementing the SFDR

The application of the SFDR is not conditional upon the formal adoption and entry into force of the LVL 2 RTS. As such, most SFDR requirements will, thus, apply from 10 March 2021 onwards. In the absence of the LVL 2 RTS, the EC's letter suggests that fund managers should take a principles-based approach to comply by 10 March 2021 with those provisions of the SFDR that rely upon the implementation of the LVL 2 RTS.

For fund managers (and financial advisers), these concern website disclosures (Article 4 SFDR) and, for funds managed and advised, these concern Product Documentation (Articles 8, 9, 10 and 11 SFDR).

With respect to Product Documentation, the EC's Letter makes reference to the various product disclosure requirements in applicable sectoral legislation. The Letter does, however, not require fund managers to implement the draft LVL 2 RTS nor the draft product disclosure templates published by the ESAs to comply with their obligations under the SFDR. There is, therefore, no obligation that fund managers should look to the draft LVL 2 RTS (including the draft product disclosure templates) as a means of satisfying their obligations under the SFDR.

The current guidance and requirement to implement the SFDR in a «principle based manner» raises a number of challenges for fund managers. In particular, many fund managers will, without any RTS in place, face issues in how to comply with the «principal adverse impacts» requirements to be published on a website under Article 4 SFDR, and the product disclosure regime under Article 8 and 9 SFDR.

In practice, the SFDR implementation might, thus, be a cumbersome exercise for fund managers as they will within a 12-month period be required to update their disclosures by 10 March 2021 (in a «principle-based manner») and again by the time that the LVL 2 RTS are published.

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