

YPOG Briefing: Updated RTS and To Do's for 2022

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Overview

As of January 1, 2022, the Taxonomy Regulation ((EU) 2020/852, the "Taxonomy") applies regarding the environmental objectives of climate change mitigation and climate change adaptation. The Taxonomy accompanies the Sustainable Finance Disclosure Regulation ((EU) 2019/2088, the "SFDR"), which is already applicable since March 2021, and, for the time being, completes the European regulative requirements for sustainability-related transparency in the financial sector. The Taxonomy establishes a classification system, which is to be applied in order to determine whether an economic activity is environmentally sustainable and supplements the disclosure requirements under the SFDR.

Most recently, in July 2021, the European Commission has issued an opinion clarifying open issues relating to the scope and product classification under the SFDR (the "Commission Decision", please see previous [YPOG Briefing](#)). In late October 2021, the European Supervisory Authorities have issued a revised draft version of the Regulatory Technical Standards (the "new RTS"). These are legislative acts substantiating the SFDR as well as the Taxonomy and providing financial market participants (for the purposes of this briefing, we are only considering VC and PE fund managers) with a more detailed guidance on how to implement the disclosure obligations. The new RTS replace a first draft from February 2021 and include the requirements resulting from the Taxonomy in addition to the disclosures requirements under the SFDR. Thus, the relevant appendixes containing mandatory templates for the disclosures in pre-contractual information as well as the periodic reports applicable to Art. 8 and Art. 9 SFDR products have been amended and now also reflect the disclosure obligations pursuant to Art. 5 and 6 Taxonomy.

The application of the Regulatory Technical Standards has already been postponed in summer 2021. Now, once again, the European Commission has postponed their application by a further six months to January 1, 2023. Hence, in 2022, market participants cannot rely on binding specifications on how to fulfil their mandatory disclosure obligations. However, the German Federal Financial Supervisory Authority (the "BaFin"), is already considering the new RTS when interpreting general Articles of the SFDR and Taxonomy. Therefore we strongly recommend amending disclosures accordingly – particularly in light of the application of the Taxonomy. Yet, it should be noted that the new RTS still has to be formally adopted by the European Commission and further amendments cannot be ruled out.

In light of the new year, we have summarized the key takeaways and To Do's arising out of the application of the Taxonomy and the new RTS below:

1. To Do's for Art. 8 SFDR products

According to the Commission Decision, typical investment exclusions in the fund documentation constitute a promotion of environmental or social characteristics, resulting in a qualification of the respective financial product as an Art. 8 SFDR product. For such products, as of January 1, 2022, further disclosures will be required in periodic reports as well as in pre-contractual information according to Art. 6 in conjunction with Art. 5 Taxonomy.

Regarding the periodic reports, the first reporting period does not begin before January 1, 2022. Consequently, the first report is not due before 2023.

In respect of the pre-contractual information, information on the environmental objectives to which the investments underlying the financial product contribute shall be provided (Art. 6 sentence 1, 5(a) Taxonomy). Moreover, the information disclosed shall include a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable (Art. 6 sentence 1, Art. 5(b) Taxonomy).

The environmental objectives are defined in Art. 9 to Art. 15 Taxonomy, whereby from January 1, 2022, only two of the six objectives are already applicable (Art. 27 para. 2 Taxonomy). The criteria for environmentally sustainable economic activities can be found in Art. 3 Taxonomy as well as in the comprehensive technical assessment criteria for each of the environmental objectives. Since the pre-contractual information, unlike the periodic reports, must be prepared and disclosed at a time when the investment portfolio is still in the built-up process, the information outlined above can only be disclosed for investments already made during the fundraising or prior to a (final) closing.

It remains unclear whether Art. 6 in conjunction with Art. 5 Taxonomy also stipulates a disclosure obligation for investments yet to be made. In general, no disclosure obligation on future investments can be derived from the wording of the regulation itself. However, it should be noted that the competent supervisory authorities and the European Commission have taken a considerably conservative and expansive view on the disclosure obligations under the SFDR in the past. Thus, it is rather unlikely (although cannot be excluded) that a more lenient view will be taken with regards to the Taxonomy. Taking this into account and in light of a cautious interpretation, we would recommend including a short statement on the intended classification of the product under the criteria of the Taxonomy ex ante.

Further, it remains unclear whether the aforementioned information must be disclosed for all investments made by an Art. 8 product. Art. 5 Taxonomy refers to an investment "(...) that contributes to an environmental objective within the meaning of point (17) of Article 2 of [the SFDR] (...)". The fact that the contribution to an environmental objective is an essential characteristic of a sustainable investment as well as the reference to the corresponding definition in the SFDR suggests that Art. 5 Taxonomy only applies to the portion of a portfolio that can be classified as sustainable investments. With respect to the remaining part of the portfolio, only a negative statement is to be included, stating that the investments underlying the financial product do not take into account the EU criteria for environmentally sustainable economic activities.

2. To Do's for Art. 6 SFDR products

The disclosure obligations applicable to Art. 6 SFDR products (conventional financial products) resulting from the Taxonomy are more limited. According to Art. 7 Taxonomy, only the above-

mentioned negative statement must be published in the pre-contractual information and the periodic reports.

In case of fund managers registered under Sec. 2 para. 4, Sec. 44 KAGB (German Investment Code), the reference of Art. 7 Taxonomy to Art. 6 para. 3 and Art. 11 para. 2 SFDR does, at a first glance, take no effect: Both provisions determine the documents through which financial market participants must disclose their information, but do not contain any regulation for fund managers registered under Sec. 2 para. 4, Sec. 44 KAGB. However, Art. 7 Taxonomy should in light of the Commission Decision be applied analogously in such cases. The same should apply to the fact that Art. 11 para. 1 SFDR does not directly constitute any reporting obligations for conventional financial products at all.

3. Amendments to the website disclosures are not necessary

The new RTS are also intended to give practical guidance on the disclosure obligations for fund managers pursuant to Art. 5 and Art. 6 Taxonomy. Since both articles only refer to two of the three disclosure mediums set forth in the SFDR, i.e. the pre-contractual disclosures and the periodic reports, no modifications regarding the website disclosures are required. Thus, for the time being, the website disclosures can remain unchanged as far as they are up to date.

4. No consideration of adverse impacts as an Art. 9 SFDR product

Within another area, the new RTS grant fund managers further leeway. This specifically relates to fund managers of Art. 9 SFDR products (so-called impact funds) which are characterized by their sustainable investment objective. Like other financial market participants, fund managers of Art. 9 products are obliged to disclose whether or not they consider so-called principal adverse impacts, i.e., adverse effects of investment decisions on sustainability factors ("PAI(s)" or "PAI Statement"). Until now, the market has taken the view that fund managers of Art. 9 SFDR products would have no choice whether or not to consider PAIs, since an investment would only be considered sustainable in accordance with the SFDR if it does not significantly harm any of the objectives laid down in Art. 2 para. 17 SFDR. Hence, it was assumed that taking into account PAIs is mandatory for evaluating whether an investment qualifies as sustainable.

The new RTS, however, suggests a different interpretation in Art. 22: According to thereto, a disclosure regarding an Art. 9 SFDR product may state that PAIs are not considered. In practice, this might be particularly relevant for Art. 9 products with a social objective. This is the case, as the PAI Statement as well as the mostly environmentally-related indicators, which must be collected and form the basis for the disclosures, might often not fit such financial product. Hence, going forward, it is also possible to disclose that PAIs are not taken into account although marketing an Art. 9 product.

The PAI Statement as well as the indicators specified in the Regulatory Technical Standards itself have not undergone any further changes. Following the postponement of the application of the new RTS, the first reference period will be from January 1 to December 31, 2022, and the first disclosure is to be made on June 30, 2023.

5. Delimitation between the product categories of Art. 8 and Art. 9 SFDR

The new RTS confirm that Art. 8 SFDR products are generally allowed to make sustainable investments, which in turn has to be disclosed accordingly. However, the effects of partially conducting sustainable investments remain uncertain: It is still unclear, whether an Art. 8 product might “slip” into the higher product classification of Art. 9 SFDR if sustainable investments are conducted above a certain threshold, which indeed would result in more extensive disclosure obligations.

In addition, the effects of the reverse case are still unclear, i.e., the extent to which Art. 9 SFDR products may conduct investments that do not meet the requirements of Art. 2 para. 17 SFDR and, thus, cannot be considered sustainable. The Commission Decision indicates that conducting non-sustainable investments is allowed for hedging purposes or to maintain liquidity. However, it remains unclear whether there is a defined maximum threshold for closed-end special AIFs, as set by BaFin in the guideline for sustainable investment funds.

This also raises the question of how to deal with an investment fund that has a sustainable investment objective, consequently qualifies as an Art. 9 SFDR product and communicates this accordingly in the pre-contractual disclosures – but ultimately conducts non-sustainable investments only or to a large extent. Since both the SFDR and Taxonomy aim at transparency, there are good arguments that fund managers are only obliged to disclose their planned and actually realized investments but are not bound with regard to their investment decisions and portfolio composition.

Outlook

Although the new RTS require some changes to ESG-related disclosures, there is no need for a fundamental revision of the information disclosed so far. Yet, the disclosure obligations for fund managers have been further increased with the Taxonomy and are now subject to a higher degree of complexity due to the intertwining of SFDR and Taxonomy.

This new level of complexity is even enhanced by the postponed application of the Regulatory Technical Standards, which results in a divergence between the application of the regulations on the one hand and the application of their substantiating legislative acts on the other hand.

Lastly, the requirements set forth in the Taxonomy are far more technical and detailed than those provided for in the SFDR. In the long term, it will therefore be essential for most fund managers to not only seek legal advice for fundamental questions and the product classification, but also to seek support for the technical adaptation in their processes, data collection and processing.

We are happy to support you and open for further exchange.

Your contact at YPOG:



Lennart Lorenz
Partner, Hamburg

☎ +49 40 607728198

📱 +49 151 40228698

✉ lennart.lorenz@ypog.law



Antonia von Treuenfeld
Associate, Berlin

☎ +49 30 7675975 169

📱 +49 151 40228526

✉ antonia.vontreuenfeld@ypog.law



Anne Maria Weiske
Associate, Berlin

☎ +49 30 7675975 181

📱 +49 151 402285 35

✉ annemaria.weiske@ypog.law