



Matheson



Commission Answers ESAs’  
Queries on Implementation  
of the Sustainable Finance  
Disclosure Regulation



On 14 April 2023, the European Commission (“**Commission**”) published the [answers](#) to the eight questions submitted to it by the European Supervisory Authorities (“**ESAs**”) in September 2022 in relation to the implementation of the Sustainable Finance Disclosure Regulation (“**SFDR**”). The questions addressed key issues including the definition of “sustainable investment” and the categorisation of funds with the objective of reducing carbon emissions and funds that use a Paris-aligned Benchmark (“**PAB**”) or Climate Transition Benchmark (“**CTB**”).

The Commission’s answers include some helpful clarifications, although for many the guidance would have been welcome at an earlier date – for example, funds tracking PAB / CTB that reclassified from Article 9 to Article 8 funds in late 2022, because of concerns that they could not meet the Commission’s requirement that all investments of an Article 9 fund (with the exception of a small proportion intended for specific purposes such as hedging or liquidity) should be sustainable investments (see our earlier update “[European Commission Responds to ESAs’ Questions on SFDR Priority Issues](#)”). The Commission has now amended its previous guidance to confirm that passively tracking a PAB / CTB will be sufficient on its own for a product to be classified as an Article 9 product.

The Commission’s general approach reinforces the purpose of the SFDR as a disclosure regime and, as was widely anticipated, the Commission has not introduced new restrictions on what can be defined as a sustainable investment, stating that it is for financial market participants (“**FMPs**”) to make this assessment and to disclose their methodology.

### The Definition of Sustainable Investment

In order to come within the definition of “sustainable investment” in the SFDR, a sustainable investment must (1) positively contribute to an environmental or social objective while (2) doing no significant harm to other environmental or social objectives (“**DNSH**”) and (3) investee companies must demonstrate good governance.

The ESAs raised questions in relation to the definition of sustainable investment addressing: (a) whether the sustainable investment test applies at entity level or activity level; and (b) the interpretation of the positive contribution limb of the test.

### Application at Entity or Activity Level



Does the definition of sustainable investment in the SFDR apply at entity level or activity level, ie, would an investment in an investee company which has one economic activity, among several economic activities, that contributes to an environmental or social objective, be considered to be a sustainable investment in whole or in part?

The Commission has adopted a flexible approach in its answer to this question, stating that the SFDR does not prescribe any specific approach to determine the contribution of an investment to environmental or social objectives. The Commission has left it to financial market participants (“**FMPs**”) to disclose the methodology they have applied to carry out their assessment of sustainable investments and clarified that sustainable investment can be measured at the level of a company and not only at the level of a specific activity.

## FMPs to Assess Sustainability / Transition Activities



Should the economic activity being carried out by the investee company in itself contribute to an environmental or social objective or would it be sufficient that an investee company carries on an economic activity in a sustainable manner or that the economic activity is covered by a transition plan?

The Commission notes that the SFDR does not set out minimum requirements that qualify the three concepts contained within the definition of sustainable investment in the SFDR ie, (1) contribution to an environmental or social objective; (2) do no significant harm to any environmental or social objective; and (3) the investee company follows good governance practices. FMPs must carry out their own assessments of each investment and disclose their underlying assumptions. The Commission emphasises that this gives FMPs an increased responsibility towards the investment community and means that they should exercise caution when measuring the key parameters of a sustainable investment.

The Q&A also makes it clear that referring to a transition plan that aims to ensure that the investment does not significantly harm any environmental or social objectives in the future would not be considered to be sufficient; the DNSH test must be satisfied at the time of the investment.

### Reduction of Carbon Emissions

#### Passive and Active Investment Strategies



Can financial products that have the objective of reducing carbon emissions be either passive or active products?

The Commission reiterates its view expressed in an earlier Q&A that Article 9(3) SFDR is neutral in terms of product design. Both passive and active funds may therefore come with the scope of Article 9(3).



Does an active product with the objective of the reduction of carbon emissions have to meet any specific requirements when it has designated an index as a reference benchmark?

The Commission notes that the SFDR is a transparency regulation and it does not prescribe the use of PAB or CTB. Where a product does not track a PAB or CTB, the SFDR requires a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.

## Promotion as an Environmental Characteristic



Can a financial product “promote” carbon emissions as an “environmental characteristic” as opposed to having it as an “objective”?

The SFDR does not prevent a product from promoting carbon emissions reduction as part of its investment strategy if the product does not have sustainable investment as its objective. FMPs should ensure that fund documentation and marketing communications do not mislead investors into thinking that having the reduction of carbon emissions as a promoted environmental characteristic means that the product has sustainable investment as its objective.

## PAB / CTB Tracking Products



Can PAB / CTB tracking products automatically be deemed to fulfil the conditions of Article 9(3) and Article 2(17) SFDR?

Passive PAB / CTB products are not required to provide a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement, as these products are deemed to have sustainable investments as their objective. We understand this to mean that such products do not need to consider whether investments held to track the performance of such benchmarks meet the sustainable investment definition under Article 2(17) SFDR, as such investments are deemed to comply with that definition. In July 2021, the Commission had stated that Article 2(17) must be considered by such products, leading many Article 9 PAB / CTB funds to reclassify as Article 8 funds, due to concern that not all of their underlying investments would meet the sustainable investment definition.

By contrast, FMPs of actively managed products focused on carbon emissions reductions, ie, products that do not seek to track a PAB or CTB, must explain why they consider that their products have sustainable investment as their objective in order to be classified under Article 9, ie, their assessment must conclude that their investments come within the definition of “sustainable investment” in Article 2(17).

While the clarification provided by the Commission here is helpful, it does give rise to ambiguity as to whether a fund tracking a PAB / CTB must be classified under Article 9 SFDR. The clarifications provided by the Commission that: (1) funds tracking PABs / CTBs are deemed to make sustainable investments (in response to Question 1); and (2) a reduction in carbon emissions may constitute promotion of an environmental characteristic under Article 8 SFDR (in response to Question 4), are helpful in themselves and might suggest that a PAB / CTB tracking fund may be classified under either Article 8 or Article 9 SFDR. However, the Commission’s response to Question 5 casts some doubt on this conclusion, where it states that “*products [tracking a Paris-aligned Benchmark (PAB) or a Climate Transition Benchmark (CTB)] are deemed to have sustainable investments as defined in Article 2, point (17) SFDR as their objective*” (underlining added). This formulation, which tracks the wording of Article 9, could be interpreted to mean that all PAB / CTB tracking funds are deemed to be Article 9 products.

Our view is that the clarifications provided by the Commission are intended to be facilitative and emphasise the role of the FMP in carrying out its own assessment and disclosing its methodology. We therefore believe that it is open to a PAB / CTB tracking fund to disclose that it promotes the reduction of carbon emissions as an environmental characteristic and, while the investments held to track the benchmark are deemed to be sustainable investments, the fund does not have sustainable investment as its objective and can therefore be classified under Article 8 SFDR. It is unlikely that any further clarification will be provided in the short-term by either the Commission or any of the national regulators and so it will likely fall to the market to determine how such funds will now be classified.

## Principal Adverse Impacts

### Principal Adverse Impacts at Product Level



What is the meaning of “consider” in Article 7(1)(a) SFDR? Does consideration require the disclosure of the action taken by the FMP to address the principal adverse impacts of the product’s investments?

The description related to adverse impacts provided at product level, where PAI are considered at entity level, should include both a description of the adverse impacts and the procedures put in place to mitigate those impacts.

### 500 Employee Threshold



Should the average number of 500 employees in Article 4 SFDR be understood to include interim workers or workers employed by shared-service centres?

As the SFDR does not contain a definition of employee, the definition of who constitutes an employee is governed by national law.

## Periodic Reporting for Portfolio Management



Should the average number of 500 employees in Article 4 SFDR be understood to include interim workers or workers employed by shared-service centres?

Only one annual report is required under the SFDR. FMPs should therefore include the relevant disclosures annually in every fourth report.

## Comment

While the Commission's approach in underscoring the aim of the SFDR as a transparency regulation and the flexibility afforded in relation to the definition of "sustainable investment" is to be welcomed, some interpretation challenges and practical challenges relating to data availability remain in relation to the implementation of the SFDR.

The regulatory framework continues to evolve. On 12 April 2023, the ESAs issued a consultation on the review of the SFDR Level 2 measures on 12 April 2023, which could lead to further changes to the requirements relating to the content and presentation of disclosures under the SFDR. The outcome of the ESMA consultation on guidelines on funds' names using ESG or sustainability-related terms, which proposed quantitative thresholds for the use of such terminology, remains unclear. In a speech delivered in December 2022, Commissioner McGuinness indicated that the Commission would undertake a comprehensive assessment of the implementation of the SFDR, with the review to focus on how the regulation ensures legal certainty, but also usability and its role in mitigating greenwashing. In light of all of these initiatives, it may be the case that the Commission has held fire for now, but further changes may be on the horizon.

*Please get in touch with your usual Asset Management and Investment Funds Department contact or any of the contacts listed in this publication should you require further information in relation to the material referred to in this briefing note.*

*Full details of the Asset Management and Investment Funds Department, together with further updates, articles and briefing notes written by members of the Asset Management and Investment Funds team, can be accessed at [www.matheson.com](http://www.matheson.com).*

## Contacts

**Matheson**



**Tara Doyle**

Partner

T +353 1 232 2221

E tara.doyle@matheson.com



**Michael Jackson**

Managing Partner

T +353 1 232 2000

E michael.jackson@matheson.com



**Dualta Counihan**

Partner

T +353 1 232 2451

E dualta.counihan@matheson.com



**Shay Lydon**

Partner

T +353 1 232 2735

E shay.lydon@matheson.com



**Philip Lovegrove**

Partner

T +353 1 232 2538

E philip.lovegrove@matheson.com



**Liam Collins**

Partner

T +353 1 232 2195

E liam.collins@matheson.com



**Elizabeth Grace**

Partner

T +353 1 232 2104

E elizabeth.grace@matheson.com



**Oisín McClenaghan**

Partner

T +353 1 232 2227

E oisín.mcclenaghan@matheson.com



**Michelle Ridge**

Partner

T +353 1 232 2758

E michelle.ridge@matheson.com



**Barry O'Connor**

Partner

T +353 1 232 2488

E barry.oconnor@matheson.com



**Donal O'Byrne**

Partner

T +353 1 232 2057

E donal.o'byrne@matheson.com



**Catriona Cole**

Partner

T +353 1 232 2458

E catriona.cole@matheson.com



**Anthony Gaskin**

Partner

T +353 1 232 3043

E anthony.gaskin@matheson.com



**Brónagh Maher**

Professional Support Lawyer

T +353 1 232 3757

E bronagh.maher@matheson.com



**Orlaith Finan**

Partner

T +353 1 232 2351

E orlaith.finan@matheson.com



**Eunan Hession**

Partner

T +353 1 232 2402

E eunan.hession@matheson.com

# Matheson

This Matheson LLP (“Matheson”) material contains general information about Irish law and about our legal services. This material is not intended to provide, and does not constitute or comprise, legal advice on any particular matter and is provided for general information purposes only. You should not act or refrain from acting on the basis of any information contained in this material, without seeking appropriate legal or other professional advice.

## DUBLIN

70 Sir John Rogerson’s Quay,  
Dublin 2  
Ireland

T: +353 1 232 2000  
E: [dublin@matheson.com](mailto:dublin@matheson.com)

## CORK

Penrose One,  
Renrose Dock,  
Cork, T23KW81

T: +353 21 465 8200  
E: [cork@matheson.com](mailto:cork@matheson.com)

## LONDON

Octagon Point,  
5 Cheapside,  
London EC2V 6AA

T: +44 20 7614 5670  
E: [london@matheson.com](mailto:london@matheson.com)

## NEW YORK

200 Park Avenue  
New York, NY 10166  
United States

T: +1 646 354 6582  
E: [newyork@matheson.com](mailto:newyork@matheson.com)

## PALO ALTO

530 Lytton Avenue  
Palo Alto, CA 94301  
United States

T: +1 650 617 3351  
E: [paloalto@matheson.com](mailto:paloalto@matheson.com)

## SAN FRANCISCO

156 2nd Street  
San Francisco CA 94105  
United States

T: +1 650 617 3351  
E: [sf@matheson.com](mailto:sf@matheson.com)