

ENGLAND AND WALES

Guidance Note: SFDR

“THE TEAM IS MADE UP OF WELL-PLACED AND EXPERIENCED INDIVIDUALS SUPPORTED BY RESPONSIVE PARTNERS WHO ARE CLEARLY KNOWLEDGEABLE AND UP TO SPEED ON THE MATTER AT HAND.”

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GLOSSARY

AIFs: alternative investment funds.

AIFMs: alternative investment fund managers.

ESG: environmental, social and governance.

EU: European Union.

financial adviser: as defined in the SFDR, but including an investment firm, credit institution, AIFM or UCITS management company that provides investment advice.

financial products: as defined in the SFDR, but including pension products and schemes, AIFs and UCITS.

FMPs: financial market participants, as defined in the SFDR, but essentially asset managers, including investment firms and credit institutions that provide portfolio management, pension product manufacturers, AIFMs and UCITS management companies.

Low Carbon Benchmark Regulation: (Regulation (EU) 2019/2089 amending Regulation (EU) 2016/1011 [Benchmark Regulation] as regards EU Climate Transition Benchmarks, EU Paris-aligned benchmarks and sustainability-related disclosures for benchmarks.

SFDR: Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (or the Sustainable Finance Disclosure Regulations).

Taxonomy Regulation: Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment and amending the Disclosure Regulation.

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The SFDR is one element of the European Commission’s action plan on sustainable finance, which was published in 2018 (the other components of the action plan being the Low Carbon Benchmark Regulation and the Taxonomy Regulation).

The aim of the SFDR is to provide greater transparency and consistency for investors by requiring certain financial services firms to make prescribed, standardised sustainability-related disclosures about their financial products and investment advice. It therefore reduces the risk of “greenwashing” by financial services firms.

WHEN DID THE SFDR TAKE EFFECT?

The SFDR came into force on 29 December 2019, with the majority of provisions applying from 10 March 2021, although various technical standards and other amends have been made since then and more are expected.

WHO IS CAUGHT BY THE SFDR?

The SFDR applies to FMPs (essentially firms that invest money on behalf of their clients) which manufacture financial products and financial advisers which provide investment or insurance advice. (Compliance with the SFDR is not required by financial advisers which employ fewer than three people.) Where firms both manufacture financial products and provide such advice, they should comply with the requirements for the service in question.

As an EU regulation, the SFDR only has direct effect within the EU and so firms outside of an EU member state (for example, the UK) will not be within scope. However, such firms could still find themselves caught if, for example, they market funds within an EU member state. As ESG issues are becoming increasingly significant across many sectors and industries, entities are also finding themselves

within scope as a result of contractual negotiations.

The UK is, however, not sitting on its laurels in this area. The Financial Conduct Authority is proposing to put in place a UK version of the SFDR which will include disclosure obligations, restrictions on the use of sustainability-related terms for products and in marketing and the introduction of labels for sustainable investments. A consultation on these proposals closed earlier this year and a Policy Statement is expected within the next few months.

WHAT ARE THE DISCLOSURE REQUIREMENTS?

The SFDR includes a number of disclosure obligations for in-scope firms and it is important to remember that these obligations will apply regardless of whether the relevant financial product to which the disclosure relates is marketed or described as “green” or “sustainable” or similar.



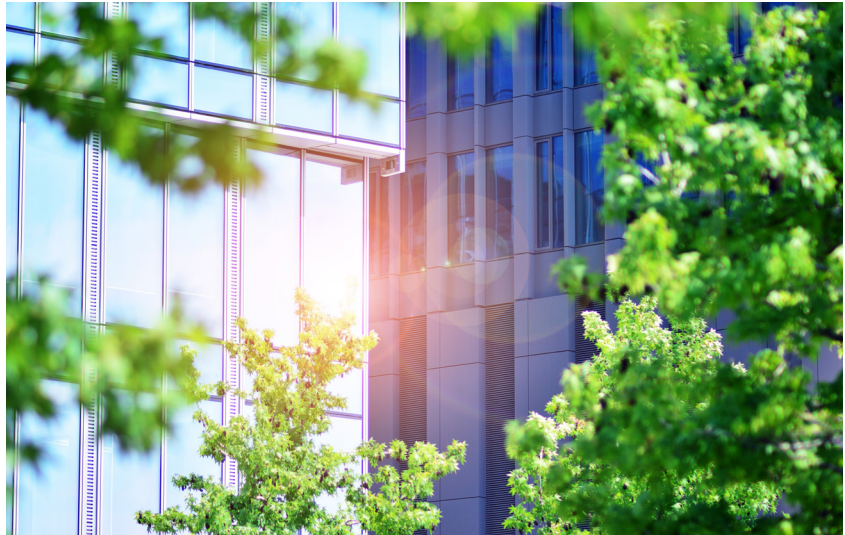
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The disclosure requirements relate to three key points – sustainable investment, sustainability risk and sustainability factors, each of which are defined in the SFDR, but which broadly mean as follows:

- Sustainable investment – an investment in an economic activity that contributes to an environmental objective (as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land; on the production of waste; on greenhouse gas emissions; or on its impact on biodiversity and the circular economy) or social objective (i.e. tackling inequality or the fostering of social cohesion, social integration and labour relations) or an investment in human capital or economically or socially disadvantaged communities.
- Sustainability risk – an ESG condition or event that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.
- Sustainability factors – environmental, social and employee matters; respect for human rights; anti corruption and anti bribery matters.

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There are three types of disclosure referred to under the SFDR, namely disclosures to be made on a relevant entity’s website (website disclosures), information to be provided to investors (pre-contractual disclosures) and periodic reporting to investors. The information required to be disclosed for each disclosure type will depend on various factors, including (a) the entity in question (i.e. whether it is an FMP or financial adviser), (b) which of the three key points (as set out above) the disclosure relates to; and (c) the financial product in question, but the requirements are set out in more detail in the SFDR itself and in various supplementary and guidance documents, including a set of Q&A which was published in May 2023.

Certain technical standards have also been implemented which go into further detail about the actual content of the information to be disclosed and how such information should be presented.

Some of the disclosure obligations operate on a “comply or explain” premise and so even where an in-scope entity decides that a disclosure is not relevant, reasons for that decision may have to be given.

WHAT ARE THE PENALTIES FOR NON-COMPLIANCE?

Currently, there are no official penalties for non-compliance with the SFDR. That said, failure to comply could have adverse effects on a business’s reputation and could potentially result in “greenwashing” claims. Consider too the employment angle. Many employees are now interested in the ESG credentials of their employer. Failure to comply with the SFDR may discourage new recruits from joining a firm while retention rates could also suffer if individuals choose to move to a “greener” employer.

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Practical points

- The SFDR imposes a significant burden on entities to which it applies and may result in material adjustments having to be made to a business's operations and ESG strategy. It is therefore crucial that in-scope entities consider their disclosure obligations and responsibilities carefully and in-depth, taking professional advice where necessary.
- Entities which may be an FMP or financial adviser need to consider whether they are within scope of the SFDR. Remember that entities based outside of the EU may also fall within the SFDR remit due to contractual obligations or if, for example, they market funds within the EU.

- In-scope entities need to ensure that they are up-to-speed on the disclosures they are required to make under the SFDR and decide whether any internal operational or strategy changes are required as a result. This is unlikely to be a swift and simple process and will require a significant amount of resources, not least putting in place staff training so that everyone involved is fully cognisant of the SFDR requirements and obligations.
- Any marketing communications made by FMPs or financial advisers must be consistent with the information provided to investors pursuant to the SFDR.
- Going forward, in-scope entities will need to maintain their awareness of the SFDR

requirements and obligations and have the flexibility to respond to any changes. The SFDR is a moving beast, with various milestones in place over the coming months.

If you would like advice on anything covered in this note, please speak to a member of the Forsters CRE Sustainability team.

The law is accurate as at July 2023.



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