Regulation in motion – The Sustainable Finance Disclosure Regulation (SFDR)

MAIN IMPLEMENTATION ISSUES AND PRACTICAL GUIDANCE
Contents

The sustainable disclosure challenge 3
Overview of questions and practical guidance 8
Beyond green – embedding social, employee and governance matters 18
The broader picture – Sustainable Finance Strategy, Green Deal and country initiatives 21
ESG as disruptor and gamechanger for the EU fund industry 23
SFDR and the global disclosure landscape 24
How we can help 26
Key contacts 28
Glossary of terms 30
Footnotes 31

QUESTION NO. 1: HOW CAN THE SFDR BE APPLIED BEFORE THE ENTRY INTO FORCE OF THE RTS?
QUESTION NO. 2: DOES THE SFDR APPLY TO THIRD-COUNTRY AIFMS?
QUESTION NO. 3: DOES THE SFDR APPLY TO REGISTERED EU AIFMS?
QUESTION NO. 4: DO THE PRE-CONTRACTUAL DISCLOSURE OBLIGATIONS APPLY TO EXISTING FUNDS RESERVED FOR PROFESSIONAL INVESTORS OR RESPECTIVE PORTFOLIO MANAGEMENT MANDATES?
QUESTION NO. 5: TO WHAT EXTENT DOES SFDR APPLY TO AIFS THAT HAVE BEEN PLACED OR ARE NO LONGER ACTIVELY MARKETED?
QUESTION NO. 6: WHAT LEVEL OF DETAIL IS REQUIRED FOR THE DISCLOSURE ON PAI AT THE LEVEL OF THE FUND MANAGER BEFORE THE ENTRY INTO FORCE OF THE RTS?
QUESTION NO. 7: FROM WHICH DATE WILL FUND MANAGERS USING THE “EXPLAIN” OPTION BE REQUIRED TO DISCLOSE A RESPECTIVE STATEMENT AT FUND LEVEL?
QUESTION NO. 8: HOW CAN FUND MANAGERS COPE WITH THE SCARCITY OF DATA FOR THE PAI DISCLOSURE?
QUESTION NO. 9: IN WHICH LANGUAGES DOES A FUND MANAGER HAVE TO DISCLOSE UNDER SFDR?
QUESTION NO. 10: IS THERE A FAST-TRACK PROCEDURE TO APPROVE PRE-CONTRACTUAL DOCUMENTS?
QUESTION NO. 11: WHO HAS TO PUBLISH AN AMENDED REMUNERATION POLICY?
QUESTION NO. 12: WHAT NEEDS TO BE DONE IN RELATION TO THE REMUNERATION POLICY?
QUESTION NO. 13: HOW DOES A FUND MANAGER IDENTIFY RELEVANT SUSTAINABILITY RISKS?
QUESTION NO. 14: HOW SHOULD SUSTAINABILITY RISKS BE DISCLOSED?
QUESTION NO. 15: HOW CAN “NORMAL” FUNDS BE DISTINGUISHED FROM LIGHT GREEN FUNDS?
QUESTION NO. 16: DO THE ENVIRONMENTAL OR SOCIAL CHARACTERISTICS OF A LIGHT GREEN FUND HAVE TO BE BINDING FOR THE FUND MANAGER?
QUESTION NO. 17: DOES THE “NO SIGNIFICANT HARM PRINCIPLE” ALSO APPLY TO LIGHT GREEN FUNDS?
QUESTION NO. 18: CAN A DARK GREEN FUND INVEST ONLY IN SUSTAINABLE INVESTMENTS?
QUESTION NO. 19: HOW CAN CONFIDENTIAL INFORMATION BE DISCLOSED ON THE WEBSITE?
QUESTION NO. 20: WILL A DARK GREEN FUND WITH A CARBON EMISSIONS REDUCTION OBJECTIVE HAVE TO USE AN EU CLIMATE BENCHMARK?
QUESTION NO. 21: WHEN WILL THE DISCLOSURE INFORMATION UNDER THE SFDR HAVE TO BE UPDATED?
QUESTION NO. 22: WHAT IS THE RELATIONSHIP BETWEEN SFDR AND TAXONOMY IN RELATION TO ENVIRONMENTALLY SUSTAINABLE INVESTMENTS?
The sustainable disclosure challenge

2021 has started with a frenzy of activities, announcements and promises on sustainability and climate change from policymakers and big business – from US president Joe Biden’s “Climate Day” program published on 27 January 2021 to BlackRock CEO Larry Fink’s 2021 letter to CEOs. Sustainability and environmental, social and governance (ESG) questions make it to the front pages of any business journal across the globe.

Amid all this buzz it is easy to forget that the EU Commission’s ambitious Sustainable Finance Strategy will become real in 2021: From 10 March 2021 the SFDR requires Fund Managers of AIFs and UCITS as well as investment firms providing portfolio management or investment advice under the framework established by MiFID to disclose how they consider sustainability risks in their investment processes and products and how they deal with principal adverse impacts (PAI) of their investment decisions on sustainability factors. Fund Managers of Funds promoting environmental or social characteristics (Art. 8 SFDR, so-called Light Green Funds) or having a sustainable investment objective (Art. 9 SFDR, so-called Dark Green Funds) will also have to disclose information on how these characteristics and objectives are achieved and measured.

Further implementation deadlines will follow in 2022 and 2023 in relation to Fund documents and reporting.

The transition to a carbon-neutral economy provides opportunities, not just risks. By shifting the horizon away from the short term and contributing to a more sustainable economic trajectory, the financial sector can become a powerful force acting in our collective best interest. The future path for carbon emissions and the climate is uncertain, but it remains within our power to influence it.

Christine Lagarde, President of the ECB
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<thead>
<tr>
<th>Disclosure topic</th>
<th>Fund Manager</th>
<th>“Normal” Fund</th>
<th>Fund promoting environmental and/or social characteristics</th>
<th>Fund having a sustainable investment objective</th>
<th>Regulatory technical standards (RTS) (final draft)</th>
<th>Implementation deadline</th>
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<tr>
<td>Integration of sustainability risks in investment decisions (if relevant)</td>
<td>Website (Art. 3 SFDR)</td>
<td>Pre-Contractual Documents (Art. 6 para. 1 lit. (a) SFDR)</td>
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<td>Likely impacts of sustainability risks on Fund returns (if relevant)</td>
<td>N/A</td>
<td>Pre-Contractual Documents (Art. 6 para. 1 lit. (b) SFDR)</td>
<td>Pre-Contractual Documents (Art. 6 para. 1 lit. (b) SFDR)</td>
<td>Pre-Contractual Documents (Art. 6 para. 1 lit. (b) SFDR)</td>
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<td>10 March 2021</td>
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<td>Consistency of remuneration policies with the integration of sustainability risks</td>
<td>Website (Art. 5 SFDR)</td>
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<td>N/A</td>
<td>N/A</td>
<td>10 March 2021</td>
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<tr>
<td>Consideration of principal adverse impacts of investment decisions on sustainability factors</td>
<td>Website (Art. 4 SFDR) (&quot;comply or explain&quot; mechanism, mandatory compliance for big Fund Managers/groups)</td>
<td>• Pre-Contractual Documents (Art. 7 SFDR)</td>
<td>• Pre-Contractual Documents (Art. 7 SFDR)</td>
<td>• Pre-Contractual Documents (Art. 7 SFDR)</td>
<td>Art. 4 to 9 for Fund Manager</td>
<td>Fund Manager:</td>
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<td>• Annual report (Art. 7 para. 1, Art. 11 para. 2 SFDR)</td>
<td>• Annual report (Art. 7 para. 1, Art. 11 para. 2 SFDR)</td>
<td>• Annual report (Art. 7 para. 1, Art. 11 para. 2 SFDR)</td>
<td>N/A for Fund level disclosure</td>
<td>• 10 March 2021 “comply or explain”</td>
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<td>• 30 June 2021 “comply” for big Fund Managers/groups</td>
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<td>Compliant Fund Manager:</td>
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<td>• 30 June 2022 first PAI Statement</td>
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<td>• 30 June 2023 first reference period reporting in PAI Statement</td>
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<td>Funds of compliant Fund Managers:</td>
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<td>• 30 December 2022 for Pre-Contractual Documents</td>
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<td>• 1 January 2023 for annual report</td>
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### Overview on disclosures under SFDR for Fund Managers and Funds

<table>
<thead>
<tr>
<th>Disclosure topic</th>
<th>Fund Manager</th>
<th>“Normal” Fund</th>
<th>Fund promoting environmental and/or social characteristics (Light Green)</th>
<th>Fund having a sustainable investment objective (Dark Green)</th>
<th>Regulatory technical standards (RTS) (final draft)</th>
<th>Implementation deadline</th>
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| Fulfilment of environmental and/or social characteristics (including index alignment/methodology) | N/A | N/A | • Pre-Contractual Documents (Art. 8 SFDR) | N/A | Pre-Contractual Documents: Art. 13 to 19 | • 10 March 2021 for Pre-Contractual Documents and website  
• 1 January 2022 for annual report |
| Achievement of the sustainable investment objective (including index alignment/methodology) | N/A | N/A | N/A | • Pre-Contractual Documents (Art. 9 SFDR) | Pre-Contractual Documents: Art. 20 to 27 | • 10 March 2021 for Pre-Contractual Documents and website  
• 1 January 2022 for annual report |
| Alignment to Taxonomy | N/A | • Pre-Contractual Documents (Art. 7 Taxonomy)  
• Annual report (Art. 7 Taxonomy) | • Pre-Contractual Documents (Art. 6 Taxonomy, Art. 8 para. 2a SFDR)  
• Website (Art. 10 SFDR)  
• Annual report (Art. 6 Taxonomy, Art. 11 para. 1 lit. (d) SFDR) | • Pre-Contractual Documents (Art. 5 Taxonomy, Art. 9 para. 4a SFDR)  
• Website (Art. 10 SFDR)  
• Annual report (Art. 5 Taxonomy, Art. 11 para. 1 lit. (c) SFDR) | N/A | • 1 January 2022 for non-alignment and climate change mitigation/adaptation objectives  
• 1 January 2023 for other objectives |
## SFDR implementation timeline

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
<th>Description</th>
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<tbody>
<tr>
<td>SFDR enters into force</td>
<td>29 December 2019</td>
<td>Mandatory disclosure of PAI for big Fund Managers/groups</td>
</tr>
<tr>
<td>First application date</td>
<td>10 March 2021</td>
<td>RTS enter into force</td>
</tr>
<tr>
<td>First PAI Statement under RTS</td>
<td>30 June 2021</td>
<td>Disclosure on alignment with first two Taxonomy objectives for all Funds</td>
</tr>
<tr>
<td>PIA disclosure at Fund Level</td>
<td>30 June 2022</td>
<td>First detailed PAI Statement for compliant Fund Managers based on RTS</td>
</tr>
<tr>
<td>Second Taxonomy alignment</td>
<td>December 2022</td>
<td>Disclosure of PAI at Fund level for compliant Fund Managers in Pre-</td>
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<tr>
<td>Annual reporting on PAI at Fund level</td>
<td>01 January 2023</td>
<td>Contractual Documents</td>
</tr>
<tr>
<td>First detailed PAI Statement under RTS</td>
<td>30 June 2023</td>
<td>Disclosure on alignment with all Taxonomy objectives for all Funds</td>
</tr>
<tr>
<td>Report on first PAI reference period</td>
<td>30 December 2022</td>
<td>Annual report containing specific characteristics for Funds according to</td>
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<td>Art. 8 and 9 SFDR</td>
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**First PAI reference period for compliant Fund Managers**
The EU Commission’s aim behind this is to create transparency for end investors and combat “greenwashing”, i.e. misrepresentation of Funds as “green” or sustainable although they do not meet respective standards.\(^6\)

In the current “ESG hype” on the global fund market this is definitely not an empty concern.\(^7\) Greenwashing concerns motivated the French AMF to provide detailed guidance on disclosure for Funds incorporating non-financial approaches in March 2020.\(^8\) The Irish Central Bank has put greenwashing in the Irish fund industry under close scrutiny in its 2021 risk outlook report.\(^9\) In addition, the Spanish CNMV reminds Fund Managers in a new draft statement on SFDR (not yet published) that the credibility of information on sustainable investments is considered essential.

Although the concept of Sustainability and ESG is not foreign to many Fund Managers servicing long-term institutional investors, it is the first time that the entire EU fund industry has had to assess, describe and monitor sustainability risks relevant for its Funds. Moreover, the SFDR is not limited to the impact of sustainability risks on the Fund Managers’ processes or Funds: when assessing the material adverse impact of their investment decisions on sustainability factors (Art. 4 SFDR), Fund Managers will need to look beyond their Funds at a broad range of different matters, from environmental, social and employee to human rights, anti-corruption and anti-bribery (Art. 1 para. 24 SFDR) (so-called ‘double materiality approach’).

Hence a lot of imagination is needed – and unfortunately even more so because many provisions of the SFDR still need to be filled with life by the RTS, guidance from the supervisors or market practice. The final Draft RTS have just been published by the ESA\(^10\) (after many calls for action from the fund industry and the ESAs),\(^11\) but its (extremely detailed) disclosure rules will (luckily) only apply from 1 January 2022. Moreover, the Draft RTS only cover the PAI assessment at Fund Manager level (Art. 4 SFDR) and the specific product disclosures for Light Green and Dark Green Funds (Art. 8 to 11 SFDR). Fund Managers currently struggling with the disclosure of sustainability risks (Art. 6 SFDR) and the amendment of their remuneration policies (Art. 5 SFDR) will not find any guidance in the Draft RTS.

To support you in the challenging exercise of implementing a regulation in motion, we have screened market practice and industry guidance at EU level and in seven different countries in the EU (France, Germany, Italy, Ireland, Luxembourg, The Netherlands and Spain). The results of our review are presented in the form of questions answered across jurisdictions and accompanied by practical guidance on how to deal with them.
Overview of questions and practical guidance
Question No. 1: How can the SFDR be applied before the entry into force of the RTS?

The EU Commission recommends to addressees of the SFDR to provide their disclosures as of 10 March 2021 in line with the high level and principle-based requirements of the SFDR. It points out that the SFDR application is not conditional on the formal adoption of the Draft RTS in the next few months and their entry into force on 1 January 2022. In line with this statement, the Irish Central Bank has underlined that it will require full compliance with SFDR requirements as from 10 March 2021 and that there will be no “disclosure light” until the RTS are available. The French AMF has directed Fund Managers to its latest “Position-Recommendation” on information to be provided by collective investment schemes incorporating non-financial approaches. To support Italian Fund Managers and investment firms in the implementation of the SFDR Italy’s CONSOB has made reference to existing guidance on ESG disclosures, such as the ESMA Guidelines on certain aspects of the MiFID II suitability requirements. The Dutch AFM has linked the sustainability factors under the SFDR to the ESG factors under the Taxonomy Regulation and has announced that it will consider the constraints caused by the lack of RTS in its regulatory oversight. When releasing their final report on the Draft RTS on 4 February, the ESAs have announced that the plan is to issue a public supervisory statement before 10 March 2021 to achieve a consistent application of the SFDR. Hopefully this will come soon – most Fund Managers are in the middle of implementing the SFDR requirements and a last minute supervisory guidance will certainly not be helpful in this task.

Question No. 2: Does the SFDR apply to third-country AIFMs?

Apparently this is a question even the ESAs do not have a final answer to. In their recent letter to the EU Commission, the ESAs have asked the EU Commission to clarify the extent to which SFDR applies to third-country AIFMs; for example, when marketing EU AIFs under a national private placement regime. Similar questions could arise if non-EU AIFMs manage EU AIFs or provide portfolio management or investment advice to EU AIFs. Portfolio management is defined in Art. 2 para. 6 SFDR by reference to Art. 4 para. 1 no. 8 MiFID II and covers discretionary mandates relating to financial instruments. Investment advice is defined in Art. 2 para. 16 SFDR by reference to Art. 4 para. 1 no. 4 MiFID II and covers the provision of personal recommendations on transactions relating to financial instruments. Non-EU AIFMs providing portfolio management or investment advice to EU AIFs have to fulfil the obligations for financial advisors according to Art. 2 para. 11 SFDR. A number of EU fund industry associations have stated that SFDR should also apply to non-EU AIFMs if there is a nexus with the EU territory, either via the domicile of the managed or advised AIF or via the country in which marketing activities are carried out. This principle should be applied both ways, i.e. if an EU AIF is marketed outside the EU, the respective AIFM would still need to make the SFDR disclosures. In our opinion, since the SFDR obligations are linked to the existing EU regulatory frameworks (AIFMD, UCITSD and MiFID), the disclosure obligations under SFDR should only apply to non-EU AIFMs to the extent they are covered by the respective frameworks. Accordingly, as an example, if and to the extent the cross-border provision of portfolio management or investment advice by a non-EU AIFM does not fall under MiFID II (which is the case as long as the non-EU AIFM does not specifically solicit target clients or potential clients in the EU), the non-EU AIFM does not have to comply with SFDR.

Question No. 3: Does the SFDR apply to registered EU AIFMs?

In their recent letter to the EU Commission, the ESAs have also asked to which extent the SFDR applies to registered AIFMs. No final answer has been provided to this question yet – maybe this will be addressed in the ESAs’ public supervisory statement to be expected before 10 March 2021. In the meantime, Fund Managers can only have recourse to the wording and the objective of SFDR. Since the SFDR disclosure obligations are linked to the financial product provided (see Art. 2 para. 1 and 12 SFDR) and AIFs managed by a registered AIFM fully qualify as AIFs according to Art. 4 para. 1 lit. (a) AIFMD, it has been argued in the market that Art. 2 para. 1 lit. (e), para. 12 lit. (b) and para. 13 SFDR covers both “full” AIFMs and registered AIFMs. Nevertheless, it may be sensible to alleviate the SFDR’s disclosure obligations for registered AIFMs in light of their limited business model.

GOAL 17: Strengthen the means of implementation and revitalize the global partnership for sustainable development.
Question No. 4: Do the pre-contractual disclosure obligations apply to existing Funds reserved for professional investors or respective portfolio management mandates?

Fund Managers dealing with professional investors have often set up dedicated Funds which are reserved to one or several professional investors or provide portfolio management services in the context of existing portfolio management mandates. It has therefore been questioned whether the pre-contractual disclosures under Art. 6 to 9 SFDR (for “normal”, Light Green and Dark Green Funds) are also required for these existing investor relationships. Again the answer can be based on the connection between SFDR and the existing EU regulatory frameworks (AIFMD, UCITS and MiFID).

Accordingly, it has been argued that by virtue of the SFDR, the Fund Manager should not be required to amend its Pre-Contractual Documents already issued to these investors. In particular, the explanation of an existing ESG investment strategy should not constitute a material change requiring an update of the Pre-Contractual Documents. However, if an existing investor subscribes to additional units of a Fund or increases an existing portfolio management mandate, this could trigger pre-contractual disclosure obligations under AIFMD or MiFID II, as the case may be, and the respective Pre-Contractual Documents would then have to be aligned with SFDR.

Question No. 5: To what extent does SFDR apply to AIFs that have been placed or are no longer actively marketed?

Similar to the previous question, this question can be answered on the basis of the relationship between SFDR and the existing EU regulatory frameworks (AIFMD, UCITS and MiFID). For Funds which have already been placed (eg closed-ended AIFs whose subscription period has ended) or Funds which are no longer actively marketed, usually no situation can arise in which the Fund Manager would be required to make available Pre-Contractual Documents. Hence it has been argued that for these Funds the pre-contractual disclosure obligations in Art. 6 to 9 SFDR should not apply (again based on the assessment that the SFDR disclosure is not a material amendment which would require an update of the Pre-Contractual Documents).

The provisions in Art. 4 to 9 Draft RTS prescribing content and form of the detailed PAI Statement at Fund Manager level will only apply from 1 January 2022. They are extremely detailed and it can be doubted that retail investors will be able to fully digest their content. However, for professional investors subject to their own ESG requirements (under SFDR, NFRD or voluntary initiatives like the Principles of Responsible Investment) as well as for the EU fund industry as a whole, they can serve as a valuable basis for further disclosure, management of ESG investment objectives (for example net-zero investing), peer review and overall transparency of ESG practices in the market.

Based on the delayed entry into force of the Draft RTS, it has been agreed in the market that the descriptions of the internal processes and relevant standards at the Fund Manager level will be sufficient for implementation by 10 March 2021 and that disclosure of specific PAI indicators according to the Draft RTS is not yet required. To the extent the required information is available, it may make sense to already structure the PAI disclosure following the items set out in Art. 4 para. 2 Draft RTS, without including the detailed information set out in Art. 5 to 9 Draft RTS.
Question No. 6: continued

It should be noted that all Fund Managers complying with Art. 4 para. 1 lit. (a) SFDR in 2021 (on 10 March 2021, on 30 June 2021 for big Fund Managers/groups or on any other date in 2021) can publish a generic disclosure on PAI which does not have to take into account the Draft RTS. Their first detailed PAI Statement according to Art. 4 to 9 Draft RTS will only become due by 30 June 2022, followed by the first PAI Statement including reference period reporting on 30 June 2023. If the Fund Manager decides to comply on a date after 1 January 2022 (when the Draft RTS enter into force) it will have to publish a full PAI Statement (without reference period reporting) even if this is before 30 June 2022. Such Fund Managers will need to publish the PAI Statement including the first reference period reporting by 30 June of the following year.

Under the first draft of the RTS published for consultation in April 2020, the first reference period reporting for compliant Fund Managers would become due on 30 June 2022. Following the criticism by various fund managers, their first detailed PAI Statement according to Art. 4 to 9 Draft RTS will only become due by 30 June 2022, followed by the first PAI Statement including reference period reporting on 30 June 2023. If the Fund Manager decides to comply on a date after 1 January 2022 (when the Draft RTS enter into force) it will have to publish a full PAI Statement (without reference period reporting) even if this is before 30 June 2022. Such Fund Managers will need to publish the PAI Statement including the first reference period reporting by 30 June of the following year.

Under the first draft of the RTS published for consultation in April 2020, the first reference period reporting for compliant Fund Managers would become due on 30 June 2022. Following the criticism by various fund associations, including the German BVI, the ESAs have decided to postpone the first detailed PAI Statement according to Art. 4 to 9 Draft RTS will only become due by 30 June 2022, followed by the first PAI Statement including reference period reporting on 30 June 2023. If the Fund Manager decides to comply on a date after 1 January 2022 (when the Draft RTS enter into force) it will have to publish a full PAI Statement (without reference period reporting) even if this is before 30 June 2022. Such Fund Managers will need to publish the PAI Statement including the first reference period reporting by 30 June of the following year.

Question No. 7: From which date will Fund Managers using the “explain” option be required to disclose a respective statement at Fund level?

Art. 7 para. 1 SFDR requires Fund Managers to disclose the consideration of PAI at Fund level by 30 December 2022. The Draft RTS do not contain any details on this PAI disclosure since the ESAs have only been asked to develop standards in relation to the Fund Manager level disclosure in Art. 4 SFDR. For the annual report disclosure Art. 7 para. 1 second sentence SFDR refers to the Draft RTS provisions on the Fund Manager PAI Statement. For the Pre-Contractual Documents no such reference exists but it can be expected that the ESAs and the national supervisors will expect Fund Managers to align the PAI assessment in the annual reports and the Pre-Contractual Documents.

If Fund Managers choose to apply the “explain” option in Art. 4 para. 1 lit. (b) SFDR, they will have to mirror this in the Fund level disclosure according to Art. 7 para. 2 SFDR. This paragraph does not make reference to 30 December 2022 as a start date and is covered by the general provision on entry into force on 10 March 2021 in Art. 20 para. 2 SFDR. Accordingly, the Luxembourg CSSF has recently stated that the duty to disclose the “explain” option in the Pre-Contractual Documents already applies from 10 March 2021. In some markets Art. 7 para. 1 and para. 2 SFDR are seen as one single obligation which applies from 30 December 2022. Considering the ambiguous wording and the limited effort required to comply with Art. 7 para. 2 SFDR, it might be recommendable to include the “explain” statement in the Pre-Contractual Documents and the annual report as well. It could already be drafted along the lines of the “no consideration statement” described in Art. 11 Draft RTS.

Question No. 8: How can Fund Managers cope with the scarcity of data for the PAI disclosure?

The Fund Manager disclosure on PAI under Art. 4 SFDR is a central element of the SFDR’s transparency toolbox. However, missing reliable data is a key concern for the EU fund industry, and this has been explicitly acknowledged by the ESAs during the consultation phase of the Draft RTS. Following the consultation process there have been some alleviations: the ESAs have agreed to defer the PAI reference period reporting to 2023 (see above Question No. 6) and they have also taken up the proposal made by EFAMA to base the reference period reporting on specific reference dates (31 March, 30 June, 30 September and 31 December each year) instead of a full reference period.

Nevertheless, the Draft RTS still require considerable effort from Fund Managers to obtain the required data, not only for the first investment level, but also for the underlying investments. In the case of financings for specific projects, this “look-through” principle requires that the Fund Manager take into account the PAI of the targeted project. If the Fund Manager cannot obtain this information, it cannot be considered to fulfill its duties under Art. 4 para. 1 lit. (a) SFDR – which probably means that the Fund Manager has to choose the “explain” option to the extent this is available.

Different from recommendations in the market, which see the direct contact with investee companies as the primary source of information, the ESAs leave it to the Fund Manager to obtain the required data “through all reasonable means available.” According to the non-exclusive list in the Draft RTS, this can also include external research providers, internal financial analysts/specialists, specifically commissioned studies, publicly available information or shared information from peer networks or collaborative initiatives. However, the ESAs acknowledge that in the case of insufficient data, direct engagement with the investee companies will become necessary. This mirrors current market practice according to which many Fund Managers make use of external ESG data providers who have tailored their products to SFDR.
Question No. 9: In which languages does a Fund Manager have to disclose under SFDR?

SFDR itself does not contain any provisions relating to the language in which the disclosures have to be made. Accordingly, to the extent they are part of the disclosures under existing EU regulatory frameworks (AIFMD, UCITSD, MiFID II), for example, for the Pre-Contractual Documents and the annual reports, it would make sense to apply the same language requirements which apply to the respective disclosure document. The SFDR adds new disclosure obligations with regard to the Fund Manager website regarding the PAI Statement/disclosure of PAI and the information on Light Green and Dark Green Funds (Art. 4 and 10 SFDR). According to the Draft RTS, these website disclosures must be made in the language of the Fund Manager’s home country, in a language customary in the sphere of international finance and, in addition, in the language of each EU country in which the Fund Manager markets its Funds. Depending on the scope of the Fund Manager’s distribution activities, a multitude of different language versions would be required. Surprisingly, no differentiation is made between retail Funds and Funds for professional investors – for the latter it is widely recognised in the EU that an English language version of all mandatory documentation is sufficient. But the current wording is unfortunately very clear and requires the language of the home country plus international finance language plus the language of all EU countries in which Funds are marketed.

Question No. 10: Is there a fast-track procedure to approve Pre-Contractual Documents?

Luxembourg and Ireland have already launched fast-track procedures, and Spain is considering doing this as well:

- Luxembourg’s CSSF has established a fast-track procedure covering changes required to implement the SFDR in those Pre-Contractual Documents which require a CSSF visa stamp. The fast-track procedure is available for the UCITS prospectus and AIFMs updating the prospectus/issuing document of AIFs which are formed as Luxembourg specialised investment Funds or Luxembourg Funds which do not qualify as AIFs. However, updates must be limited to the changes required under SFDR and cannot include material modifications according to CSSF Circular 14/591.

- The Central Bank of Ireland confirmed that the Irish fast-track facility is available for SFDR related disclosures. All other changes must comply with the usual Central Bank review process for the relevant Fund. If a prospectus/supplement has been filed with the Central Bank for review (this applies to new Funds and post-authorisation amendments) the disclosures made in relation to SFDR may be reviewed. The Central Bank explicitly expects that Funds and Fund Managers will make a determination as to whether Article 8 or Article 9 of the SFDR applies.

- The Spanish CNMV has announced recently that it plans to establish a simplified procedure for updating Fund prospectuses in order to adapt them to the requirements of Articles 6 and 7 SFDR (sustainability risk and PAI assessment on Fund level).

Question No. 11: Who has to publish an amended remuneration policy?

According to Art. 5 para. 1 SFDR Fund Managers have to include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks. It has been asked whether Fund Managers and Investment Firms without a remuneration policy will need to establish one by virtue of the SFDR obligation. Some legal advisors claim that following the objectives of the SFDR all Fund Managers and investment firms should have a remuneration policy considering the integration of sustainability risks. However, the wording of Art. 5 para. 2 SFDR clearly links the obligation to include sustainability risks to the duty to have a remuneration policy under the existing EU regulatory frameworks (AIFMD, UCITSD, MiFID). Accordingly, if a Fund Manager is not obliged to have a remuneration policy under these frameworks, it has been argued in the market that it will not need to set up a remuneration policy for the purposes of SFDR (although this may rarely be the case under the EU regulatory frameworks).
Neith the SFDR nor the Draft RTS provide any details on the obligation set out in Art. 5 SFDR. The only guidance can be taken from recital 22 SFDR which focuses on three items:

- promotion of sound and effective risk management with respect to sustainability risks;
- no encouragement of excessive risk-taking with respect to sustainability risks; and
- the link between remuneration and risk-adjusted performance.

These terms should be quite familiar to Fund Managers because they are also part of the general provisions on remuneration and remuneration policies for Fund Managers. Accordingly, SFDR does not introduce new remuneration principles, but only a new category of risks to be taken into account for the remuneration policy. In line with the existing principles for remuneration policies, the Fund Manager should look at the sustainability risk profiles of the Funds it manages (to be prepared under Art. 6 SFDR) and consider them in the design of its remuneration policy.

Sustainability risks are defined very generically in Art. 2 para. 22 SFDR, which does not provide much guidance and the Draft RTS do not cover Art. 6 SFDR. Even more important, since this is a new type of risk disclosure, there is no historic data available (for example, on impact and frequency of sustainability risks). Accordingly, when performing the sustainability risk assessment under Art. 6 SFDR Fund Managers will first need to create an inventory of all potential sustainability risks, rank them according to relevance and then determine their probability, likely impact etc. The PAI indicator tables in the Draft RTS may serve as a source of inspiration when creating the inventory of potential sustainability risks. In any case, building up a sustainability risk record which is comparable to the records on financial risks will take a lot of time.
Question No. 14: How should sustainability risks be disclosed?

Aside from recital 15 SFDR, which allows for qualitative or quantitative disclosure, and the wording of Art. 6 SFDR, there is no further guidance on how to disclose sustainability risks. The draft RTS do not apply to Art. 6 SFDR. It should be noted, however, that the concept of disclosing risks in Pre-Contractual Documents is very well-known to Fund Managers when it comes to financial risks. Accordingly, Fund Managers could structure their disclosures on sustainability risks in a similar way to the existing disclosures on financial risks, along the following lines:

• Which material sustainability risks have been identified by the Fund Manager for the Fund?

• How are these sustainability risks considered in the investment process for the Fund?

• Can these sustainability risks have an impact on the Fund’s returns and if yes, what impact?

While the disclosure on the investment process can be generic and does not need to deal with each single sustainability risk, the other disclosures should focus on individual sustainability risks which could be categorised as either “environmental,” “social” or “governance” in line with the definition in Art. 2 para. 22 SFDR. If sustainability risks can have an impact on the Fund’s returns, the respective impact should be described specifically; for example, “social risk: lack of employee protection at investee companies may lead to reputational damage and hinder the investee companies in ensuring a suitable workforce which may have an impact on the investee companies’ performance and their value.”

Accordingly, it has been noted in the market that sustainability risks and their likely impacts will need to be adapted to each Fund depending on the target assets, locations, investment strategies (active/passive) etc. In the case of umbrella Fund structures, a qualitative disclosure could only be made jointly for all sub-funds to the extent the same principles apply (for example, in relation to the investment process). Quantitative disclosures would always have to focus on the specific sub-fund.

Question No. 15: How can “normal” Funds be distinguished from Light Green Funds?

This is one of the most challenging questions of the SFDR implementation since the respective criteria set out in Art. 8 para. 1 SFDR (“promotes among other characteristics, environmental or social characteristics”) are very generic and neither the SFDR nor the Draft RTS provide further guidance. According to recital 18 Draft RTS, such Funds can cover various investment approaches and strategies, from best-in-class to specific sectoral exclusions. Moreover, recital 19 Draft RTS explicitly mentions that Funds could be considered to promote environmental or social characteristics if they take into account PAI and/or apply the “no significant harm principle” (Art. 2a and Art. 2 para. 17 SFDR) to their sustainable investments (see below Question No. 15). At the same time, recital 21 Draft RTS clarifies that Light Green Funds can invest in a wide range of underlying assets which may not have to be sustainable investments (as defined in Art. 2 para. 17 SFDR) or contribute to the Fund’s environmental or social characteristics.

According to the fund association Irish Funds, this ambiguity forces Fund Managers to give careful consideration to the demarcation between “normal” Funds and Light Green Funds. The wording in the Pre-Contractual Documents needs to be reviewed carefully to ensure it does not include any reference to environmental or social aspects that may cause regulators to consider that a Fund has been incorrectly classified as a “normal” Fund. Likewise, Fund Managers may be concerned about “greenwashing” when classifying a Fund under Art. 8 SFDR if the Fund does not really pursue an ESG-related investment strategy.
Question No. 15: Continued

In line with these concerns, the EU fund industry has called for more clarifications on the meaning of the term “promotion” in the consultation process. Aside from the recitals mentioned above, no further guidance has been included in the Draft RTS. In their recent letter to the EU Commission, the ESAs raised five different questions solely on this issue:

- Is the name of a Fund including words like “sustainable,” “sustainability” or “ESG” sufficient to qualify a Fund under Art. 8 SFDR?
- Could the mandatory disclosure of detailed sustainability risks and PAIs according to Art. 6 para. 1 SFDR and Art. 7 para. 1 SFDR cause a Fund to qualify under Art. 8 SFDR since environmental and social aspects are mentioned in the Pre-Contractual Documents?
- Does a Fund need to invest a minimum share of its investments to attain its designated environmental or social characteristic in order to qualify under Art. 8 SFDR?
- Does an intrinsic characteristic of a Fund, such as a sectoral exclusion (for example tobacco) which is not advertised, also qualify as “promotion”?
- Could compliance with a national legal obligation applying to the Fund Manager (for example, ban on investment in cluster munitions) also bring the Fund into the scope of Art. 8 SFDR?

Although all market participants agree that a clearer definition is required, there are different views on how to achieve this. On the one hand, it has been argued in the market that “promotion” should be more than just marketing and that a Light Green Fund must have an investment strategy which aims to further environmental or social characteristics. As an example, a Fund having a name with ESG-related elements (“net-zero” or “ESG”) should not be by virtue of its name qualify under Art. 8 SFDR. It should be noted, however, that such Fund names bear a great reputational risk of greenwashing accusations, as pointed out by several fund associations, and that it cannot be excluded that supervisors in the EU or third countries will conduct a strict review of product naming after 10 March 2021 (as has already been done in France in 2020).

On the other hand, it has been argued in the market that “promotion” only relates to the active marketing of a Fund with its environmental or social characteristics and that the marketing documents of a Fund should be decisive to determine its qualification under Art. 8 SFDR. On the contrary, a description of these characteristics in the Pre-Contractual Documents should not be sufficient. This would not fit to the role and purpose the Pre-Contractual Documents have in the context of the EU regulatory frameworks (AIFMD, UCITS, MiFID). Accordingly, the ESAs underline the importance of the legal documentation including the Pre-Contractual Documents for the responsibility and the supervision of the Fund Manager.

A number of fund associations have questioned in the consultation process for the Draft RTS whether sectoral exclusions or national law bans applicable to all Funds of a Fund Manager can lead to a qualification under Art. 8 SFDR. According to recital 18 Draft RTS, sectoral exclusions can in principle qualify a Fund under Art. 8 SFDR. However, as a response to these concerns, recital 25 Draft RTS now clarifies that exclusion strategies which only lead to the exclusion of a limited number of investments or are based on exclusions required by law should not be sufficient. In this context the fund association Irish Funds notes that the ESAs had already considered at the Open Hearing on SFDR that exclusions based on legal restrictions would not qualify a Fund under Art. 8 SFDR.

Finally, it should be noted that even the EU Commission appears not to be overly happy with the broad definition in Art. 8 SFDR. In the current draft for the amendment of the MiFID II delegated act implementing sustainability criteria in the suitability assessment, a new Fund category will be introduced: so-called “Art. 8 plus” or “middle green” Funds will need to have a minimum proportion of sustainable investments or consider PAIs at Fund level from 30 December 2022 and only such Funds are considered suitable for clients with ESG preferences.

Overview of questions and practical guidance

Question No. 16: Do the environmental or social characteristics of a Light Green Fund have to be binding for the Fund Manager?

Art. 15 lit (a) Draft RTS requires that the investment strategy of a Light Green Fund contains “binding elements” for the selection of investments to attain environmental or social characteristics promoted by the Fund. According to the interpretation in the market, such binding elements can be positively formulated selection criteria; for example, within the framework of a “best-in-class” approach, or negative exclusion criteria. To avoid “greenwashing,” recital 20 Draft RTS states explicitly that only such criteria should be disclosed that are binding on the investment decision-making process. If the Fund Manager can disapply or override these criteria at its discretion, they do not qualify the Fund under Art. 8 SFDR. It has been claimed in the market that any discretion of the Fund Manager on how it weighs the data on the environmental and social criteria should lead to an exclusion of the respective Fund from Art. 8 SFDR. This may go a bit too far considering that the weighing of information and the assessment of chances and risks are an inherent part of any investment decision (at least for active investment strategies) and that not all investments of a Light Green Fund have to be sustainable or aligned with its environmental or social characteristics. In any case, characteristics that the Fund Manager may discard entirely at its discretion should not qualify a Fund under Art. 8 SFDR. Moreover, if a Fund's investment strategy “by accident” has a beneficial impact on environmental or social characteristics without being specifically designed to target these characteristics, it should also not be considered as a Light Green Fund.

15
Question No. 17: Does the “no significant harm principle” also apply to Light Green Funds?

The “no significant harm principle” pursuant to Art. 2a SFDR has been introduced into the SFDR by the Taxonomy and is the SFDR’s equivalent to the Taxonomy’s minimum safeguards according to Art. 3 lit. (c) and Art. 18 Taxonomy. According to the wording of the SFDR, this principle only applies to sustainable investments defined in Art. 2 para. 17 SFDR that are made by Dark Green Funds according to Art. 9 SFDR. However, according to Art. 16 para. 1 lit. (b) Draft RTS, Light Green Funds may also invest in sustainable investments to which the “no significant harm principle” will need to be applied. Fund associations have criticised that this blurs the line between Light Green and Dark Green Funds, but the respective provisions have remained basically unchanged in the Draft RTS now published by the ESAs.

Question No. 18: Can a Dark Green Fund invest only in sustainable investments?

In their letter to the EU Commission, the ESAs have asked whether a Dark Green Fund can only invest in sustainable investments (as defined in Art. 2 para. 17 SFDR) and, if not, whether a minimum share of sustainable investments/maximum share of “other” investments applies. According to Art. 23 para. 2 lit. (b) Draft RTS, a Fund qualifying under Art. 9 SFDR may have a remaining proportion of investments which do not qualify as sustainable investments. Recital 23 Draft RTS clarifies that Funds qualifying under Art. 9 SFDR need to disclose their remaining non-sustainable investments to demonstrate how those investments do not prevent the Fund from attaining its sustainable investment objective. The Draft RTS do not contain any specific thresholds in this regard. It has been argued in the market that a Dark Green Fund should invest more than 50% of its assets in sustainable investments. The wording “remaining investments/proportion” in the Draft RTS supports the claim that such investments should in any case not dominate in the Fund portfolio.

Question No. 19: How can confidential information be disclosed on the website?

If the Fund is not a retail Fund, neither the Fund Manager nor the investors are interested in making the detailed disclosures under SFDR available to the public. Since the objective of the SFDR is to provide disclosures to the investors, it has been argued in the market that the information to be disclosed under Art. 10 SFDR can be featured in a password protected area on the website accessible only to the respective investors.
Question No. 20: Will a Dark Green Fund with a carbon emissions reduction objective have to use an EU Climate Benchmark?

It has been questioned in the consultation phase whether a Fund qualifying under Art. 9 SFDR can use any benchmark or is restricted to the newly introduced EU Climate Benchmarks in the Benchmarks Regulation. This has been taken up by the ESAs in the Draft RTS: Art. 27 Draft RTS now clarifies that such a Fund has to use an EU Climate Benchmark if such a benchmark is available. In the light of the EU Commission’s Green Deal and the required alignment to the goals of the Paris Climate Agreement, this clarification makes perfect sense.

Question No. 21: When will the disclosure information under the SFDR have to be updated?

This question is only relevant for the information published on the website (Art. 4, Art. 5 and Art. 10 SFDR) and in the Pre-Contractual Documents (Art. 6 to 9 SFDR) since subsequent changes of disclosed information do not affect Fund annual reports (Art. 11 SFDR).

For the website disclosures, Art. 12 SFDR provides that the relevant information must be kept up to date on an ongoing basis. Accordingly, Fund Managers should constantly monitor whether the disclosed information is still correct and, if necessary, perform the required amendments. Such amendments then have to be clearly explained.

Neither the SFDR nor the Draft RTS contain specific provisions on updates to Pre-Contractual Documents. In line with the general principles applicable to these Pre-Contractual Documents under the existing EU regulatory frameworks (AIFMD, UCITS and MiFID), they will need to be updated in case of material changes to the SFDR disclosure information.

Question No. 22: What is the relationship between SFDR and Taxonomy in relation to environmentally sustainable investments?

The SFDR’s definition of a “sustainable investment” is much broader than the scope of the Taxonomy and can also include sustainable investments with an environmental objective which are not covered by the Taxonomy (which is limited to six specific environmental objectives: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems). Moreover, while the Taxonomy is (currently) limited to environmental objectives (with certain minimum social safeguards attaching), the SFDR definition of sustainable investment also includes social objectives.

Accordingly, the ESAs have acknowledged that as a potential consequence of differences between SFDR and the Taxonomy, Dark Green Funds may hold a portfolio that is fully or partly composed of investments which are not Taxonomy-compliant, (i.e. which are not invested in “environmentally sustainable economic activities” as defined under the Taxonomy). Accordingly, a Dark Green Fund under Art. 9 SFDR could be 0% Taxonomy compliant. Moreover, since the SFDR concept of environmental objectives does not refer to Taxonomy, it would in theory be possible that a Fund Manager uses its own definitions of environmental objectives outside of Taxonomy. To avoid confusion and “greenwashing,” the ESAs have already indicated that they intend to deal with this inconsistency, likely by integrating the Taxonomy definitions into SFDR. In line with this expected development, Irish Funds points out that it is advisable for Fund Managers marketing Art. 9 Funds to consider the extent to which the investments would align with the Taxonomy, even though the Taxonomy will only apply from 1 January 2022.
Beyond green – embedding social, employee and governance matters

A claim we often hear in relation to the EU Sustainable Finance Strategy is that the EU Commission merely focuses on “green” environmental aspects. While this holds true for the Taxonomy in its current status, the SFDR has a much broader perspective: A “sustainable investment” (Art. 2 para. 17 SFDR) made by a Light Green or Dark Green Fund can have environmental or social objectives (for example social integration, tackling inequality, support to disadvantaged communities). When considering sustainability risks (Art. 2 para. 22 SFDR) in their investment decisions (Art. 6 SFDR) Fund Managers will need to look at environmental, social or governance events or conditions which could have a material negative impact on the value of the respective investment. The analysis of PAI on sustainability factors at Fund Manager and Fund level extends to environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters (Art. 2 para. 24).

In tables 1 to 3 to the Draft RTS the ESAs have set out detailed PAI indicators containing a number of employee and human rights indicators as well as indicators linked to good governance. Although this has been strongly criticised in the consultation process for the Draft RTS, the ESAs have reaffirmed that the PAI indicators relating to objectives and core principles of the EU set out in table 1 (including social and employee matters and human rights) are mandatory and will need to be considered by all Fund Managers issuing a PAI Statement under Art. 4 SFDR and the RTS. According to the opinion of the EU Commission, these PAI indicators shall also serve to define the “no significant harm principle” under Art. 2a SFDR Fund Managers will only have to apply the PAI indicators in their first PAI Statement in 2022. But they are a good indication of the direction of travel the EU Commission would like to take. Employee matters and human rights, as well as certain governance topics, are prominently featured, in line with upcoming legislative projects, (for example on mandatory human rights due diligence in supply chains). Admittedly the respective PAI indicators are still very generic (for example No. 23 – need to have a human rights policy) and lack the sophistication of the environmental PAI indicators for which the EU Commission could use its work on the Taxonomy. We expect, however, that the EU Commission’s progress on respective legislative projects will also affect the PAI indicators, tightening the “ESG” net also with regard to the “S” and the “G.”

GOAL 11: Make cities and human settlements inclusive, safe, resilient and sustainable.
PAI Indicators according to Draft RTS

All mandatory indicators (Table 1) + 1 voluntary indicator (Table 2) + 1 voluntary indicator (Table 3)

<table>
<thead>
<tr>
<th>TABLE 1: MANDATORY</th>
<th>Indicators applicable to investments in investee companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Green-house gas emissions</td>
<td>• Green house gas emissions</td>
</tr>
<tr>
<td></td>
<td>• Carbon footprint</td>
</tr>
<tr>
<td></td>
<td>• Green house gas intensity of investee companies</td>
</tr>
<tr>
<td></td>
<td>• Exposure to companies active in the fossil fuel sector</td>
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<tr>
<td></td>
<td>• Share of non-renewable energy consumption and production</td>
</tr>
<tr>
<td></td>
<td>• Energy consumption intensity per high impact climate sector</td>
</tr>
<tr>
<td>Biodiversity</td>
<td>• Activities negatively affecting biodiversity-sensitive areas</td>
</tr>
<tr>
<td>Water</td>
<td>• Emissions to water</td>
</tr>
<tr>
<td>Waste</td>
<td>• Hazardous waste ratio</td>
</tr>
</tbody>
</table>

Social and employee matters

| • Violations of UN Global Compact principles and OECD Guidelines for Multinational Enterprises |
| • Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises |
| • Unadjusted gender pay gap |
| • Board gender diversity |
| • Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons) |

<table>
<thead>
<tr>
<th>TABLE 2: VOLUNTARY</th>
<th>Indicators applicable to investments in investee companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emissions</td>
<td>• Emissions of inorganic pollutants</td>
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<tr>
<td></td>
<td>• Emissions of air pollutants</td>
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<tr>
<td></td>
<td>• Emission of ozone depletion substances</td>
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<tr>
<td></td>
<td>• Investments in companies without carbon emission reduction initiatives</td>
</tr>
<tr>
<td>Energy performance</td>
<td>• Breakdown of energy consumption by type of non-renewable sources of energy</td>
</tr>
<tr>
<td>Water, waste and material emissions</td>
<td>• Water usage and recycling</td>
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<tr>
<td></td>
<td>• Investments in companies without water management policies</td>
</tr>
<tr>
<td></td>
<td>• Exposure to areas of high water stress</td>
</tr>
<tr>
<td></td>
<td>• Investments in companies producing chemicals</td>
</tr>
<tr>
<td></td>
<td>• Land degradation, desertification, soil sealing</td>
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<tr>
<td></td>
<td>• Investments in companies without sustainable land/agriculture practices</td>
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<tr>
<td></td>
<td>• Investments in companies without sustainable oceans/seas practices</td>
</tr>
<tr>
<td></td>
<td>• Non-recycled waste ratio</td>
</tr>
<tr>
<td></td>
<td>• Natural species and protected areas</td>
</tr>
<tr>
<td></td>
<td>• Deforestation</td>
</tr>
<tr>
<td>Green securities</td>
<td>• Share of securities not certified as green under a future EU legal act setting up an EU Green Bond Standard</td>
</tr>
</tbody>
</table>

Social and employee matters

| • Investments in companies without workplace accident prevention policies |
| • Rate of accidents |
| • Number of days lost to injuries, accidents, fatalities or illness |
| • Lack of supplier code of conduct |
| • Lack of grievance/complaints handling mechanism related to employee matters |
| • Insufficient whistleblower protection |
| • Incidents of discrimination |
| • Excessive CEO pay ratio |

Human rights

| • Lack of a human rights policy |
| • Lack of due diligence |
| • Lack of processes and measures for preventing trafficking in human beings |
| • Operations and suppliers at significant risk of incidents of child labour |
| • Operations and suppliers at significant risk of forced or compulsory labour |
| • Number of identified cases of severe human rights issues and incidents |
## PAI Indicators according to Draft RTS

All mandatory indicators (Table 1) + 1 voluntary indicator (Table 2) + 1 voluntary indicator (Table 3)

### Table 1: Mandatory

#### Indicators applicable to investments in sovereigns & supranationals

- **Environmental**
  - Green house gas intensity

- **Social**
  - Investee countries subject to social violations

#### Indicators applicable to investments in real estate assets

- **Fossil fuels**
  - Exposure to fossil fuels through real estate assets

- **Energy efficiency**
  - Exposure to energy-inefficient real estate assets

### Table 2: Voluntary

#### Indicators applicable to investments in sovereigns & supranationals

- **Green securities**
  - Share of bonds not certified as green under a future EU act setting up an EU Green Bond Standard

#### Indicators applicable to investments in real estate assets

- **Emissions**
  - Green house gas emissions

- **Energy consumption**
  - Energy consumption intensity

- **Waste**
  - Waste production in operations

- **Resource consumption**
  - Raw materials consumption for new construction and major renovations

- **Biodiversity**
  - Land artificialisation

### Table 3: Voluntary

#### Indicators applicable to investments in investee companies

- **Anti-corruption and anti-bribery**
  - Lack of anti-corruption and anti-bribery policies
  - Cases of insufficient action taken to address breaches of standards of anti-corruption and anti-bribery
  - Number of convictions and amount of fines for violation of anti-corruption and anti-bribery laws

#### Indicators applicable to investments in sovereigns & supranationals

- **Social**
  - Average income inequality score
  - Average freedom of expression score

- **Human rights**
  - Average human rights performance

- **Governance**
  - Average corruption score
  - Non-cooperative tax jurisdictions
  - Average political stability score
  - Average rule of law score
Amid all the details of SFDR implementation, Fund Managers and Investment Firms are well advised not to lose sight of the big picture. The SFDR is only one element of the EU Commission’s Sustainable Finance Strategy, which will be renewed in 2021 to align with the EU Commission’s ambitious Green Deal to make the EU a climate-neutral continent by 2050.69

Policymakers and supervisors in many EU countries share the EU Commission’s focus on sustainable finance. As an example, according to AMF, one of the top priorities of the 2021 supervisory program will be to speed up the transition to sustainable finance and move towards quality non-financial disclosure.70 With regard to climate change, AMF has been entrusted with a broad mission to monitor the quality of information provided by Fund Managers in the Loi PACTE and has set up a dedicated team for this purpose.71 The Spanish CNMV has created a dedicated internal committee that coordinates all activities with regard to sustainable finance.72 Italy has set up its own National Resilience and Relaunch Plan73 which aims, inter alia, at promoting circular economy investment and emissions reduction in line with the Green Deal, and CONSOB has formed a Steering Committee whose task it will be to monitor the evolution of ESG regulations, analyse specific sustainable finance issues such as the issue of green bonds and develop standards on sustainable finance and accounting.74 In its National Plan for Sustainable Development75 focused on the UN Agenda 2030,76 Luxembourg provides ten priority fields of action for public institutions, businesses and NGOs. Based on this plan, Luxembourg has just launched its Sustainable Finance Strategy.77 Moreover, Luxembourg is the first EU country to launch a sustainability bond framework meeting the Green, Social and Sustainability Bonds principles of the International Capital Markets Association.78 Similar to France, Ireland has identified sustainable finance as one of its top priorities and opportunities within its Finance 2025 strategy.79
EU Sustainable Finance Strategy

2018 Action Plan on Financing Sustainable Growth | Renewed Sustainable Finance Strategy 2021

Common language | Regulate market for ESG data, research and ratings
Unified EU classification system to define what is sustainable (Taxonomy Regulation (EU) 2020/852 covers 6 environmental objectives, draft Delegated Regulation including annexes with technical screening criteria published in November 2020)
Ensure good quality, reliable and comparable ESG data, research and rating providers (current pressure by ESMA and industry associations)

Labelling and benchmarks
Allowing investors to identify and assess ESG investments:
EU Ecolabel for financial products: 3rd draft criteria published in October 2020, final draft criteria to be expected in April 2021, adoption of Commission Decision planned for Q4 2021
Climate Benchmarks Regulation (EU) 2019/2089

GREEN LABELS | CLIMATE BENCHMARKS

INTEGRATION OF AND DISCLOSURE ON ESG IN INVESTMENT
Duty for financial services providers to consider ESG in investment processes and disclose on sustainability risks and ESG objectives for insurance, investment and financial services products (Sustainable Finance Disclosure Regulation (EU) 2019/2088, final report on Draft RTS published in February 2021)

Investment advice | Distribution
Suitability assessment for insurance products, investment funds and other financial products must take into account customer sustainability preferences (to be incorporated in IDD | MiFID II, drafts published in June 2020, final drafts expected for 2021)

Risk management | Favorable treatment of sustainable investments
Integrate climate risk into insurers’, banks’ and asset managers’ risk management (to be incorporated in Solvency II Delegated Regulation, draft Delegated Regulation published in June 2020, consultation in 2020)
Recalibrate capital requirements provisions for sustainable investments:
MiFID II: final drafts expected for 2021

Non-financial reporting and accounting treatment of sustainable investments
EU Commission Guidelines on Reporting Climate-Related Information amended in June 2019 with regard to climate-related information
EU Commission and European Financial Reporting Advisory Group address accounting treatment of sustainable investments under IFRS with IASB
ESG as disruptor and gamechanger for the EU fund industry

Against this backdrop, ESG is not just another compliance exercise. Placing sustainability wording in your fund documentation and on your website to "tick the box" is necessary. But it will not be sufficient in the long term to align your business to the changing market and regulatory conditions created by the fundamental shift in business and society required to tackle climate change and ESG issues. This is not a purely European topic; across the globe policymakers and supervisors have identified climate change, and more broadly, ESG to be the main challenge of this decade.

Understandably, this is not an easy task considering the current "jungle" of ESG rules, initiatives and discussions. But Fund Managers and Investment Firms can be guided by three main questions:

• Which Sustainability and ESG issues are material to my business?

• Which are my Sustainability and ESG objectives?

• Which steps will it take to apply and follow through on these objectives in my day-to-day business?

The implementation of the SFDR requires Fund Managers to think about sustainability risks and the impact of their investment decisions and therefore should be approached strategically as an opportunity to start with this exercise.
SFDR and the global disclosure landscape

Disclosure and reporting on sustainability and ESG impacts of business activities are the foundation of any sustainable business strategy. While they do not by themselves make markets and businesses more sustainable, they create the required transparency allowing businesses to rethink their strategies for the future and enter the transformation process. The global reporting landscape is however still very fragmented and characterised mainly by private initiatives.

**PRINCIPLES-BASED GUIDANCE ON “HOW” INFORMATION IS STRUCTURED AND WHICH BROAD TOPICS SHOULD BE COVERED**
- Carbon Disclosure Project (CDP)
- Climate Disclosure Standards Board (CDSB)
- International Integrated Reporting Council (IIRC)
- EU Non-financial Reporting Directive (NFRD)
- Task Force on Climate-related Financial Disclosures (TCFD)
- EU Sustainable Finance Disclosure Regulation (SFDR)

**SPECIFIC, REPLICABLE AND DETAILED REQUIREMENTS FOR “WHAT” SHOULD BE REPORTED FOR EACH TOPIC**
- Global Reporting Initiative (GRI)
- ISO (International Organization for Standardization) (e.g. ISO 26000: Social Responsibility, ISO 20400: Sustainable Procurement)
- Stakeholder Capitalism Metrics (WEF)
- EU SFDR Regulatory Technical Standards (RTS)
- EU Taxonomy Regulation
- EU NFRD Guidelines on Reporting Climate-Related Information

**DEFINITIONS AND FORMULAS HOW TO “MEASURE” PERFORMANCE ON EACH TOPIC**
- Stakeholder Capitalism Metrics (WEF)
- ISO Standards, e.g. ISO/TS 14067: Carbon Footprint
- EU SFDR Regulatory Technical Standards (RTS)
- EU Taxonomy Regulation (draft) Delegated Regulation (including annexes)
- EU NFRD Guidelines on Reporting Climate-Related Information

Regulation in motion

SFDR and the global disclosure landscape
This can be a puzzling mixture for which the *Financial Times* has used the term “alphabet soup.”

The EU has made a head start in ensuring transparency and creating a level playing field for Fund Managers and other financial industry participants. The SFDR and the Taxonomy, together with the review of the NFRD, will create the first binding cross-border framework for ESG disclosure and reporting, including clear ESG metrics for the Taxonomy’s six environmental objectives. Certainly a big and challenging task for the EU fund industry – but if played well, it is also a unique chance to attract money and customers across the globe with the ever-accelerating demand for more sustainable investments.

*From January through November 2020, investors in mutual funds and ETFs invested $288 billion globally in sustainable assets, a 96% increase over the whole of 2019. I believe that this is the beginning of a long but rapidly accelerating transition – one that will unfold over many years and reshape asset prices of every type. We know that climate risk is investment risk. But we also believe the climate transition presents a historic investment opportunity.*

Larry Fink, CEO of BlackRock

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**GOAL 13:**

Take urgent action to combat climate change and its impacts.
How we can help

Our sustainability and ESG offering – from regulatory compliance to future sustainability strategy

In the short term and to help you deal with rapidly approaching regulatory deadlines, we can help you:

• **get clarity** on regulation and technical standards and provide market insights based on our credentials with your peers as well as proactive engagement with key industry bodies;

• **work out disclosures** that are relevant to your business and compliant with the evolving regulatory requirements;

• **perform a gap analysis** to benchmark your as-is status against your to-be status; and

• **educate your teams** on the SFDR and the EU Sustainable Finance Strategy through a sector-driven approach.

Because sustainability and ESG have become a board-level strategic issue and requires a broader, forward-looking approach, we can also help you:

• **engage with your board** and facilitate awareness raising sessions with senior-level executives based on our familiarity with global sustainability frameworks, standards and initiatives;

• **identify sustainability and ESG topics** relevant for your business, achieve clarity on your objectives and set up an action plan tailored to your business;

• **put in place a sustainability and ESG governance structure** with clear indicators, reporting lines and a framework of policies and procedures encompassing the full spectrum of the sustainability agenda;

• **implement your action plan** throughout your business lines from a legal and advisory perspective;

• **manage your sustainability and ESG projects**, including change management and training, and pilot cross-functional teams across multiple jurisdictions;

• **carry out automated ESG due diligence** as part of your transactions; and

• **structure and set up ESG products** and services you intend to offer going forward.
How we can help you make a difference

Industry insights
We maintain an ongoing ESG dialogue with major industry players and we contribute to ESG related initiatives via industry associations, thought leadership and pro bono cooperation.

Quality and Expertise
We work with a community of skilled and experienced lawyers including many former inhouse counsel, supervisors and other industry experts who bring the expertise and seniority to properly address your needs.

From promise to action
We help you to turn general principles and objectives into a business-focused ESG action strategy and to embed ESG in the DNA of your business.

Making business better

Holistic approach
We understand the disruptive power and chances of ESG and consider ESG from all angles relevant for your business.

Skilled in law and business
We are experienced in dealing with novel and work-in-progress legal frameworks and know how to break down and apply them pragmatically to your business.

Global and local
We know what is relevant in your country and industry and we connect this to global frameworks and initiatives on ESG (e.g. PRI, TCFD, GRI, Net-Zero Asset Owner Alliance).
## Key contacts

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## Glossary of main terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AFM</strong></td>
<td>Dutch financial supervisory authority (Autoriteit Financiële Markten)</td>
</tr>
<tr>
<td><strong>AIFM(S)</strong></td>
<td>AIF manager according to Art. 4 para. 1 lit. (b) AIFMD</td>
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<tr>
<td><strong>AIFS</strong></td>
<td>EU alternative investment funds according to Art. 4 para. 1 lit. (a) AIFMD</td>
</tr>
<tr>
<td><strong>AMF</strong></td>
<td>French financial supervisory authority (Autorité des marchés financiers)</td>
</tr>
<tr>
<td><strong>BAFIN</strong></td>
<td>German financial supervisory authority (Bundesanstalt für Finanzdienstleistungsaufsicht)</td>
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<tr>
<td><strong>BVI</strong></td>
<td>German Investment Fund Association (Bundesverband Investment und Asset Management)</td>
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<tr>
<td><strong>CNMV</strong></td>
<td>Spanish Securities Market Commission (Comisión Nacional de Mercado de Valores)</td>
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<tr>
<td><strong>CONSOB</strong></td>
<td>Italian financial supervisory authority (Commissione Nazionale per le Società e la Borsa)</td>
</tr>
<tr>
<td><strong>CSSF</strong></td>
<td>Luxembourg financial supervisory authority (Commission de Surveillance du Secteur Financier)</td>
</tr>
<tr>
<td><strong>DARK GREEN FUND</strong></td>
<td>Fund having a sustainable investment objective according to Art. 9 SFDR</td>
</tr>
<tr>
<td><strong>DRAFT RTS</strong></td>
<td>Draft regulatory technical standards to SFDR in the final report published by the ESAs on 4 February 2021</td>
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<tr>
<td><strong>EFAMA</strong></td>
<td>European Fund and Asset Management Association</td>
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<tr>
<td><strong>ESAS</strong></td>
<td>European Supervisory Authorities</td>
</tr>
<tr>
<td><strong>ESMA</strong></td>
<td>European Securities and Markets Authority</td>
</tr>
<tr>
<td><strong>ESG</strong></td>
<td>Environmental, social and governance aspects of sustainable business</td>
</tr>
<tr>
<td><strong>FUND MANAGERS</strong></td>
<td>Managers of AIFs or UCITS</td>
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<tr>
<td><strong>FUNDS</strong></td>
<td>AIFs and UCITS</td>
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<tr>
<td><strong>LIGHT GREEN FUND</strong></td>
<td>Fund promoting environmental or social characteristics according to Art. 8 SFDR</td>
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<td><strong>PAI</strong></td>
<td>Principal adverse impacts on sustainability factors according to Art. 4 SFDR</td>
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<tr>
<td><strong>UCITS</strong></td>
<td>Undertakings for collective investment in transferable securities according to Art. 1 UCITSD</td>
</tr>
</tbody>
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Footnotes

16. CONSOB, Richiamo di attenzione n. 1/20 del 12-3-2020, see https://www.consol.it/documents/46180/46181/ra_2020_01_pdf/9433eda6-9a4e-4d71-9673-0e074f5a0817
21. Securities, money-market instruments, investment funds, derivatives, contracts for difference and emissions allowances, see Annex I. Section C MiFID II
22. Since SFDR applies based on the type of financial product offered, a non-EU AIFM managing an EU AIF and providing portfolio management or investment advice to an EU AIF would have to fulfil the Fund Manager obligations and the obligations as financial adviser, see recital 7 SFDR
23. See recital 111 and Art. 42 MiFID II
25. As defined in Art. 3 para. 2 AIFMD
27. See the list of pre-contractual information under Art. 6 para. 3 SFDR
28. [Link to source] See Art. 4 para. 1 and para. 3 Draft RTS

29. See Art. 4 para. 3 lit. (a) (i) Draft RTS

30. See Art. 4 para. 3 lit. (a) (ii) Draft RTS

31. [Link to source] See recital 6 Draft RTS

32. [Link to source] See recital 7 Draft RTS

33. Applicable to Fund Managers via Art. 4 para. 3 lit. (b) draft RTS

34. [Link to source] See recitals 13 and 39 and Art. 5 para. 2, Art. 33 para. 2 and Art. 46 para. 2 draft RTS

35. [Link to source] See recital 5 Draft RTS

36. [Link to source] See recital 4 Draft RTS

37. [Link to source] See recital 8 Draft RTS

38. [Link to source] See recital 15 SFDR

39. [Link to source] See recital 22 SFDR

40. [Link to source] Similar to No. 78 of the ESMA Guidelines on sound remuneration policies under the AIFMD, see [Link to source]

41. [Link to source] See recital 10 SFDR

42. [Link to source] For example see Annex II No. 1 (a) AIFMD and No. 77 et seq. of the ESMA Guidelines on sound remuneration policies under the AIFMD, see [Link to source]

43. [Link to source] See recital 12 SFDR

44. [Link to source] See recital 17 SFDR

45. [Link to source] See recital 18 SFDR

46. [Link to source] See recital 19 SFDR

47. [Link to source] See recital 20 SFDR

48. [Link to source] See recital 21 SFDR

49. [Link to source] See recital 22 SFDR

50. For example see Art. 23 para. 1 lit. (a) AIFMD

51. [Link to source] See recital 23 SFDR

52. [Link to source] See recital 24 SFDR

53. [Link to source] See recital 25 SFDR

54. [Link to source] See recital 26 SFDR

55. [Link to source] See recital 27 SFDR

56. [Link to source] See recital 28 SFDR

57. [Link to source] See recital 29 SFDR
Footnotes

58. EFAMA response to ESAs consultation on draft RTSs under SFDR, p.16, see http://www.efama.org/Publications/Public/20-4050-EFAMA%20response%20to%20ESAs%20consultation%20on%20draft%20RTSs%20under%20SFDR.pdf; Invest Europe’s Response to the ESAs Joint Consultation Paper concerning ESG disclosures, p. 4, see https://www.investeurope.eu/media/3341/20200901-esas-consultation-rts-sustainability-disclosures_response_for-website.pdf


60. Roß/Scherber, Nachhaltige Finanzinstrumente – ein neuer Produkttyp für den europäischen Finanzmarkt, RdF 2020, 250, 254

61. See recital 21 Draft RTS

62. See also recital 33 Draft RTS

63. EFAMA response to ESAs consultation on draft RTS under SFDR, p. 16, see http://www.efama.org/Publications/Public/20-4050-EFAMA%20response%20to%20ESAs%20consultation%20on%20draft%20RTSs%20under%20SFDR.pdf


65. See also recital 26 Draft RTS on monitoring and control mechanisms

66. See recital 26 SFDR


68. See recital 6 Draft RTS


71. Loi du 22 mai 2019 relative à la croissance et la transformation des entreprises


74. https://www.consofb.it/documents/46180/46181/pa1921.pdf/3a2f91c1-7541-4c2c-b2b8-a21854e159

75. https://cooperation.gouvernement.lu/dam-assets/politique-cooperation-action-humaine/documents-de-reference/strat%C3%A9gie/Strat%C3%A9gie-MAEE-EN.pdf

76. https://sdgs.un.org/2030agenda


84. See FT Moral Money of 6 October 2019 “Companies struggle to digest ‘alphabet soup’ of ESG arbiters.” https://on.ft.com/36N9wjX (for subscribers)

