BVK Kompakt

Update on SFDR and Taxonomy

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17 February 2022

#506.810.334

Scope

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- Fully authorised EU AIFMs
- Sub-threshold AIFMs
- Non-EU AIFMs / AIFs marketed in the EU

SFDR and Taxonomy: Key Dates

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Step	Date
SFDR level 1 in effect SFDR level 2	10 March 2021 1 January 2023
EU Taxonomy applies to specified types of investment that contribute to the climate change mitigation and adaptation environmental objectives.	1 January 2022
SFDR Article 8 and Article 9 disclosure and reporting templates apply.	1 July 2022
EU Taxonomy applies to specified types of investment that contribute to environmental objectives: water and marine resources, transition to circular economy, pollution prevention and control and protection and biodiversity objectives .	1 January 2023
First annual report published by fund in scope of Article 8 with reporting in form for SFDR template.	To be confirmed, depending on fund's first financial reporting period.

SFDR

The Four Tiers of ESG Disclosure under SFDR

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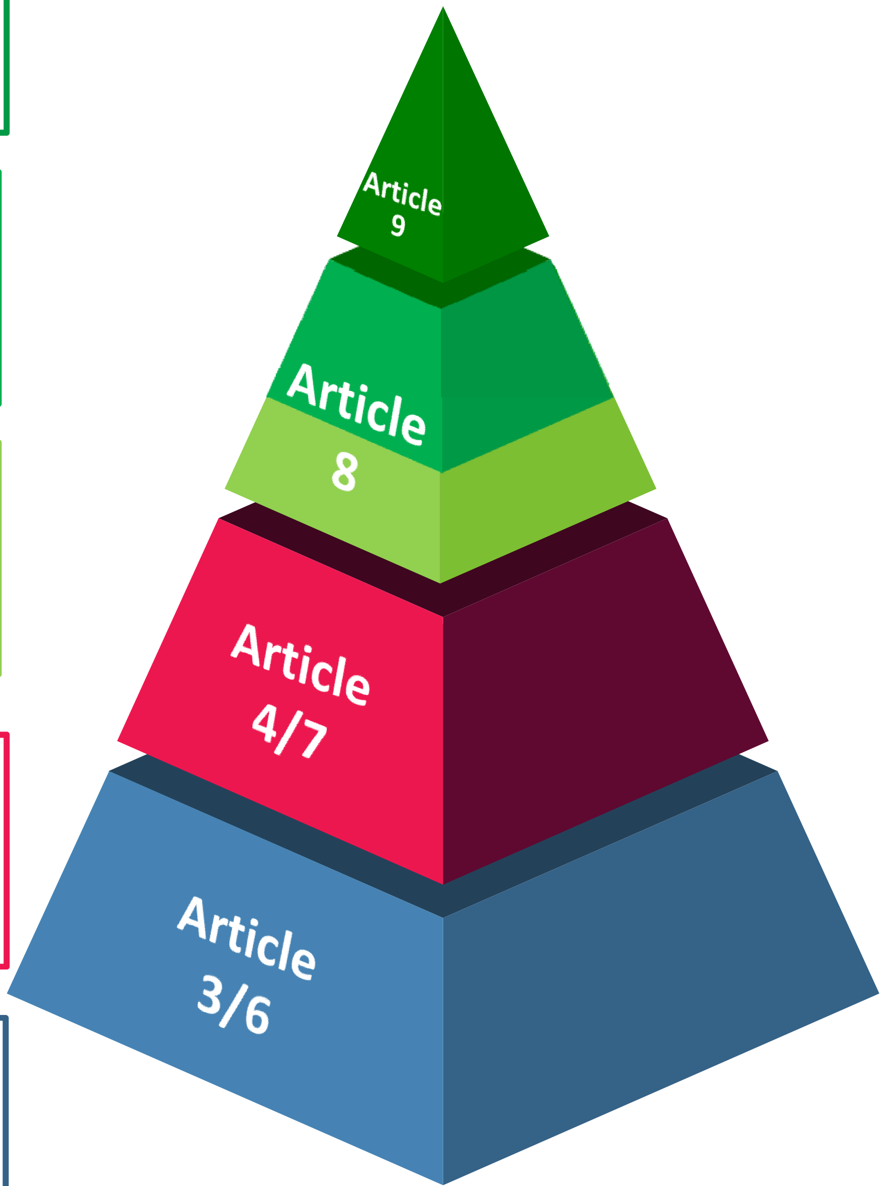
Article 9 Funds: Products that have "sustainable investments" as core objective.

Article 8 Funds: Products that promote specific "environmental or social characteristics" for part of their investments and also make "sustainable investments".

Article 8 "Light" Funds: Products that promote specific "environmental or social characteristics" for part of their investments but do not make "sustainable investments".

Article 4 Funds: Firms that consider "principal adverse impacts" of the investments on sustainability - externalities for <u>all</u> their products. Opt-out available to smaller sponsors.

Article 3 Funds: Firm to integrate "sustainability risks" that could cause a material negative effect on the investment's value.



Article 9 Funds: Product level disclosure, with product level information on website.

Article 8 Funds: Product level disclosure, with product level information on website. Additional disclosure for "sustainable investments".

Article 8 "Light" Funds: Product level disclosure, with product level information on website.

Article 4/7 Funds: Firm (website) and product level disclosure.

Article 3/6 Funds: Firm (website) and product level disclosure. Substantially met through existing disclosure.

Summary of Sustainable Fund Classifications under SFDR

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Disclosure, compliance and operational obligations increase depending on the classification

Mainstream	Light Green	Mid Green/ Article 8+	Dark Green
SFDR: "Article 6"	**SFDR: "Article 8"**	**SFDR: "Article 8"**	**SFDR: "Article 9"**
Any product which is not light/mid or 8+/dark green (A8/9).	Products which "promote" environmental and/or social characteristics.	Products which commit to making (at least some) "sustainable investments".	Products which must invest exclusively in "sustainable investments".

What choices have your peers made?

Additional SFDR disclosure obligations: PPM, AIF annual report and website.

Taxonomy reporting?

How to Classify a Fund Under SFDR

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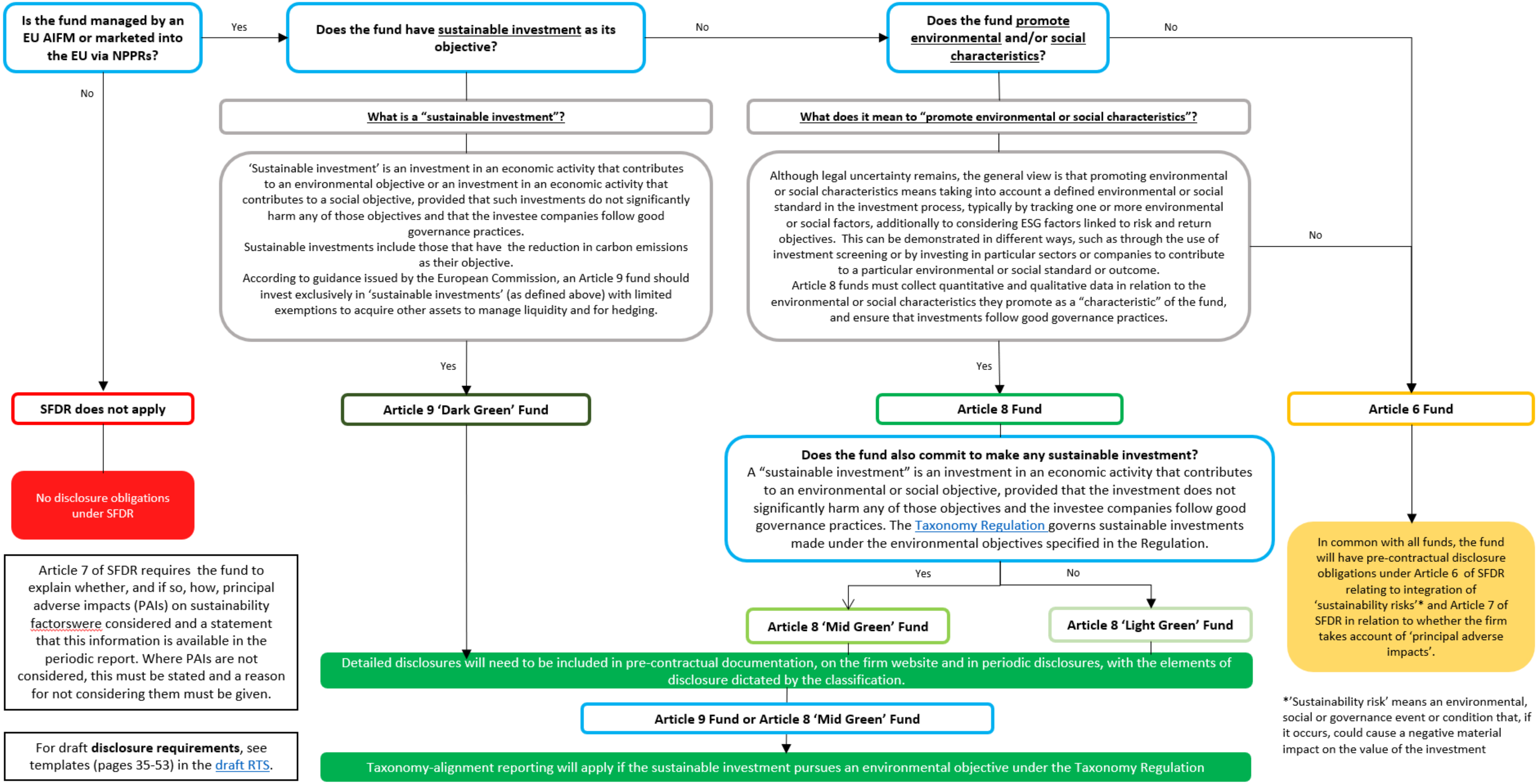
This chart, and in particular the disclosure obligations described, deals with SFDR product-level obligations and does not deal with **firm level** obligations which are additionally required for in-scope firms.



Legal Impact of SFDR: Disclosures

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SFDR Classification	Types of Disclosures	Public Website	Pre-Investment Docs	Periodic Reporting
Article 6 Mainstream	Qualitative disclosures re: integration of sustainability factors in investment decisions and potential impact of ESG factors on investment performance		✓	
Article 8 Light Green	Detailed disclosures using a template	✓	✓	✓
Article 8 + Mid Green	Detailed disclosures using a template Taxonomy alignment disclosure	✓	✓	✓
Article 9 Dark Green	Additional disclosures relating to impact metrics using a template Taxonomy alignment disclosure	✓	✓	✓

Frequent Questions

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- Scope of Art. 8?
  - Minimum requirements

    6 Is there a minimum of promoted/sustainable investments?
  - Qualification as Art. 8 without promoting environmental or social characteristics?
- Shall I use the pre-contractual disclosure templates?
  - Applicable not before January 2023
  - Prior guidance
  - Collection of data already now!
- Is Taxonomy mandatory for Art. 8?
- Is Taxonomy mandatory for Art. 9?

“Principal Adverse Impacts” (PAIs)

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6 Relevant for Art. 4 firms

	EU Firm Level Disclosure	Product Level Disclosure
Summary	• Flexibility to “opt in or out” / “comply or explain” for the majority of firms • “Opting in” requires firms to collect and report data points on the “principal adverse impacts” of their investment decisions - Report aggregated data for the entire portfolio (not just a single product) annually on a website - Material data collection exercise - Consultancy solutions are in their infancy	• Signify in pre-contractual disclosures: - Whether the firm has “opted in” at firm level and, if so, whether it also “opts in” to report PAI data in respect of this product - Or alternatively that the firm has opted out at firm level (and therefore may not opt in for this product) • If opting in, report PAI data periodically to investors
Deadline	**Has applied from 10 March 2021, but detailed PAI reporting for firms which “opt in” is not required until 2023**	**Has applied from 10 March 2021 for funds which “opt out”** **Funds which “opt in” must comply by 30 December 2022**

What are the Mandatory SFDR PAI KPIs?

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For firms that are required to report them, or that "opt in", there are 14 mandatory PAI KPIs (set out below) and many other "optional" KPIs

ENVIRONMENTAL MATTERS

1. Greenhouse gas emissions (Scope 1, 2 and from 1/1/2023 Scope 3)
2. Carbon footprint
3. GHG intensity of investee companies
4. Exposure to companies active in the fossil fuel sector
5. Share of non-renewable energy
6. Energy consumption intensity per high-impact climate sector
7. Activities negatively affecting biodiversity-sensitive areas
8. Emissions to water
9. Hazardous waste ratio

SOCIAL AND EMPLOYEE, RESPECT FOR HUMAN RIGHTS, ANTI-CORRUPTION AND ANTI-BRIBERY MATTERS

10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises
11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines for Multinational Enterprises
12. Unadjusted gender pay gap
13. Board gender diversity
14. Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)

ADDITIONAL MANDATORY KPIs FOR SOVEREIGNS AND SUPRANATIONALS

15. Investee countries subject to social violations

ADDITIONAL MANDATORY KPIs FOR REAL ESTATE ASSETS

16. Exposure to fossil fuels through real estate assets
17. Exposure to energy-inefficient real estate assets

Recent Developments?

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- ESMA recently published its Sustainable Finance Roadmap
  - there is a very definite statement of intent to address perceived green-washing concerns for Article 8 SFDR funds, and a reference to the Commission's planned work on "minimum sustainability criteria, or a combination of criteria for financial products that disclose under Article 8 of SFDR".

Taxonomy

Taxonomy Regulation - Overview

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Objective	• The EU Taxonomy is a complex and ambitious framework which establishes the criteria to determine whether an economic activity is "environmentally sustainable". • The EU Taxonomy is complementary to the SFDR and is intended to create a common language for environmentally sustainable investments across the EU.
Deadline	• Taxonomy Regulation applicable **January 2022** (in respect of the two climate change objectives) and **January 2023** (for other environmental objectives).
Requirement	• All "financial market participants" must disclose information on how their underlying investments meet the criteria for environmental sustainability, or state that they do not take account of the Taxonomy Regulation.
Future	• The EU Taxonomy will also impact an increasing number of large EU companies who will need to make similar disclosures and may to some extent narrow gaps. • Planned "social" Taxonomy and a possible "brown" Taxonomy.

Taxonomy Regulation – Reporting Trigger

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- Mainstream products (Article 6 SFDR) are **<u>not</u>** required to report Taxonomy alignment.
- Environmental Article 9 SFDR products **<u>are</u>** required to report Taxonomy alignment.
- The trigger for Environmental Article 8 SFDR products is **<u>unclear</u>**. Two trigger points:
  - Taxonomy reporting is only required for those Environmental Article 8 products which commit to making “sustainable investments”; or
  - Taxonomy reporting is required for any Environmental Article 8 product which makes a “sustainable investment”.

Taxonomy Regulation - Objectives

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- To be "taxonomy aligned" an investment must "**contribute substantially**" to at least one of the following six objectives:
  1. **climate change mitigation**
  2. **climate change adaptation**
  3. sustainable use and protection of water and marine resources
  4. transition to a circular economy
  5. pollution prevention and control
  6. protection and restoration of biodiversity and ecosystems

Yet to be finalised

- It must also "**do no significant harm**" to any other objective and comply with minimum social safeguards (separate test to DNSH test in SFDR).
- The Taxonomy is underpinned by detailed Technical Screening Criteria (TSC). The TSC in relation to objectives 1 and 2 have been published.
- These tests will need to be embedded in DD/monitoring processes for in-scope products.

The Taxonomy – How an Economic Activity Contributes to a Sustainable Environmental Objective

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Climate change mitigation	Climate change adaption	Use and protection of water & marine resources	Circular economy and waste prevention	Pollution prevention and control	Protection of healthy ecosystems

Economic activity is environmentally sustainable if:

- ✓ It substantially contributes to one or more of the six objectives.
- ✓ It does not significantly harm any of the six objectives (specified in the Technical Screening Criteria).
- ✓ It meets the Technical Screening Criteria.
- ✓ It complies with the minimum safeguards on social and governance aspects (ILO Declaration on Fundamental Principles and Rights at Work, International Bill of Human Rights, UN Guiding Principles on Business and Human Rights).

Technical Screening Criteria define specific economic activities (as further listed in Taxonomy) that make a substantial contribution to an environmental objective, the quantitative and qualitative threshold that the economic activity must pass and define the test for "do no significant harm" to any other environmental objective.

Final Technical Screening Criteria for climate change mitigation and adaptation published in April 2021 and apply in January 2022.
EU ongoing work for Technical Screening Criteria for other environmental objectives.

How to Calculate to What Extent the Investments Underlying the Financial Product Are Taxonomy-aligned

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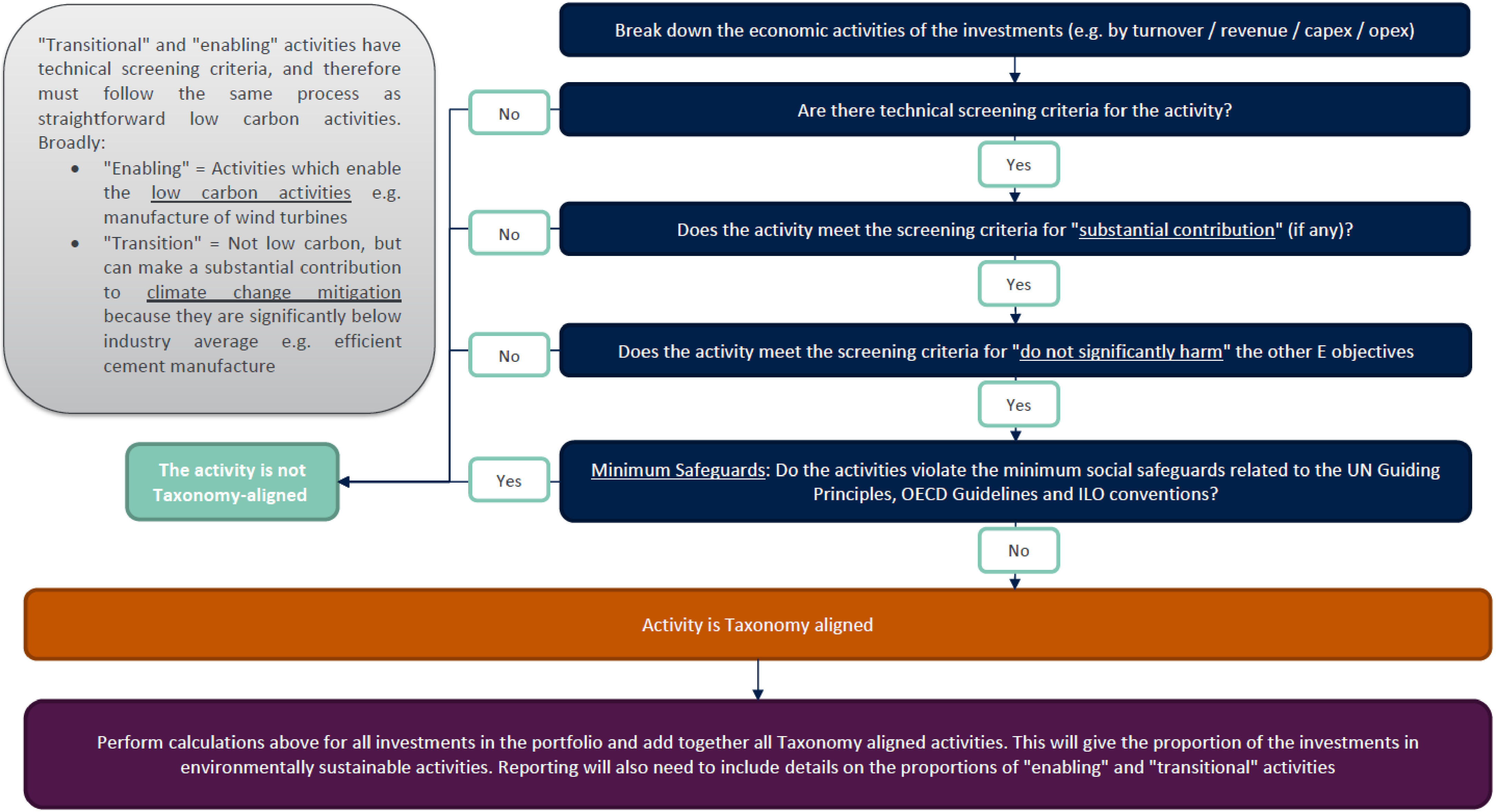

How the EU Taxonomy Fits in the Sustainable Finance Framework

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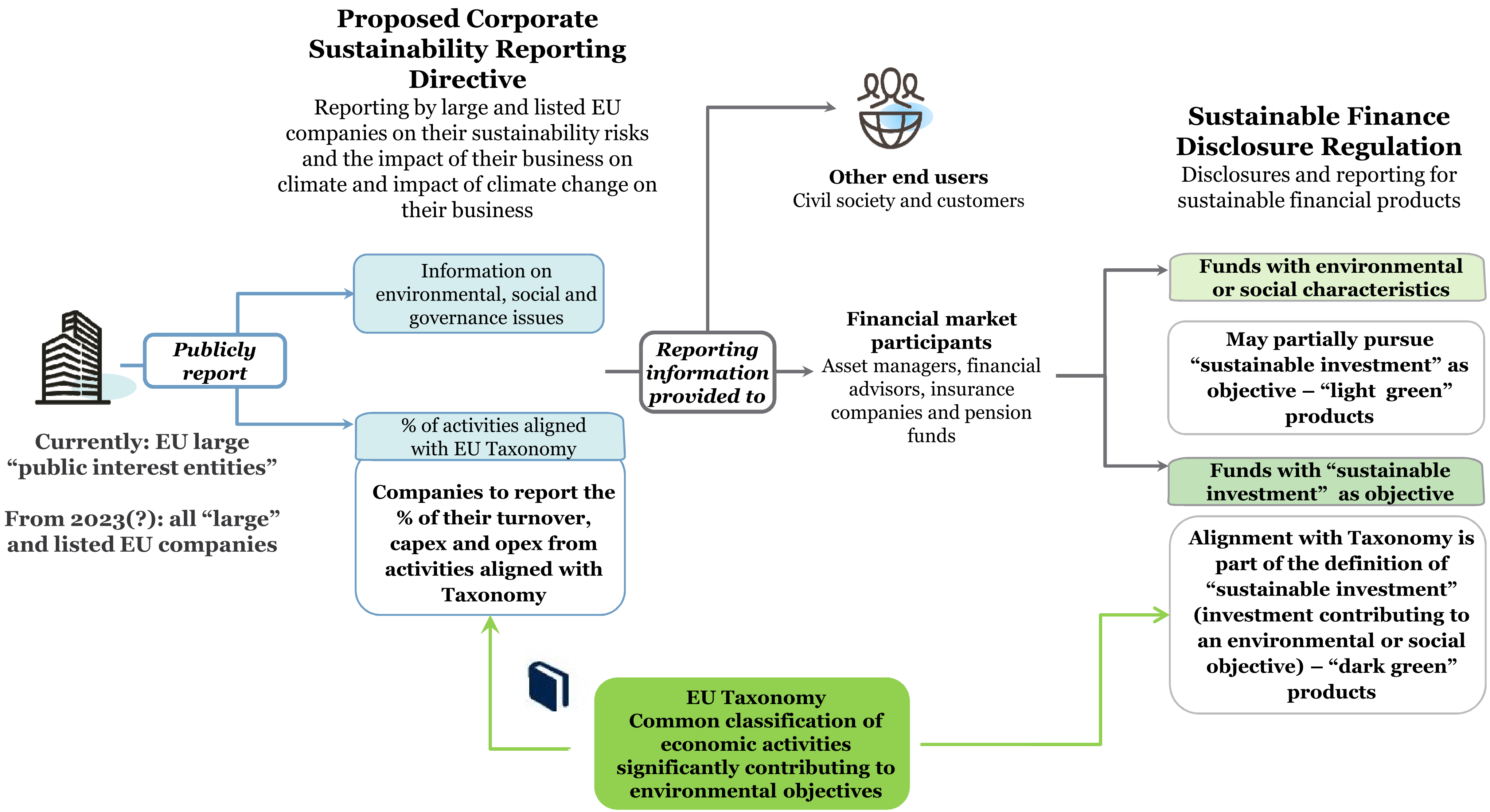

The Taxonomy - Coverage

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The Taxonomy does not cover all economic activities

Taxonomy covers 70 activities in 7 sectors (*based on NACE)*:

- AGRICULTURE AND FORESTRY
- MANUFACTURING
- ELECTRICITY, GAS, STEAM AND AIR CONDITIONING SUPPLY
- WATER, SEWAGE, WASTE AND REMEDIATION
- TRANSPORT
- INFORMATION TECHNOLOGIES
- BUILDINGS

Activities eligible to be in scope

Own performance	**Enabling activities**
Activity itself contributes to objective, such as wind energy generation and high carbon emitting manufacturing	Activity enables a contribution by another activity, such as wind turbine manufacture or energy storage

Technical screening criteria

Taxonomy aligned activities

If meets thresholds for eligibility criteria, will be taxonomy aligned

Technical screening criteria may become more stringent over time

If does not meet thresholds for eligibility criteria, will not be taxonomy aligned

Eligible for improvement measures

Checks Required for Taxonomy Alignment

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Taxonomy Alignment under the Technical Screening Criteria

- ✓ Identify the economic activities conducted by the company (e.g. power generation, energy intensive manufacturing or energy storage) that could be aligned.
- ✓ For each potentially aligned activity, verify whether the company meets the relevant technical screening criteria – e.g. electricity generation <100 g CO_2e/kWh.
- ✓ Verify that the "do no significant harm" criteria are met by the company.
- ✓ The basis of these checks will either be the company's own disclosures of Taxonomy alignment (if subject to sustainability reporting under the Non Financial Reporting Directive) or the fund's due diligence information derived from the company or data providers. No explicit requirement for external assurance or audit.
- ✓ Conduct due diligence to avoid any breach of the minimum social safeguards specified in the Taxonomy Regulation.
- ✓ Calculate proportion of alignment of investments with the Taxonomy and prepare disclosures at the investment fund level. For this purpose, debt and equity are treated in the same way. Note the future "EU Green Bond" standard, which are debt instruments that are used to finance Taxonomy compliant projects or economic activities.

Taxonomy – Minimum Social Safeguards

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- Principles for Responsible Business Conduct

Your Presenters

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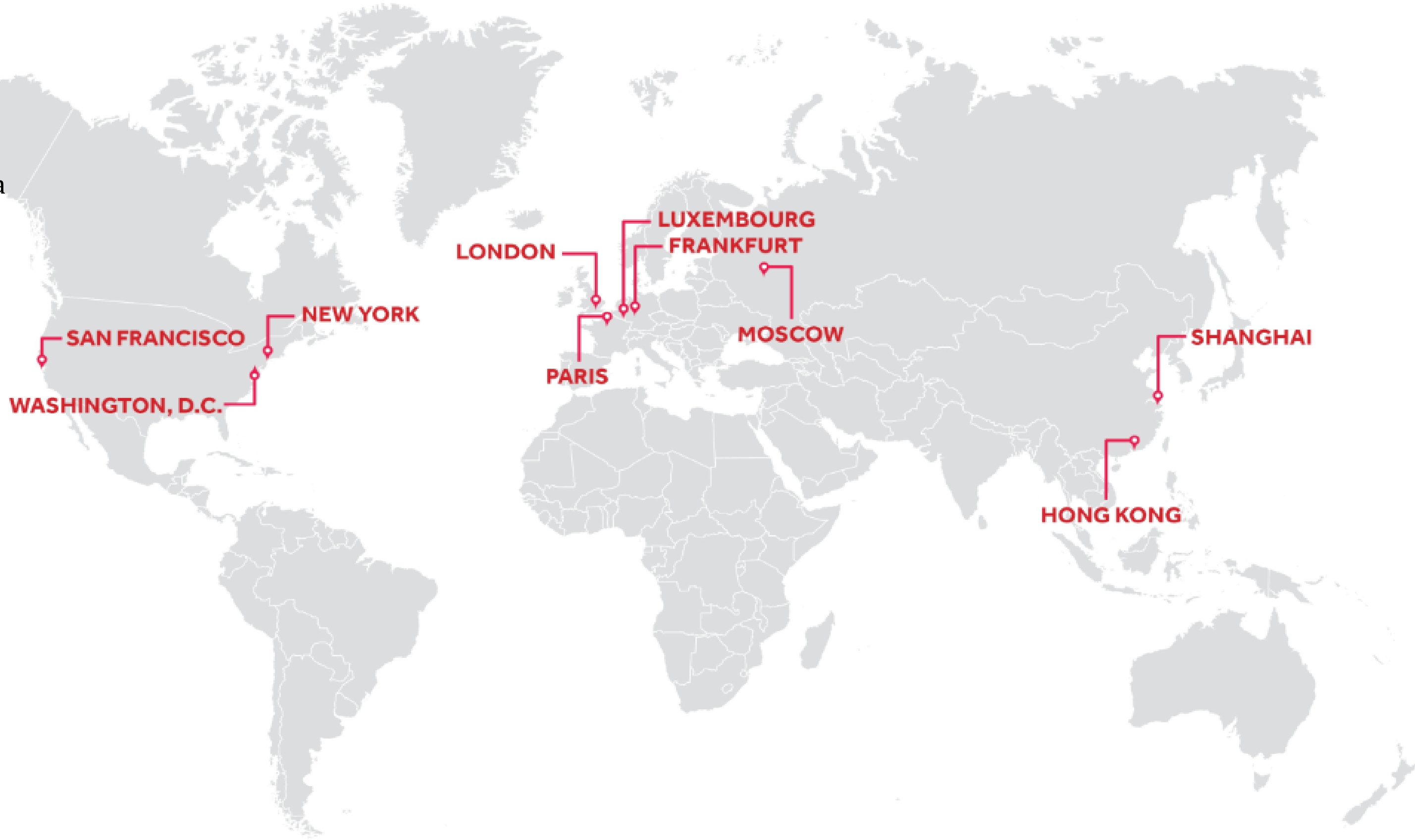

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