

Voluntary Disclosure of PAIs—European Supervisory Authorities Publish Annual Report

10 October 2023

On 28 September 2023, the European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority, together referred to as the “ESAs”) published a report (the “Report”) on how firms have disclosed information on “principal adverse impacts” (“PAIs”) under the Sustainable Finance Disclosure Regulation (the “SFDR”). The SFDR requires firms (also referred to as “FMPs”) above a certain size to publish information on their websites on their consideration of PAIs in the form of aggregated data across all their funds (and other financial products), and gives firms the option to include PAI information in fund-specific annual reports.

The Report contains observations by the ESAs and national competent authorities (“NCAs”) and gives recommendations to NCAs and the European Commission on good and bad practices.

Main Findings Outlined in the Report

The ESAs observed an overall improvement in the quality of information disclosed in relation to PAIs. More firms have published PAI disclosures, and such disclosures are also easier to find on their websites.

The Report states that firms should improve their explanations of why they do not consider PAIs, which the ESAs consider is often incomplete and/or not satisfactory. Specifically, the ESAs state that, for firms that opt out “*The ESAs do not consider [declarations that firms do not comply because they are under the 500 employees’ threshold or because of the current limitations on readily available data]*¹ to be a sufficient justification for explaining why the FMP does not consider the adverse impacts of its investment decisions and recommend supervisory follow-up to ensure appropriate understanding of the relevant provisions. At a minimum, the ESAs consider it best practice that FMPs should at least

¹ Explanatory note by Debevoise & Plimpton LLP.

indicate a target date for when they intend to start to consider PAI indicators.” In addition to that, the ESAs criticised that disclosures “were hidden under ‘required information’ or in the ‘download’ section” of FMPs’ websites and were therefore uneasy to find. While the Report does not clearly state where disclosures shall be put on the website, it is clear about the fact that all firm-level disclosures under the SFDR should be in one place.

The ESAs make limited comments about product-level disclosures of PAI considerations, as they have limited examples to comment on, and intend to address that in the future. Interestingly, the ESAs in that context confirm that the product-level disclosures of PAI considerations are voluntary. The ESAs also state that NCAs should step up their efforts to provide FMPs with guidance on how to comply with the disclosure obligation on PAI considerations at the product level, since it is said to be perceived “challenging” to make these disclosures.

Good and Bad Practices for Disclosures of PAI Considerations

In terms of guidance for firms, the ESAs provide examples of good and bad practices in the Report for disclosures of PAI considerations at both firm and product levels (please see the annex that contains a duplicate of the table provided in the Report—good practices are highlighted in green, bad practices are highlighted in red).

The Report contains examples that are assessed by the ESAs in categories of “dos” and “don’ts”. In particular, the ESAs expect firms not solely to refer to international initiatives (e.g., Net-Zero Asset Owner Alliance or UN Principles for Responsible Investments) in their statement or to justify their non-consideration of PAIs by reason of having fewer than 500 employees or a lack of clarity on calculation of PAIs. In fact, the ESAs expect FMPs to be detailed in their disclosures (e.g., through identification of actions to mitigate PAIs, a description of the methodologies and data used, and a summary of the engagement policy) and to describe how PAI considerations are shaped into the organisational policies and procedures.

The Report contains less guidance in terms of “dos” and “don’ts” for disclosures on PAI considerations on a product level. It is, however, said to be a good practice to reserve the publication of more information on product level after 30 June 2023, the date on which the first firm-level PAI statement was due. It is doubtful whether this information helps FMPs with the compliance of their financial products, since no guidance for the concrete content of the obligation is provided. It will therefore be interesting to see the successor of this Report next year that is said to be comprised of more information on product-level PAI disclosures.

Recommendations to NCAs and the European Commission

The Report further contains recommendations to NCAs and the European Commission based on its findings.

To the European Commission, the Report, *inter alia*, recommends reconsidering the different approaches to differentiate between FMPs in terms of proportionality at the threshold of 500 employees, and the ESAs are of the view that it should be dropped in favour of a criterion that considers the size of investments by FMPs. Also, it is recommended to restate the product-level disclosure into a “*comply or explain*” provision to ensure flexibility for FMPs.

To NCAs, the Report, among other things, recommends facilitating the exchange of best practices within the financial industry and also building a greater degree of its own competence for handling the SFDR and its obligations. In that context, the ESAs note that the terms “*consider*” and “*take into account*” have been confused by NCAs. “*Take into account*” shall only be used in the context of the “*do no significant harm*” principle that applies to sustainable investments under the SFDR and “*consider*” shall only be used for PAIs. Apparently, the ESAs consider “*take into account*” as a binding commitment not to cause any harm, whereas “*consider*” has the aim to prevent negative impacts. Even more concerning is that the Report encourages NCAs to use enforcement tools for FMPs that are still not compliant. Since the SFDR is obviously a topic of great interest on the European level, the likelihood of the use of such enforcement tools by NCAs should not be underestimated.

Annex²

Entity level disclosures – do’s and don’ts		
Issue	Example	ESA’s Assessment
Disclosure of due diligence	The statement includes a description of strategies for identifying and weighting key adverse impacts on sustainability factors, and an assignment of responsibility for implementation within organisational policies and procedures	Complete statement on due diligence and transparency policies

² The annex duplicates the tables on p. 9–12 of the Report with slight editorial amendments.

Entity level disclosures – do’s and don’ts		
Issue	Example	ESA’s Assessment
Detailed statement	The statement includes identification and prioritisation of PAIs, actions taken to mitigate such impacts, description of engagement policy, list of international standards respected and degree of alignment with the Paris Agreement, last date of update	PAI statement include details/ relevant information
Disclosure of due diligence	Adherence of the company and/or group to sustainability related international organisations and initiatives (e.g., Net-Zero Asset Owner Alliance, Climate Action 100+, Principles for Responsible Investments)	The statement on disclosure of due diligence is not detailed/substantiated
Partial, voluntary disclosures	An FMP, while not falling directly under Article 4(1)(a), includes at group-level disclosures about adverse effects on sustainability in their investment decisions and assesses their impact on sustainability factors	FMPs deciding to consider PAIs at group level but not on a solo basis
Fewer than 500 employees	FMPs explaining that the rationale for not considering PAI was that they employ fewer than 500 employees	The ESAs believe that when FMPs do not consider any adverse impacts of investment decisions on sustainability factors, it is a good practice to include in the statement clear reasons for why they do not do so and information as to whether and when they intend to consider such adverse impacts
Lack of legal clarity and unclear procedures	FMPs referring to unclear procedures and lack of legal clarity to calculate PAI impact	The ESAs have provided numerous clarifications and responses to stakeholders’ queries to provide clarity to the market (including formulae in the JC 2023 09 consultation paper), and

Entity level disclosures – do’s and don’ts		
Issue	Example	ESA’s Assessment
		other FMPs have managed to calculate PAIs
Confusion between PAI statement and integration of sustainability risks	FMPs disclosing information about their policies on the integration of sustainability risks in their investment decision-making process	ESG/sustainability risks are not relevant for the purpose of PAI statement, and including such references in the PAI statement can result in confusion for investors
Absence of website	FMPs do not comply because they do not have a website	Disclosures under Articles 3–5 SFDR require a website
Different information for professional and retail investors	FMP providing different information for professional and retail investors	It is important that disclosures are the same for professional and retail investors, and that they are made easy and straightforward to find, irrespective of the type of investor

Product level disclosures – do’s and don’ts		
Issue	Example	ESA’s assessment
Indication of when more information will be provided	FMPs stating that they reserve the publication of further information on PAI consideration for their first PAI entity statement, due on 30 June 2023	The indication of when further information will be provided is an example of good practice, without prejudice to presenting the reasons for not considering the PAI on sustainability factors according to Article 7(2) SFDR
Confusion between Article 7 (1) SFDR and Article 7 Taxonomy Regulation	FMP confusing compliance under Article 7(1) SFDR with the statement under Article 7 Taxonomy Regulation (transparency of other	Those are very different as Article 7 Taxonomy Regulation relates to disclosures for products not taking into account the EU

Product level disclosures – do’s and don’ts		
Issue	Example	ESA’s assessment
	financial products, e.g., non-Article 8 and Article 9 SFDR products) in pre-contractual disclosures and periodic reports	criteria for environmentally sustainable economic activities

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Please do not hesitate to contact us with any questions.



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