ESAs Publish 2024 Report on Disclosure of PAIs Under the SFDR

18 November 2024

On 30 October 2024, the European Supervisory Authorities (the "ESAs") published the 2024 edition of their report on disclosure of principal adverse impacts ("PAIs") under the Sustainable Finance Disclosure Regulation (the "SFDR") (the "Report"). The SFDR contains the obligation for firms to state if they consider PAIs of investment decisions on sustainability factors and give information on PAIs in respect of all their investment portfolios. Smaller firms can opt out of this obligation.

The Report reflects the results of surveys by the ESAs of the views of national competent authorities in EU member states and contains a market overview, examples of good and bad disclosure practices and recommendations by the ESAs to the European Commission.

Please see our Debevoise In Depth on the ESAs' 2023 report here.

Market Overview for Firm-Level and Product-Level PAI Disclosure. The ESAs found that most asset managers have opted out of disclosing PAIs at the firm level. The Report states that approximately 40% of financial market participants voluntarily considering PAIs are asset managers, but the Report does not differentiate between different types of asset managers (such as between private and public equity managers), so it is likely that considering PAIs is still not as common for certain types of asset managers as the Report may suggest. On the other hand, the Report highlights the challenges faced by financial market participants in reporting on PAIs as (i) 10% of the surveyed financial market participants that opted to report on PAIs failed to provide information on most mandatory firm-level PAI indicators and (ii) lack of comparable and usable data still continues to be the biggest obstacle.

At the product level, the ESAs note that there are a high number of products that make PAI disclosures, although the managers of these products do not report on PAIs at the firm level. This indicates that many asset managers are not in a position to publish PAI information at the firm level, which requires reporting of aggregate PAI data for all funds, but are willing to report PAI information for those products for which they can obtain relevant data. However, the Report shows the proportion of all financial products in scope of SFDR that have made PAI disclosures but does not show the proportion of investment funds in scope of SFDR. It is therefore not clear whether PAI consideration on the product level has become more common for investment funds since 2023. In general, the lack of comparable and usable PAI data means PAI consideration is not market practice but only adopted by funds with strong sustainability-related ambitions.

In general, the Report does not address or mention the practice that many asset managers have adopted of reporting PAI data without giving information on how they have considered the data in their investment decisions. It could therefore be said that such disclosure is not an explicitly bad practice in the view of the ESAs.

Good and Bad Practices. The Report contains general observations on good and bad practices that relate to the disclosure of PAI data at the firm level and at the product level. There are not any new or surprising aspects. According to the ESAs, the disclosure should be clear (e.g. no abbreviations or firm-internal scoring without explanations) and easy to find (prominently displayed in the sustainability-related part of the firm's website). Information should not be generic but specific to the product or the firm, and there should be clear targets for the next reporting period to make it easier for investors to compare and track such targets.

Recommendations to the European Commission. Similar to the previous report, the ESAs state that the threshold for firms to consider PAIs at firm level for firms with "more than 500 employees" may not be a meaningful way to measure the extent to which investments may have principal adverse impacts on sustainability factors. The ESAs therefore suggest a threshold that is based on the size of the investments of a financial market participant—for an asset manager, its total assets under management.

Conclusion. Although the ESAs draw an overall positive conclusion with regard to PAI disclosure at the firm level and the product level in the Report, it is clear that consideration and disclosure of PAIs within the SFDR framework are still challenging for the asset management industry and specifically for private equity sponsors and funds. PAI data is currently more readily available for listed portfolio companies. With the Corporate Sustainability Reporting Directive (CSRD) applying to unlisted companies from 2025, more private fund sponsors will be able to consider and report on PAIs. In practice, it seems that firm-level PAI disclosure is less common (and deemed also less useful by many) than product-level disclosure/consideration.

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Please do not hesitate to contact us with any questions.

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