

EU Sustainability Disclosure Rules Impacting US, Asian and Other Non-EU Portfolio Companies

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At Cooley, we're increasingly speaking to clients in the US, Asia and elsewhere who are surprised by the intensity of environmental, social and governance (ESG) requests and covenants coming from their investors. Often these requests stem from the disclosure obligations imposed on investors by the European Union's Sustainable Finance Disclosure Regulation (SFDR). Don't be caught off guard – read our FAQ below.

1. What are the European financial sustainability disclosure rules?

The SFDR began to apply in 2021, although many of its obligations only became mandatory in 2022 and 2023. It requires fund managers and other financial market participants to make certain disclosures on their investment decisions and financial products, including the extent to which sustainability information is taken into consideration in investment decision-making and advisory processes.

One of the main objectives of the SFDR is to make it easier for investors to distinguish and compare financial products available in the EU.

2. To whom does the SFDR apply?

The scope of the SFDR is relatively broad, and most EU-based fund managers and investment advisers are required to comply. In addition, US, Asian and other non-EU fund managers or advisers that market financial products in the EU or provide portfolio management services or investment advice to EU funds need to comply with the SFDR for each product they market to their EU-based clients or EU funds they manage or advise.

3. How does the SFDR impact US, Asian and other non-EU portfolio companies?

Investors that are in scope of the SFDR are likely to require non-EU portfolio companies to provide information, and possibly also agree to ESG covenants, to enable them to comply with their own obligations under the SFDR. Clients increasingly are receiving hefty ESG data requests (e.g., for their emissions data or to explain how their activities are aligned with the 'EU taxonomy'). Clients also are receiving requests to perform certain duties, such as keeping emissions below a certain level, that ultimately can be traced back to investors who are implementing their own SFDR compliance processes.

4. What kind of information requests can non-EU portfolio companies expect?

To comply with the SFDR, investors and fund managers that are in scope will need certain information from their non-EU portfolio companies, even if those non-EU portfolio companies are not covered by the SFDR. In our experience, the information requested encompasses a variety of ESG indicators, such as:

- **Environmental** – This may include the carbon footprint of the portfolio company, share of nonrenewable energy consumption and nonrenewable energy production of portfolio companies from nonrenewable energy sources compared to

renewable energy sources, tonnes of emissions to water generated, and tonnes of hazardous or radioactive waste generated by portfolio companies.

- **Social** – This may include the share of investments in companies without workplace accident prevention policies, share of investments in portfolio companies without any supplier code of conduct (against unsafe working conditions, precarious work, child labour and forced labour), and share of investments in entities without a human rights policy.
- **Governance** – This may include the share of investments in portfolio companies involved in violation of the United Nations Global Compact principles or the Organisation for Economic Co-operation and Development (OECD) Guidelines on Multinational Enterprises.
- **EU taxonomy** – Portfolio companies often are asked to provide information on the extent to which their activities are aligned with the 'EU taxonomy', which is a classification system that establishes a list of activities qualifying as 'environmentally sustainable' to the EU.

5. What disclosures are required from non-EU fund managers?

Non-EU fund managers are required to make fund-level disclosures in respect of funds that they market in the EU, or to which they provide investment advice or portfolio management services. Certain exemptions apply – e.g., funds selling to EU investors by reverse solicitation generally only will be exempt from the disclosure requirements.

We've outlined some types of disclosures required of non-EU fund managers with funds covered by the SFDR below.

Pre-contractual disclosures

These include explanations of whether and how a financial product considers principal adverse impacts (PAIs) on sustainability factors. Additional pre-contractual disclosure obligations apply to financial products that promote environmental or social characteristics (sometimes called Article 8 funds or 'light green' funds), and financial products that have sustainable investment as their objective (Article 9 funds or 'dark green' funds).

Periodic reports

These include descriptions of the way sustainability risks are integrated into their investment decisions and the results of the assessment of the likely impacts of sustainability risks on returns of their financial products. Certain fund managers also will have to include in their periodic report an explanation of whether and, if so, how the financial product considers PAIs on sustainability factors. Again, additional disclosure obligations apply to light and dark green funds.

Website disclosures

These include, for light green funds, a description of the environmental or social characteristics of the product and, for dark green funds, the sustainable investment objective of the product.

The European Commission has adopted [Regulatory Technical Standards](#) that provide templates for pre-contractual and periodic disclosures.

6. Are there any changes on the horizon?

The European authorities are currently [consulting on the review of EU Regulatory Technical Standards](#), which would have the effect of expanding the SFDR disclosure framework. This could involve, for example, extending the list of social indicators for PAIs and amendments on greenhouse gas (GHG) emission reduction targets. The consultation also aims to address issues with the workability of the SFDR, such as simplification of the templates. Feedback is open until 4 July 2023.

On 13 June 2023, the European Commission proposed a [sustainable finance package](#) that would introduce the

following new measures:

- A proposed regulation on ESG ratings to increase transparency requirements for ESG ratings, with the aim of enabling investors to make better-informed investment decisions.
- The adoption of a second EU Taxonomy Delegated Act that would set the criteria for 'environmentally sustainable' activities connected to the following objectives: sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. This is expected to be adopted shortly and will apply from January 2024.

7. What other ESG disclosures are required in the EU?

In addition to the SDFR, there is a new law in the EU called the [Corporate Sustainability Reporting Directive \(CSRD\)](#), which requires listed and non-listed companies, including US, Asian and other non-EU parent companies that meet the thresholds, to report on a whole range of ESG metrics, such as climate, pollution, their own workforce, workers in the value chain and business conduct. Financial market participants and financial advisers may be subject to both disclosure regimes, unless they are explicitly exempted (e.g., alternative investment funds are exempted from the CSRD reporting).

Companies in scope of the CSRD also will need to disclose information on how and to what extent their activities are associated with economic activities that qualify as 'environmentally sustainable' under the EU taxonomy.

For more information, please contact a member of Cooley's ESG & sustainability advisory team.

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