SFDR subsidiary ESG disclosures: ESMA clarifications

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The European Securities and Markets Authority (ESMA) came out with clarifications around draft RTS under SFDR on 2 June ("Clarifications on the ESAs’ draft RTS under SFDR", JC 2022-21, 2 June 2022). For the purpose of some earlier AFII work where we have found financing vehicles/subsidiaries of excluded companies to be included in ESG indices, we would particularly like to draw attention to bullet 14 of the ESMA text:

"14. Where the investee company is a holding company, collective investment undertaking or special purpose vehicle, information about the adverse impacts of the investment decisions of those companies could look through to the individual underlying investments of those companies and consider the total adverse impacts arising from them."

Our interpretation is that, as is quite common in fixed income markets, the issuing entity of a bond should be connected with the core activities of the underlying/parent company. For example, the Luxembourgian SPV EIG Pearl1 which arguably holds a subsidiary relationship to Saudi Aramco (ARAMCO), should in our view be considered as ARAMCO in terms of looking at adverse impacts for purposes of SFDR alignment.

[continued] "Where such information is not available, in order to be able to fulfil the disclosure requirement for those investments, the RTS provided that the section should also contain details of the best efforts used to obtain the information either directly from investee companies, or by carrying out additional research, cooperating with third party data providers or external experts or making reasonable assumptions".

Our understanding of this text is that an investor/investment manager is required (“best efforts”) to investigate the actual relationships if data is missing. For example, our interpretation of this is that if there is no ESG rating on the issuer SUEK Securities DAC2, the investor should make a best effort to understand if the issuer is related to Russia’s biggest thermal coal miner JSC SUEK.

We believe these clarifications are useful to avoid circumvention, through use of complex financing structures, of certain end investors’ sustainability criteria.

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1 EIG Pearl is a 49% owner of Arabian Oil Pipeline Company, which in turn is 51% owned by Saudi Aramco. The company is a lease-lease-back vehicle for ARAMCO’s oil pipeline network. EIG Pearl issued inaugural bonds in January 2022, and those bonds are constituents of some ESG indices that at the same time are excluding ARAMCO. Refer to: “Oil, gas and bond pipelines: the case of Aramco/EIG/BLK”, AFII, 5 Feb 2022. “New EIG/Aramco bonds in ESG indices: EOM flow risks”, AFII, 15 Feb 2022. We selected the Aramco transaction as #4 in “Notable fixed income fossil funding deals 2021”, AFII, 21 Dec 2021.

2 We commented on this situation in “ESG Bond ETFs: Passive aggressive investing”, AFII, 17 May 2022.
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