SFDR subsidiary ESG disclosures: ESMA clarifications

Ulf Erlandsson(*); Stéphanie Mielnik, CFA

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 Pearl[1] 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 is there is no ESG rating on the issuer SUEK Securities DAC[2], 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.

---

[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.

(*) Anthropocene Fixed Income Institute (www.anthropocenefii.org), uge@anthropocenefii.org

IMPORTANT DISCLAIMER:

This report is for information and educational purposes only. The Anthropocene Fixed Income Institute ('AFII') does not provide tax, legal, investment or accounting advice. This report is not intended to provide, and should not be relied on for, tax, legal, investment or accounting advice. Nothing in this report is intended as investment advice, as an offer or solicitation of an offer to buy or sell, or as a recommendation, endorsement, or sponsorship of any security, company, or fund. AFII is not responsible for any investment decision made by you. You are responsible for your own investment research and investment decisions. This report is not meant as a general guide to investing, nor as a source of any specific investment recommendation. Unless attributed to others, any opinions expressed are our current opinions only. Certain information presented may have been provided by third parties. AFII believes that such third-party information is reliable, and has checked public records to verify it wherever possible, but does not guarantee its accuracy, timeliness or completeness; and it is subject to change without notice.

The Anthropocene Fixed Income Institute is a non-profit organization "to monitor, advocate for and influence the impact of the fixed income and bond markets in the age of human induced climate change." For more information about the Institute, please visit wwww.anthropocenefii.org or follow us using the hashtag #anthropocenefii.