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ESG policy, regulation and legislation 2020: What's relevant for UCITS managers and AIFMs?

One of the aims of the EU Action Plan on Sustainable Finance is to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth in line with UN sustainable development goals.

Under the action plan, several measures are being introduced to encourage financial market participants to take into account environmental, social and governance (ESG) factors. This briefing gives an outline of some of the EU legislative and policy developments on ESG issues which have implications for the Irish investment fund and asset management sectors.

- Sustainable, responsible and impact investing are no longer new concepts in the European asset management space
- The rate of ESG-related policy, regulatory and legislative developments at EU level has picked up pace
- ESG-related developments affect all financial sectors and will have direct and indirect implications for EU asset managers, UCITS managers and AIFMs
- Ireland's large and successful funds industry is keenly interested in what the EU developments will mean for UCITS managers and AIFMs in practical terms and what opportunities they can bring for ESG integration and broader sustainable development goals
- The Central Bank of Ireland (CBI) has specifically mentioned sustainable finance and ESG as a regulatory trend in speeches outlining the CBI's regulatory focus for 2020. The CBI has also commented that the investment funds and asset management sector is to the fore as the sustainable finance agenda moves rapidly forward.

Developments

Disclosures, Taxonomy and Benchmarks Regulations

EU Regulation	Published in Official Journal	Entry into force	Regulatory technical standards	Possible implications for UCITS managers and AIFMs
Disclosures Regulation (EU) 2019/2089	9 December 2019	29 December 2019 It shall apply from 10 March 2021.	The regulation provides for technical standards to be developed by the ESAs. The ESAs issued a consultation on 23 April 2020 (the ESA ESG Disclosures consultation) on these RTS with a closing date for comments of 1 September 2020. The deadline for submission of most of the Disclosures RTS is 30 December 2020. The RTS shall generally apply from 10 March 2021. Some provisions for products with an ESG focus or objective will apply from 1 January 2022.	AIFMs and UCITS managers are in scope. There are disclosure requirements at manager and at product level including: <ul style="list-style-type: none"> ■ Assessment of how sustainability risks are integrated in the investment decision-making process ■ Publication of policies on integration of sustainability risks ■ Consideration and disclosure of adverse sustainability impact ■ Integration of sustainability risks in remuneration policies ■ "Pre-contractual" disclosures on integration of sustainability risks .in UCITS & AIF prospectuses. ■ Specific obligations and disclosure where a fund has an objective of sustainable investment or promotes environmental characteristics ■ Financial statement disclosure

EU Regulation	Published in Official Journal	Entry into force	Regulatory technical standards	Possible implications for UCITS managers and AIFMs
Benchmarks Regulation (EU) 2019/2089 EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks	9 December 2019	10 December 2019	The regulation amends the Benchmarks Regulation (EU) 2016/1011 (BMR). The BMR provides for regulatory and implementing technical standards.	<ul style="list-style-type: none"> ■ BMR continues to have implications for funds and you can read about this in the ALG publication on the BMR. ■ May lead to investor perception that two new benchmark standards become the indices against which investments with an ESG objective must be benchmarked.
Taxonomy	22 June 2020	12 July 2020 Provisions relating to the environmental objectives of climate change mitigation and climate change adaptation apply from 1 January 2022. Provisions relating to sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems environmental objectives apply from 1 January 2023.	Regulatory technical standards and delegated acts are provided for. The Taxonomy Regulation supplements the Disclosures Regulation. The expected date for delivery of the RTS on the "do not significantly harm" concept is 31 December 2020.	<ul style="list-style-type: none"> ■ The EU Taxonomy will be a list of economic activities with criteria assessing their contribution to 6 environmental objectives. It is flexible enough to adapt to different investment styles and strategies. ■ The Taxonomy's common classification, while not mandatory for all product types, could be used by UCITS managers and AIFMs to inform decision making in order to foster investment in environmentally sustainable activities. ■ Managers marketing investment products as environmentally sustainable would need to explain whether, and how, they have used the Taxonomy criteria. ■ There are disclosure obligations in the Taxonomy Regulation which are intended to align with the requirements of the Disclosures Regulation.

UCITS Directive and AIFMD amendments

The European Commission has published draft delegated acts, or Level 2 provisions, amending UCITS Directive and AIFMD regarding the sustainability risks and sustainability factors to be taken into account for UCITS and AIFMs. These were published on 8 June 2020 for consultation until 6 July 2020.

The proposed amendments set out definitions of sustainability risks and sustainability factors by reference to those definitions in the EU Disclosures Regulation. The other amendments relate to:

- **Organisational Requirements:** general requirements on procedures and organisation, resources, and control by senior management, supervisory function and governing body
- **Operating Requirements:** conflicts of interest and due diligence
- **Risk Management:** taking into account sustainability risks effectively

The delegated directive for UCITS and the delegated regulation for AIFMs shall apply from the first day of the twelfth month after

publication in the Official Journal of the European Union. Because the UCITS draft delegated act is a delegated directive, rather than a regulation, before the date of application of the UCITS delegated act, member states will need to put in place appropriate local laws, regulations or administrative provisions to comply with the delegated directive.

ESMA technical guidance

The draft delegated acts have issued following a European consultation process, including the European Securities and Markets Authority (ESMA) final report technical guidance which issued in April 2019. ESMA's guidance was designed to translate into amendments to Level 2 provisions for UCITS managers and AIFMs and consequently the draft delegated acts reflect ESMA's proposals with little adjustment.

ESMA's approach means that the provisions in the draft delegated acts builds on existing risk management and governance provisions. UCITS managers and AIFMs will need to consider whether and how to integrate ESG risk factors into their existing risk appetite statements, policies and risk management frameworks. Analysis should be done on how best to demonstrate that the UCITS manager or AIFM has the necessary resources and expertise for the effective integration of sustainability risks. There will need to be identification of any conflicts arising in the context of integrating sustainability risks. Where UCITS managers, UCITS or AIFMs are obliged to consider or voluntarily consider principal adverse impacts of investment decisions on sustainability factors as required under the EU Disclosures Regulation, they must disclose how their due diligence policies take those principal adverse impacts into account.

EU Ecolabel

Closely aligned with the Taxonomy Regulation is the ongoing technical work on development of EU Ecolabel criteria for retail financial products. UCITS and retail AIFs are included in the proposed definition of financial products that are in scope of the EU Ecolabel. This would mean that managers of in scope UCITS and retail AIFs could apply for classification as a financial product which meets the criteria of the EU Ecolabel.

The second technical report on draft proposals for product scope and criteria is ready and available for discussion at the second working group meeting which took place on 25 March 2020. It contains detailed proposals for compliance with EU Ecolabel financial product criteria for UCITS and retail AIFs such as portfolio composition, exclusions, engagement, information for retail investors and content of information on the Ecolabel.

What should UCITS managers and AIFM managers do now?

Even for fund managers who have not already planned or developed fund products with sustainable or ESG objectives or screens, it is time to

- become familiar with the new EU ESG regulations and other legislation
- put ESG on the strategy planning agenda
- find out about the 23 April 2020 ESA consultation on the draft RTS under the Disclosures Regulation and review if you will be responding by 1 September 2020
- keep watch for other forthcoming consultations, delegated acts and technical standards
- stay tuned to ESG-related industry work

By doing so UCITS managers and AIFMs can identify what provisions of EU ESG policy, regulation or legislation may apply to them and begin to plan accordingly.

You can contact a member of the A&L Goodbody Asset Management & Investment Funds [team](#) for further information.

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