

ASSET MANAGEMENT &  
INVESTMENT FUNDS

## ESMA Supervisory Briefing on Sustainability Risks and Disclosures in the area of Investment Management

ESMA issued a supervisory briefing on 31 May 2022 on Sustainability Risks and Disclosures in the area of Investment Management (the Briefing). The Briefing contains valuable information for industry in navigating the evolving disclosure requirements.

5 MIN READ

The Briefing is addressed to the national competent authorities (NCAs) with the intention of promoting convergence on the supervision of sustainability related disclosures. In particular those under the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation (TR), as well as the supervision of how fund managers integrate sustainability risks in their organisational frameworks and decision making processes (as required under the relevant amendments to the delegated acts under the AIFMD and UCITS Directive).

Although the Briefing is technically non-binding, it is expected that the Central Bank of Ireland (CBI) will take this into account in how it supervises fund management companies (FMCs) and UCITS and AIF products under these regulatory regimes. ESMA added that there is a particular need to promote supervisory convergence in order to minimise the risk of different

levels of investor protection depending on where products are domiciled and to enhance convergence in order to increase transparency for investors and help avoid the practice of “greenwashing”.

Notably, the Briefing states that supervision of sustainability related disclosures and the integration of sustainability risks should not impede the distribution of funds across borders under the relevant regulatory regimes.

### **Guidance for supervision of fund documentation and marketing materials**

The Briefing notes that information provided to investors must be accurate, fair, clear, not misleading, simple and concise. It also notes that the SFDR required disclosures of criteria for the selection of investments should be limited to criteria that are binding on the FMC investment decision making process given the risk of “greenwashing” where funds apply non-binding exclusion strategies.

#### ***Verification of the compliance of the pre-contractual disclosures***

The Briefing suggests that NCAs create a check list of the information to be provided in the relevant level 2 pre-contractual templates which include:

- where the sustainability information to be annexed has been included in the main body of the prospectus
- that the pre-contractual templates have been properly completed

- where the description of the manner in which sustainability risks are integrated in the investment decisions and results of the impact of those risks on the returns of the fund are included.

The Briefing lists minimum issues that should be verified on the basis of the checklist.

#### ***Verification of the consistency of information in the fund documentation and working material***

The Briefing also suggests that NCAs should assess and be satisfied that sustainability related disclosures made are consistent across fund documentation and marketing materials. In particular the way sustainability related disclosures are presented, the fund name, investment objective and policy and the investment strategy.

The risks presented by any potential perception of greenwashing were highlighted in ESMA chair, Verena Ross' speech to the Irish Funds Annual Global Funds Conference 2022.

“The ESAs will work with NCAs to reduce what one might call “over-disclosure” by investment funds under Article 8, to avoid misleading disclosures to investors about the greenness of a product. We also support future legislative efforts to create clear criteria for financial products

making sustainability disclosures. For instance, a comprehensive solution could be to introduce sustainability labels for financial products, in order to help generate much needed clarity for retail investors.

“ESMA flagged a particular concern around “Article 8” or “Article 9” being used in marketing materials as quality labels for sustainability. By way of example, an Article 8 fund might not, in fact be very sustainable. As Ms Ross noted, “the purpose of

Article 8 disclosures is to highlight any kind of environmental or social characteristics promoted by such products – however small it might be.”

## 1 PRESENTATION OF DISCLOSURES

In order for the provided information to be disclosed in a way that is clear, succinct, fair and not misleading, the Briefing suggests that the following criteria be applied:

- avoid using boiler plate language with complex legal disclaimers and technical jargon
- use of cross references and hyperlinks should be limited
- disclosures should be made in a manner that ensures investors are not required to search for provided information
- indication of the Article of SFDR under which the fund discloses the relevant information – notably, ESMA requires this be done without giving the impression of a “label” to investors

## 2 PRINCIPLES BASED GUIDANCE ON FUND NAMES

The Briefing provides that fund names should not be misleading and should be commensurate with the characteristics of the fund. Terms such as “ESG”, “green”, “sustainable”, “social”, “ethical”, “impact”, or similar should only be used when supported in a material way by evidence of sustainability characteristics, themes or objectives reflected in the fund investment objectives and policies and its strategy as described in the fund documentation. It goes on to say that a weak level of application of a fund sustainable characteristic or objective may be a risk indicator warranting further investigation and, in the case of a fund that does not demonstrate binding sustainability characteristics focused on a specific sustainability theme or pillar, may provoke a NCA to reject the use of such a specific theme or pillar in its name.

This appears to be the first instance of NCAs being encouraged to apply a level of qualitative review of the nature of the ESG or sustainability characteristics or objectives of a product rather than just how they are disclosed.

ESMA goes on to note that NCAs should communicate on these issues at an early stage and co-operate effectively to avoid a situation where national requirements impede the effective functioning of EU passports. This is significant in flagging the need to avoid local gold plating.

The Briefing goes on to note that NCAs should consider, when assessing fund names, a number of specific considerations as follows:

- While there are no legal grounds under SFDR to prohibit an Article 8 product which does not include any sustainable investments from using the term “sustainable” or “sustainability” in its name, it is advisable in order to avoid confusion for investors that those terms only be used by funds which are:

- » funds disclosing under Article 9
- » funds disclosing under Article 8 which in part invest in economic activities that contribute to environmental or social objectives
- » funds disclosing under Article 5 of TR
- The use of the word “impact” or impact investing” or any other impact related term should be used only by funds whose investments are made with the intention of generating positive, measurable social or environmental impact alongside financial returns
- Index tracking funds can use any ESG related term if the index the funds tracks or replicates is itself ESG focused.

The Briefing goes on to include a list of examples of acceptable and unacceptable fund names.

In the Irish context, the CBI has a longstanding rule that a fund name should not be misleading. The CBI does query fund names on occasion. However, this Briefing provides more granular detail.

### 3 SUSTAINABLE INVESTMENT POLICIES AND OBJECTIVES

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The Briefing notes that a sustainable investment or objective should be described in the fund documentation and the fund should be managed according to it and that any such specific objectives or characteristics should be clearly identified and more general statements, without specification, avoided.

### 4 INVESTMENT STRATEGY

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The relevant strategy should be clearly identified in the fund documentation. A non-exhaustive list of key elements which should be disclosed include:

- investment universe (including limits and thresholds)
- screening criteria applied
- specific ESG characteristics or themes or non-financial impacts
- use of benchmark indices and relative expected tracking error if applicable
- stewardship approach.

### 5 ADDITIONAL SUPERVISORY ACTIONS

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NCA should consider performing ad hoc thematic reviews covering a sample of FMCs to support their supervisory work. The Briefing goes on to note that depositaries in particular should include all ESG related investment restrictions in the monitoring of compliance of FMCs or investment managers. The Briefing also recommends that NCAs consider different types of supervisory actions to ensure that portfolio holdings of funds reflect the name, investment objective and strategy described in the fund documentation and may complement any such portfolio analysis by involving depositaries in the context of their assessments.

A CBI thematic review on sustainable finance is expected in Q3 and the ESMA led Common Supervisory Action (CSA) on sustainable finance is scheduled for 2023. We anticipate that the CBI will carry out spot checks, at a minimum.

## 6 INTEGRATION OF SUSTAINABILITY RISK BY FMCS

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The Briefing reminds NCAs that the legal obligations under the relevant amendments to the delegated acts under the AIFMD and UCITS Directive apply to all FMCS irrespective of whether they offer sustainable funds. It recommends that NCAs should verify compliance by FMCS with these requirements by checking the description of the manner in which the integration of sustainability risks are described under Article 6 SFDR disclosures and ensure that relevant internal policies and procedures are reviewed on a periodic basis.

## 7 REGULATORY INTERVENTIONS IN CASES OF BREACHES

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The Briefing notes that Article 14 of SFDR provides that NCAs be designated in accordance with sectoral legislation to monitor the compliance of FMCS with the requirements of SFDR. It goes on to note that administrative measures, including enforcement, may be appropriate in order to combat “greenwashing”. It then lists examples, such as where legally required SFDR disclosures have not been made, SFDR disclosures are severely misleading and sustainability risks have not been integrated throughout the organisation as required etc. This is the first real description of what regulatory action in relation to greenwashing looks like and would need to be considered in the context of complying with relevant disclosure obligations.

### Next steps

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The Briefing contains valuable information for regulators and for industry in navigating evolving sustainability related disclosure requirements. We expect that it will inform the CBI’s approach to assessing these disclosures and accordingly should be integrated into practice without delay. Our Asset Management & Investment Funds team is advising clients on updates to their sustainability related disclosures in fund documentation, marketing materials, website and periodic disclosures. Please contact any member of our Asset Management & Investment Funds team for further information on this topic.

## Resources



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