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ESG and Investment Funds: *ESA consultation on EU Disclosures Regulation*

The EU Regulation on sustainability-related disclosures in the financial services sector (the **EU Disclosures Regulation**) has broad ranging disclosure requirements for financial market participants.

You can read the ALG overview of the EU Disclosures Regulation and its relevance for UCITS management companies, UCITS and AIFMs [here](#).

The European Supervisory Authorities (ESAs) issued a consultation under the EU Disclosures Regulation which includes technical details of the disclosure requirements.

Summary

- The EU Disclosures Regulation provides that details of the specific requirements for content, methodologies and presentation of the relevant disclosures be set out regulatory technical standards (RTS).
- Financial market participants, such as UCITS management companies and AIFMs, and financial products, such as UCITS and AIFs, are in scope.
- The ESAs published a consultation setting out draft RTS on 23 April 2020. The consultation closes on 1 September 2020.
- Six RTS are scheduled to be delivered by 30 December 2020. The other RTS is due on 30 December 2021.
- One of the RTS relates to the due diligence statement on principal adverse impacts of investment decisions on sustainability factors. This is relevant for all UCITS management companies, UCITS and AIFMs.
- Financial products which promote ESG or have sustainable investment as their objective are subject to additional disclosure obligations. For that reason, the consultation is of particular relevance for UCITS management companies, UCITS and AIFMs that have or plan to launch these kind of products.
- The ESAs acknowledge certain challenges in preparing the RTS:
 - » There are areas where the EU Disclosures Regulation and Taxonomy Regulation could be better aligned. The ESAs have recommended that the European Commission clarify this
 - » It is difficult to calibrate the RTS for different types of disclosure documents for different financial products in order to produce a single set of uniform pre-contractual disclosures. The ESAs wish to strike a balance between pre-contractual disclosures and website disclosure. They are looking for specific feedback on these points for the RTS
 - » The consultation addresses, although not definitively, what is meant by a financial product which “promotes... environmental or social characteristics... provided that the companies in which investments are made follow good governance practices”.
- For Irish authorised UCITS and AIFs, particularly those promoting ESG or with a sustainable investment objective, there may be a need to examine the compatibility of the disclosure requirements of the EU Disclosures Regulation against the existing disclosure requirements of the Central Bank of Ireland.

Term	Explanation	Abbreviation	FP type	Description
Financial Market Participant	This includes a UCITS management company, self-managed UCITS and AIFM.	FMP	FP that promotes environmental or social characteristics.	ESG Labelled Fund
Financial Product	This includes UCITS and AIFs.	FP	FP with sustainable investment as its objective, which may or may not have a reference benchmark index.	Sustainable Fund
			FP with reduction in carbon emissions as its objective.	Carbon Reduction Fund

EU Disclosures Regulation and RTS

Below is an overview of the provisions of the EU Disclosures Regulation and the corresponding draft RTS that may be of most relevance to UCITS management companies, UCITS and AIFMs. The requirements shaded in green below apply only to ESG Labelled Funds, Sustainable Funds and / or Carbon Reduction Funds.

EU Disclosures Regulation obligation	Who	RTS proposals	Where	When Effective	EU Disclosures Regulation Article	Draft RTS Article
<p>Article 4</p> <p>Publish and maintain a due diligence statement where the principal adverse impact of investment decisions on sustainability factors are considered.</p> <p>OR</p> <p>Where adverse impacts of investment decisions on sustainability factors are not considered, clear reasons why that is the case.</p>	FMP	<p>A mandatory reporting template for the principal adverse impact statement.</p> <p>Indicators for adverse impacts for climate and environment, social / employees, human rights and corruption / bribery matters including:</p> <ul style="list-style-type: none"> ▪ A core set of mandatory indicators for principal adverse impacts. ▪ Additional indicators for environmental and social factors. <p>A statement to be published where adverse impacts are not considered.</p> <p>Publication by 30 June each year.</p>	Website	<p>10 March 2021</p> <p>RTS to be delivered by 30 December 2020</p>	4	4 - 13
<p>Article 8</p> <p>For an ESG Labelled Fund if investee companies follow good governance practices, the FMP must disclose prescribed information on (i) how those characteristics are met (ii) any index used as a reference benchmark.</p>	FMP FP	<p>A disclosure template in Annex II.</p> <p>Prescribed pre-contractual information to be presented under the following headings:</p> <ul style="list-style-type: none"> ▪ environmental or social characteristics promoted by the FP ▪ no sustainable investment objective ▪ investment strategy ▪ sustainability indicators ▪ use of derivatives ▪ website reference ▪ reference benchmark where an index has been designated. 	Pre-contractual Document	<p>10 March 2021</p> <p>RTS to be delivered by 30 December 2020</p>	8	14 - 22

EU Disclosures Regulation obligation	Who	RTS proposals	Where	When Effective	EU Disclosures Regulation Article	Draft RTS Article
Article 9	FMP	A disclosure template in Annex III.	Pre-contractual Document	10 March 2021	9	23 - 32
For a Sustainable Fund , in addition to information on integrating sustainability risks, prescribed information must be disclosed depending on whether or not an index has been used as a reference benchmark.	FP	Prescribed pre-contractual information to be presented, including under the following headings: <ul style="list-style-type: none"> ▪ sustainable investment objective ▪ no significant harm to the sustainable objective ▪ investment strategy ▪ sustainability indicators ▪ use of derivatives ▪ website reference ▪ sustainable investment objective attainment where an index has been designated ▪ objective for reduction in carbon emissions where that is an objective 		RTS to be delivered by 30 December 2020		
For a Carbon Reduction Fund , in addition to information on integrating sustainability risks, prescribed information must be disclosed.						
Article 10	FMP	In the same part of the website dealing with the particular FP and which includes marketing communications, in a section entitled, "sustainability-related disclosures", the FMP must outline the environmental / social characteristics or the sustainable investment objective of that FP.	Website	10 March 2021	10	33 - 35
For ESG Labelled Funds, Sustainable Funds and Carbon Reduction Funds , publication of a description of the environmental / social characteristics or objective; information on methodologies used to assess, measure and monitor the characteristics or objective including the data sources and screening criteria for underlying assets and the sustainability indicators used to measure the characteristics or objective.		The information must be set out under prescribed headings, depending on the type of FP such as: <ul style="list-style-type: none"> ▪ summary ▪ environmental or social characteristics / no sustainable objective / sustainable objective ▪ proportion of investments ▪ investment strategy ▪ monitoring ▪ methodologies ▪ due diligence ▪ engagement policies ▪ data sources and processing ▪ limitation to methodologies and data ▪ designated reference benchmark ▪ attainment of sustainable objective 		RTS to be delivered by 30 December 2020		
Information required under Art 8, 9 and 11.						
Article 11	FMP	A disclosure template in Annex IV and V.	Periodic Report	1 January 2022	11	36 - 52
In the periodic report:	FP	The information must be in prescribed headings including: <ul style="list-style-type: none"> ▪ attainment of the environmental or social characteristics / sustainable objective ▪ no significant harm of sustainable investment objectives ▪ top investments ▪ sustainable performance of the benchmark index ▪ proportion of sustainability-related investments ▪ actions taken to attain environmental or social characteristics. 		RTS to be delivered by 30 December 2020		
For ESG Labelled Funds the extent to which environmental or social characteristics are met.						
For Sustainable Funds and Carbon Reduction Funds the overall sustainability-related impact and where an index has been used as a reference benchmark, a comparison of the impact of the FP against the index.						

Some observations

Principal adverse impact reporting

The ESAs acknowledge that this is a relatively new area. They are also aware that availability of data is a big challenge in preparing sustainability-related information to end investors.

The ESAs consider that certain adverse impacts should always be considered principal adverse impacts and have set out a list of mandatory indicators in an annex to the draft RTS. FMPs will have no choice to determine whether their investments lead to principal adverse impacts for those indicators. Any positive value for the indicator assessment is automatically a principal adverse impact. There are also a set of suggested additional non-exhaustive indicators. FMPs have to choose at least one environmental indicator and one social indicator to be included in the principal adverse impact disclosure.

The draft RTS also propose the statement to be included where adverse impacts of investment decisions are not considered by FMPs.

Alignment with the Taxonomy Regulation

The EU Disclosures Regulation defines “sustainable investments” without reference to the Taxonomy Regulation. So, for example, an FP may invest in an equity or debt instrument which carries on a variety of activities. Some activities may be taxonomy-eligible and some may not. The ESAs discussed whether Sustainable Funds or Carbon Reduction Funds should be limited to those acquiring investments which are fully taxonomy-eligible. This would be a favourable outcome as an aid to comparability of sustainable investments and combating greenwashing.

The EU Disclosures Regulation definition of “sustainable investments” includes both environmental and social objectives. The Taxonomy Regulation limits it to environmental objectives.

Do not significantly harm

The ESAs have included in this consultation suggested proposals on “do not significantly harm” disclosure related to the adverse impact indicators. The Taxonomy Regulation empowers the ESAs to produce RTS on the concept of “do not significantly harm”. The ESAs view this as creating an opportunity to align the concept of sustainable investments in the EU Disclosures

Regulation with compliant investments financing activities in the Taxonomy Regulation.

The disclosure of principal adverse impact and significant harm may involve different use of the same indicators. The ESAs suggest that the European Commission should consider clarifying the relation between these concepts.

Proportion of investments in activities eligible in the Taxonomy Regulation

The ESAs concluded that this proportion should be disclosed by FMPs. This work has been delayed because of the extended deadlines under the Taxonomy Regulation.

Delayed pre-contractual and periodic disclosure templates

The ESAs are suggesting that sustainability-related information is contained in a dedicated section of sectoral pre-contractual disclosures. The draft RTS contain mandatory disclosure templates for pre-contractual and periodic disclosure for products promoting ESG or having sustainable investment as their objective. Placeholders for these are included in the draft RTS as Annex II, III, IV and V. Currently, the drafting of these templates has been delayed and a separate process will be launched by the ESAs for this.

Balancing pre-contractual and website disclosure

The ESAs highlighted this as a challenge. Specific feedback has been sought in the consultation on this point.

Passive and active strategy disclosure

To ensure a level playing field on disclosure, the ESAs decided that products with a sustainable investment objective relying on a passive investment strategy should disclose index-level information for the relevant disclosure requirements.

ESG product categorisation and greenwashing

The scope of FPs with environmental or social characteristics under Article 8 of the EU Disclosures Regulation is acknowledged to be very broad. It is intended to catch FPs with different environmental and social ambitions that do not qualify as Sustainable Funds under Article 9. The ESAs acknowledge the potential greenwashing risks with this broad categorisation.

The ESAs consider that the broad concept of “ESG integration” should not be enough to justify that a product promotes environmental or social characteristics. This is why the ESAs suggest that FMPs should not “over disclose” on sustainability, for example, through product categorisation.

Derivative disclosure

There must be specific disclosure on the use of derivatives and how it meets each of the environmental or social characteristics promoted by the FP.

Marketing communications

The EU Disclosures Regulation requires that marketing communications by all FMPs do not contradict the information disclosed. The draft RTS do not address marketing disclosures but the ESAs will consider their option to develop implementing technical standards on this point.

Key considerations

This consultation provides an opportunity for UCITS management companies, UCITS and AIFMs to give feedback on the formulation of the disclosure requirements under the EU Disclosures Regulation. It is particularly relevant for those with, or proposing to launch, ESG products. Feedback can be given directly, through advisers or industry representative bodies.

All UCITS management companies, UCITS and AIFMs should take the opportunity to review the ESA consultation and provide feedback.

It will take some analysis to understand exactly what the ESA proposals might mean for specific investment fund products, for example ETFs and fund of funds, and how the disclosure requirements must be interpreted for those types of products. A&L Goodbody’s Asset Management & Investment Funds team is reviewing the ESA consultation from the perspective of its impact on our clients and the Irish investment funds industry.

For more information

For more information in relation to this topic please contact your usual contact on the A&L Goodbody [Asset Management & Investment Funds team](#).

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