MAPLES GROUP

UPDATE

# New ESMA Guidance on Sustainability Risks and Disclosures

On 31 May 2022, ESMA published a supervisory briefing[1] on sustainability risks and disclosures in investment management ("Briefing"). The Briefing is targeted at EU national competent authorities ("NCAs") and aims to ensure convergence on the supervision of sustainability-related disclosures as well as the supervision of how fund managers integrate sustainability risks in their organisational framework and decision-making process.

While the Briefing is aimed at NCAs, is non-binding and not subject to any 'comply or explain' provisions, it sets out several key supervisory expectations. It also provides a useful reference point to anticipate the regulatory approaches in assessing sustainability disclosures which will be an important element to consider when implementing SFDR Phase II.

It seeks to minimise the risk of different levels of investor protection depending on where the relevant fund is domiciled or marketed on a cross-border basis and aims to combat greenwashing by providing guidance for:

- the supervision of fund documentation and marketing material, as well as guiding principles on the use of sustainability-related terms in funds' names; and
- convergent supervision of the integration of sustainability risks by AIFMs and UCITS managers ("Managers").

[1] https://www.esma.europa.eu/sites/default/files/library/esma34-45-1427_supervisory_briefing_on_sustainability_risks_and_disclosures.pdf

## Key Points

The Briefing includes the following key points:

- Information provided to investors in fund documentation and marketing material to evaluate proposed funds should be accurate, fair, clear, not misleading, simple and concise.
- NCAs should verify that pre-contractual disclosures on the environmental and / or social characteristics promoted by funds are clearly stated and sufficiently explained. NCAs are encouraged to ensure that the sustainable objective of an Article 9 SFDR financial product or the environmental or social characteristics promoted by an Article 8 financial product are clearly identified. NCAs are discouraged from approving language which is generic in nature.
- When verifying the consistency of information in the fund documentation and marketing material, NCAs should, on a risk-based approach, assess and be satisfied that the sustainability-related disclosures made are consistently described across the fund documentation and the marketing material. In assessing this consistency, NCAs should consider: (i) the way sustainability-related disclosures are presented; (ii) the fund's name; (iii) the

investment objective and policy; and (iv) the investment strategy.

- The use of boilerplate language, legal disclaimers, technical jargon and standardised text should be avoided. All sustainability disclosures should ideally be presented in one section. Cross references and hyperlinks should be limited to those required by the "*Where can the methodology used for the calculation of the designated index be found?*" and "*Where can I find more product specific information online?*" sections in Annexes II and III of the SFDR Delegated Regulation[2]. Hyperlinks should be to the exact places where the relevant information may be found and maintained overtime to ensure information is accessible on an ongoing basis.

- Funds' names should not be misleading. The use of terms such as 'ESG', 'green', 'sustainable', 'social', 'ethical', 'impact' or other ESG related terms should be evidenced by sustainability characteristics, themes or objectives that fairly and consistently reflect the investment objective, policy and strategy set out in the fund documentation.

- When assessing fund names, NCAs are encouraged to consider illustrative principles set out in the Briefing and develop or supplement them where appropriate. The term 'sustainable' or 'sustainability' should be used only by: (i) funds disclosing under Article 9 SFDR; (ii) funds disclosing under Article 8 SFDR which in part invest in economic activities that contribute to environmental or social objectives; and (iii) funds disclosing under Article 5 of the Taxonomy Regulation[3]. Similarly, the use of the word 'impact' or 'impact investing' or other impact-related term should be confined to funds which invest with the intention to generate positive, measurable social and environmental impact alongside a financial return.

Funds which designate an index as a reference benchmark could use any ESG-related terms if that index is itself ESG focused and the index tracking fund has an exclusion policy which excludes only a small number of securities. Where holdings are not materially different from a similar non-ESG index, an ESG-related term should not be used in the name.

- In terms of compliance with website disclosures' obligations, NCAs should verify that: (i) fund managers publish and maintain the information in accordance with SFDR; and (ii) the summary as defined in the SFDR Delegated Regulation[2] is published in one of the official languages and in a language customary in the sphere of international finance.

- At a minimum, NCAs should ensure that the annual report contains a prominent statement referring to where the relevant sustainability information is be found and verify all required SFDR periodic disclosures' obligations are completed properly.

- NCAs may also have recourse to additional supervisory actions such as availing of information from external sources or internal or external audit functions and ad-hoc thematic reviews. NCAs should ensure, through appropriate actions, that relevant information is provided by Managers to the appointed depositary to enable it to effectively perform its functions.

[2] https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_1_EN_ACT_part1_v6%20(1).pdf

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32020R0852

- Portfolio analysis should be considered to ensure the portfolio holdings reflect the name, investment objective, strategy and characteristics disclosed. NCAs may complement their analysis of all ESG-related investment restrictions and portfolio composition by involving the funds' depositaries in the context of monitoring investment restrictions and assessing reporting from Managers, external auditors and internal control functions.

- To ensure convergent supervisory scrutiny of the effective integration of sustainability risks by Managers (which is required from 1 August 2022 under the UCITS[4] and AIFMD Delegated Acts[5]), certain supervisory controls are set out. NCAs should verify, through risk-based desk-based and / or on-site reviews: (i) the effective implementation of sustainability risks by Managers by checking the description of these risks is integrated in investment decisions in pre-contractual fund disclosures; (ii) Managers perform periodic reviews of relevant internal policies and procedures; and (iii) compliance with the disclosure of sustainability risk integration on websites through sample checks. For further information, please see our client update Sustainable Finance - Changes for UCITS Managers and AIFMs[6].

- The Briefing contains a non-exhaustive list of examples which NCAs may consider warrant regulatory intervention to combat greenwashing. It includes failure to make legally required SFDR disclosures; inclusion of severely misleading SFDR disclosures; failure to integrate sustainability risks throughout the organisation; periodic disclosures of an Article 8 or 9 SFDR do not match or fulfil the characteristics or objectives shown in the fund documentation; and periodic disclosures of an Article 9 financial product show that significant proportions of investments do not comply with the sustainable investment criteria of Article 2(17) SFDR.

- Where a regulatory breach occurs, NCAs remain fully responsible for determining the appropriate course of action that would be most effective and mitigate supervisory risks.

## Proportionate Supervision

NCAs are encouraged to be proportionate in their supervision. The extent of information sought and the frequency and intensity of supervisory engagement should consider the fund composition, the complexity of investment policy and type of investors. Engagement should also be commensurate with the risks identified.

## How Maples Can Help

Our Funds & Investment Management group is advising Managers on updates to their decision making procedures / organisational structure and sustainability-related disclosures in fund documentation, marketing materials, websites and periodic disclosures.

## Further Information

For further information, please liaise with your usual Maples Group contact or any of the persons listed below.

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[4] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021L1270
[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R1255
[6] https://maples.com/en/knowledge-centre/2022/4/sustainable-finance-changes-for-ucits-managers-and-aifms

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