UPDATE

New Mandatory Consideration of ESG Factors for EU Investment Fund Managers

A range of new EU legislative measures on sustainable finance become effective on 1 August 2022.

The various delegated directives and delegated regulations[1] are designed to complement the obligations in Regulation (EU) 2019/2088[2] ("SFDR") and Regulation (EU) 2020/852[3] ("Taxonomy Regulation") and form part of the European Commission's package of measures to help improve the flow of money towards sustainable activities across the EU.

This update focuses specifically on the changes that will be made to the UCITS and AIFMD regimes and considers the practical implications for UCITS management companies and AIFMs (collectively "Manco(s)"), particularly in the context of existing SFDR requirements.

ESG Changes for Mancos

Commission Delegated Directive (EU 2021/1270)[4] ("UCITS Amending Directive") and Commission Delegated Regulation (EU) 2021/1255[5] ("AIFMD Delegated Regulation"), impose obligations on a Mancos to:

- Integrate sustainability risks in the management of funds;
- Include in their conflicts of interest procedures a consideration of any conflicts that may arise due to the integration of sustainability risks;
- Take into account sustainability risks as part of the due diligence in the selection and ongoing monitoring of investment; and
- Capture the procedures to manage sustainability risks in the risk management policy.

SFDR Alignment

Many of the changes broadly align with entity-level disclosure requirements that apply to firms (as financial market participants) under SFDR and accordingly will already be factored into a Manco's operating processes.

Some of these existing requirements are as follows:

- **Article 3** – Mancos must publish information about their policies on the integration of sustainability risks in their investment decision-making process on their website;
- **Article 4** – Mancos must publish whether they consider principal adverse impacts ("PAIs") of investment decisions on sustainability factors on their website; and
- **Article 5** – Mancos must publish on their website how their remuneration policies are consistent with the integration of sustainability risk.

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[1] For further details, please see our previous update, Sustainable Finance: New EU Delegated Legislation.

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN

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

[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021L1270&from=EN

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R1255&from=EN

Mandatory Consideration of Sustainability Risks

The UCITS / AIFMD Delegated Acts require Mancos to consider sustainability risks (that is, the risk of an ESG event occurring that could have a material negative impact on the value of an investment), when selecting and monitoring investments.

As sustainability risk in this context is confined to the potential impact on the financial value of investments, arguably this will already be considered. However, in the future it will be necessary to reflect (systematically and in a way that can be demonstrated objectively) that sustainability risks are being specifically considered as part of the firm's process to analyse, select and monitor investments.

Rather than this being elective or strategy-specific (as it was under SFDR), this is framed so it will apply to all funds managed - even funds categorised under SFDR as Article 6 financial products (that otherwise / until now may not have had an ESG aspect).

This will also have implications for delegation arrangements in order to ensure that delegate investment managers take these considerations into account when undertaking functions as a Manco delegate.

Actions Required

As well as enhancements to conflicts of interest, investment due diligence and risk management policies, enhancements may also be needed to the operating processes, reporting, investment oversight and fund approval processes to comply with the new requirements.

Prospectus Disclosures

The new rules also indirectly impact on fund prospectus disclosure as the existing SFDR disclosure statement (required under Article 6) on whether or not sustainability risks are taken into account in the investment process may need to be amended in cases where, to date, a negative disclosure statement has been made.

Going forward it will be necessary to reflect that sustainability risks are being specifically considered as part of the Manco's process to analyse and select investments.

This issue was highlighted in a recent ESMA Supervisory Briefing[6].

Further Information

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

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