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ESG - Ireland Moving to Greener Pastures

Introduction

Ireland along with its partners in Europe have embraced sustainable, responsible and impact investing for some time now and are seeing the benefits of this with substantial growth in this sector in recent years. This trend looks set to continue with investment funds set to attract around $420bn (€376bn) in the next five years in Europe, according to a study by research group Impactvesting. In this article we look at recent publications from the European Securities and Markets Authority (ESMA) that seek to formalise environmental, social and good governance (ESG) policy and regulation in the EU as well as an overview of strategic decisions taken by Ireland to put itself at the epicentre of ESG integration.

Overview of recent ESMA publications on ESG

On 30 April 2019 ESMA published two final reports for the benefit of the European Commission (EC) on sustainable finance initiatives to support the EC's Sustainability Action Plan in the areas of investment services and investment funds. These final reports were published concurrently with technical advices and contain detailed analysis for the industry on the integration of sustainability risks and factors, relating to ESG considerations into the Markets in Financial Instruments Directive II (MiFID II), the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings in Collective Investment in Transferable Securities (UCITS) Directive.

The final reports and technical advices will require amendments to the MiFID II, AIFMD and UCITS regulations in order to integrate sustainability risks and factors relating to ESG. Some of the headline proposals that will require amendments to the MiFID II regulation are as follows: (a) the requirement of senior management, compliance and internal audit functions to consider sustainability when undertaking their duties, (b) identification of conflicts of interest arising from distribution of sustainable investments, (c) consideration and review of risk management processes to ensure sustainability risks are included, and (d) when contemplating the organisational practices and procedures of the investment firm that ESG considerations are an integral part of those considerations.

Moreover, for AIFMD and UCITS further amendments were suggested to those regulations as follows: (a) senior management should control and take overall responsibility for the integration of ESG into their product, (b) management companies should consider how ESG will affect their organisation practices and procedures, and (c) management companies will need to consider if they are adequately resourced with employees with the requisite expertise to integrate ESG.

Later in the year on 18 July 2019 ESMA followed the two final reports and technical advices above by publishing a final report and guidelines on sustainability consideration in the credit rating market. The ESMA publications offered guidelines on disclosure requirements applicable to credit rating which were issued concurrently with technical advices on sustainability considerations in the credit rating market.

ESMA found that, while credit rating agencies (CRAs) are considering ESG factors in their ratings, the extent of their consideration can vary significantly across asset classes, according to each CRA's methodology and ESMA's guidelines to CRAs was "to ensure greater transparency around where ESG factors are considered in CRAs' credit assessments".

Against this background, ESMA will, in the coming months, consult on draft implementing measures so that these publications can be converted into formal delegated acts which will form the basis of ESG integration into financial services regulation across the EU in the next 12-18 months. These are being developed jointly with the banking and insurance sectors in order to achieve similar requirements and a level playing field across the three sectors. Legislation regarding ESG disclosures and financial benchmarks referencing assets[i] that meet certain sustainability targets have also been politically agreed and are due to be published in the Official Journal of the EU.

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Ireland has for some time now been putting ESG front and centre of its overall national strategic growth plan and this was evidenced by the publication of the "Ireland for Finance" Strategy (Strategy) which was launched in April 2019 as a successor to the IFS2020 Strategy from March 2015.

A main priority of the Strategy is the expansion of sustainable finance and a push to improve the depth and awareness of this area. The Strategy envisions a sustainable financial infrastructure in Ireland that includes green bonds, ESG and socially responsible investing (SRI) investments, sustainable infrastructural investments, climate finance and performance bonds. In line with these goals Ireland issued its first sovereign green bond in late 2018, which raised €3bn and demand came in at almost four times that level as the National Treasury Management Agency in Ireland tapped new sources of demand.

Furthermore, last year the Republic of Ireland became the world's first country to sell off its investments in fossil fuel companies, after the Fossil Fuel Divestment Act, which sets out the divestment was signed into law by the President on 17 December 2018. The State's €8bn national investment fund will be required to sell all investments in coal, oil, gas and peat "as soon as is practicable", which is expected to mean within five years.

In recent weeks Michael Hodson, the Director of Asset Management and Investment Banking of the Central Bank of Ireland gave a speech at the Asset & Wealth Management Independent Non-Executive Directors' Day where he outlined the Central Bank's hot topics for the coming year and sustainable finance was at the centre point of his speech. He noted that the Central Bank had established a dedicated working group on ESG to keep abreast of what is happening in each area of sustainable finance that is within the Central Bank's remit, and to also act as a sounding board in developing the Central Bank's sustainable finance policy. Mr. Hodson confirmed that the Central Bank had joined several international networks with a focus on sustainable finance and that the Central Bank had reviewed and was acutely aware of the recent ESMA publications discussed above and their knock-on effects on Irish regulations.

Finally, Minister for Finance Paschal Donohue has recently announced a €6 increase in the price of carbon as a first step towards the Government's commitment of increasing the price of carbon from €20 to €80 a tonne by 2030 with the increase expected to raise €90m in 2020. All proceeds will be ring-fenced to fund new climate action measures as the State looks to invest in a low carbon future.

Conclusion

It is clear that there is a large amount of momentum in Ireland and in Europe to integrate ESG into the investment decisions of investment firms and the investment objectives and strategies of investment funds. The move to ESG integration is reinforced by strategic decisions being made by the State at national and international level. ESG will very soon no longer be an ancillary consideration for firms, funds and service providers in Ireland and the EU but will instead be top of the list when strategic decisions are being taken on the firms and funds future. As one of the world's leading financial services centres for investment funds and management companies, Ireland is well positioned to play a leading global role.

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October 2019

[i] Regulation (EU) 2016/1011 to be amended.