ESG
–
Sustainable Finance Regulations
–
What you need to know

Philippe-Emmanuel Partsch
Partner

Stéphane Badey
Partner

Antoine Portelange
Associate


ESG

You will need

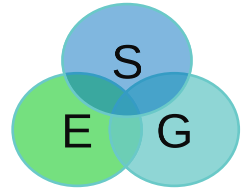
Key concepts

- ESG/Sustainability factors
- ESG/Sustainability risks
- ESG/Sustainability objective
- Adverse impacts on sustainability factors

Key concepts

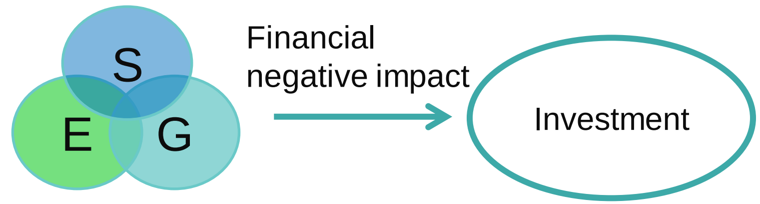
ESG/Sustainability factors

Environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.



ESG/Sustainability risks
financial risks for the investment

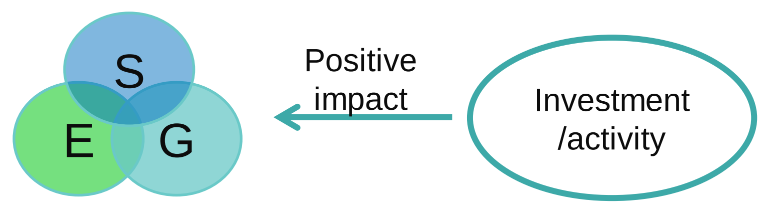
An environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material **negative impact on the value of the investment**.



For example:

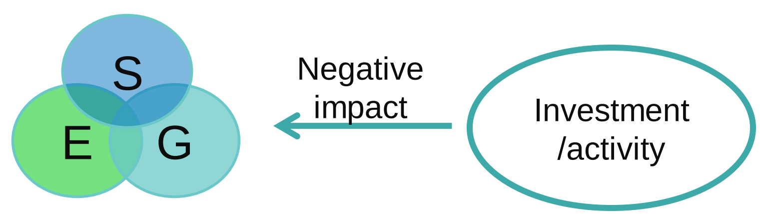
ESG/Sustainability objective
positive externalities of the investment

Taking into account non-financial environmental and social issues (sustainability factors) in a strategy



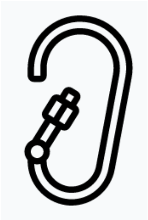
Adverse impacts on sustainability factors
negative externalities of the investment

Impacts of investment decisions and advice that result in **negative effects on sustainability factors**



You will need

Key concepts



Context

A little bit of background : the rise of ESG legislation

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- A forerunner of the sustainable finance boom : EU Directive 2014/95/EU on disclosure of non-financial and diversity information by certain large undertakings and groups (NFRD)

The NFRD is a piece of legislation from 2014 (whose transposition deadline was December 2016). It requires large listed companies to disclose on so-called ‘non-financial’ information such as diversity, human rights, bribery and corruption and environmental performance.

NFRD is currently under review and deepening

- UN - SDGs

In 2015, the UN came to an agreement on new global Sustainable Development Goals (17)

- The Paris Agreements 2016

- Directive (EU) 2017/828 amending Directive 2007/36/EC

as regards the encouragement of long-term shareholder engagement

Directive (EU) 2017/828 amending Directive 2007/36/EC
as regards the encouragement of long-term shareholder engagement

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Objective:
- provide for a comprehensive set of provisions to encourage shareholder engagement in EU listed companies, including by means of an active exercise of ownership rights
- increasing the quality and long-termism of shareholder engagement and transparency

Timing: In force

Translated into national law in Luxembourg published 20th August 2019

Practical implications for UCITS ManCos and AIFMs:
- Engagement policy
- Tools to facilitate long-term shareholder engagement

In the aftermath of the 2008 financial crisis, **institutional investor engagement has increasingly become an area of focus** for academics and policy makers. Through engagement, investors may be able to influence the strategy of firms and the way in which they approach ESG issues. Because institutional investors, such as pension funds, **tend to have a long-term liability structure and investment horizon**, there is a general expectation that engagement could steer firms towards long-term value creation and social welfare maximisation rather than pursuit of simple market value.

Institutional investors are subject to transparency obligaiton with respect to their engagement policy just like asset managers in order to develop and publicly disclosure an **engagement policy** that describes **how they integrate shareholder engagement in their investment strategy**. A **report** shall also be drawn up and published on an annual basis describing the implementation of such engagement policy.

European Commission Sustainable Finance Action Plan

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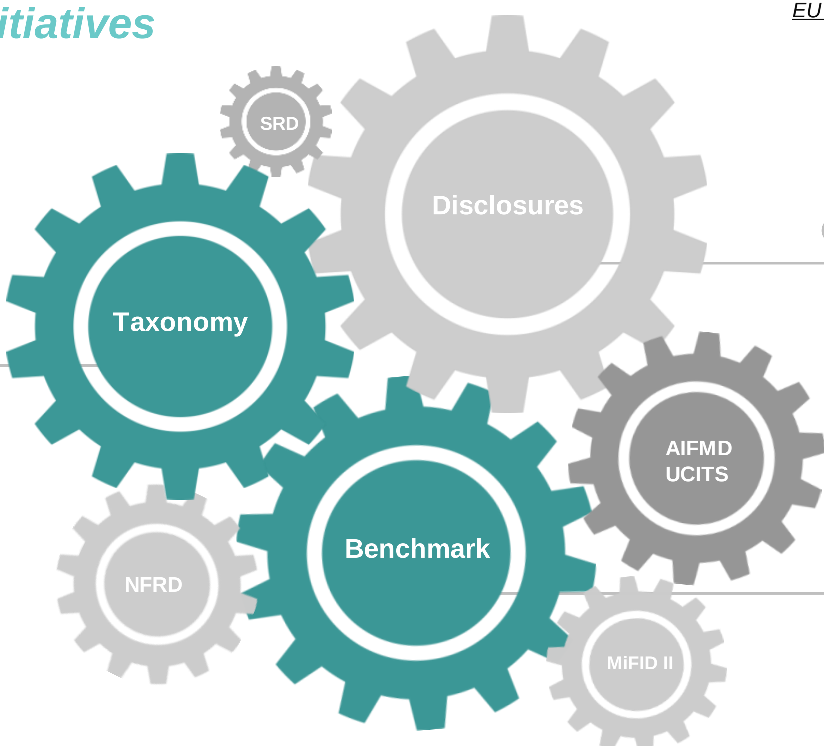
The Action Plan

The action plan published in 2018 sets out a **comprehensive strategy**, with three main objectives, to further connect finance with sustainability.

1. Reorienting capital flows towards sustainable investments
2. Mainstreaming sustainability into risk management
3. Fostering transparency and Long-termism

EU Action Plan on Financing Sustainable Growth, 2018

Key Legislative Initiatives



A proposal for a regulation on **disclosures** relating to sustainable investments and sustainability risks (published in December 2019); and

A proposal for a regulation on the establishment of a **framework** to facilitate sustainable investment (taxonomy);

A proposal for a regulation **amending the benchmark regulation** (published in December 2019).

Building on the Action Plan, the Commission is already out consulting stakeholders on its **renewed sustainable finance strategy 2.0.**, which will provide a roadmap with new actions to increase private investment in sustainable projects and activities:

EC Sustainable Finance Action Plan

Reorienting capital flows towards sustainable investments

Sous-slide Action Plan 1.

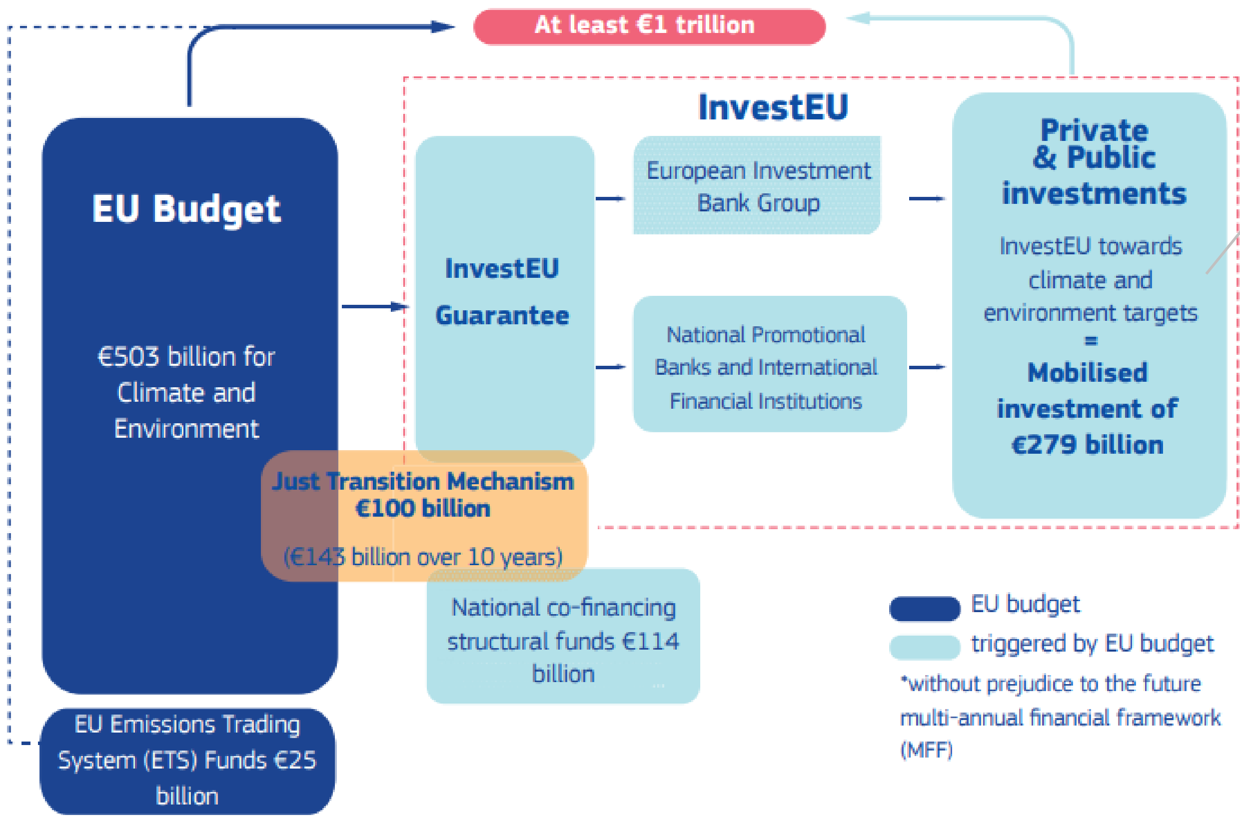
The EU strives for net-zero GHG emissions by 2050, as reiterated in the recent Green Deal…. Which requires **at least €1trillion of investments** over the next 10 years.

The EU is already providing impetus to help attract the required investments with the European Fund for Strategic Investments and other initiatives. However, the scale of the investment challenge is beyond the capacity of the public sector alone. **The financial sector has a key role to play in reaching those goals.**

Where will the money come from?

Where the **Action Plan** stated that an **additional funding of €180 to €270 bn per year** is needed, which requires the help of the private sector, the Green Deal now precises that, with the significant involvement of the EU Budget (to the amount of €503 bn), the new **aim of €1 trillion over the ten next years** could be achieved with a total amount of €279 bn of mobilised investments, both from private and public investors.

In any case, the key is that all actors, including the private financial figures, should invest in a climate-neutral and circular economy in Europe.



Investing in a climate-neutral and circular economy, 2020

European Green Deal

The European Green Deal is a new set of policy initiatives published in 2020 that globally aims to make the Europe climate neutral by 2050. The deal plans to review the majority of existing legislations and adopt new regulations/ directives on biodiversity, eco-farming, renewable energies, circular economy,…

"*It is a new **growth strategy** that aims to transform the EU into a fair and prosperous society, with a modern resource–efficient and competitive economy (…) and [to] protect the health and well–being of citizens from environment–related risks and impacts. At the same time, this transition must be just and inclusive*"

European Commission, 2020

European Green Deal

- Increasing the EU's Climate ambition for 2030 and 2050
- Mobilizing industry for a clean and circular economy
- Supplying clean, affordable and secure energy
- Building and renovating in an energy and resource efficient way
- **Financing the transition**
- A zero pollution ambition for toxic-free environment
- Preserving and restoring ecosystems and biodiversity
- From Farm to Fork: a fair, healthy and environmentally friendly food system
- Accelerating sustainable and smart mobility
- **Mainstreaming sustainability in all EU policies**

***** The Annex I to the Communication on the European Green Deal, including the indicative timetable has been adopted before the **Covid-19** crisis which already has caused delay in the contemplated timeline.

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Progress on key actions of the Action Plan

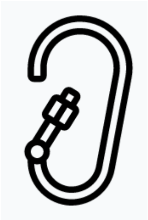
	Action	Objective	Legislative framework	Technical advice	Secondary legislation
1	**Taxonomy**	Develop a common language on environmentally sustainable economic activities	Status: approved, application from 2021 and 2022 ✓	TEG Platform on Sustainable Finance (from Sept. 2020) ✓	COM drafting secondary legislation based on TEG advice for end of 2020 and 2021
2	Standards and labels	Develop EU standards (such as EU Green Bond Standard) and labels for sustainable financial products (via ecolabel) to protect integrity and trust of sustainable finance market	Ecolabel framework for financial products expected for Q3 2021	TEG (EU Green Bond Standard) JRC (Ecolabel for financial products) ✓	COM developing voluntary EU Green Bond Standard, work on EU Ecolabel in progress
5	Benchmarks	Develop climate benchmarks and disclosures for benchmarks	Status: published, application from 2020 2021 on ESG disclosures ✓	TEG ✓	COM drafting secondary legislation based on TEG advice for 2020
7	Disclosures by financial market participants	Enhance transparency to end investors on how financial market participants consider sustainability	Status: published, application from March 2021 ✓	ESMA, EBA, EIOPA ✓	Future 6 RTS + 3 additional RTS through Taxonomy Regulation + 1 ITS
8	Sustainability in prudential requirements	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)	Pending the result of technical assessment	EBA and EIOPA ✓	Pending the result of technical assessment
9	Corporate sustainability disclosure	Enhance climate and sustainability-related information provided by corporations	Review of the non-financial reporting directive*	TEG (climate-related information) COM fitness check on corporate reporting ✓	Pending the outcome of public consultation on review of NFRD

Source: European Commission June 2020

* The Commission issued guidelines on reporting climate-related information in June 2019

You will need

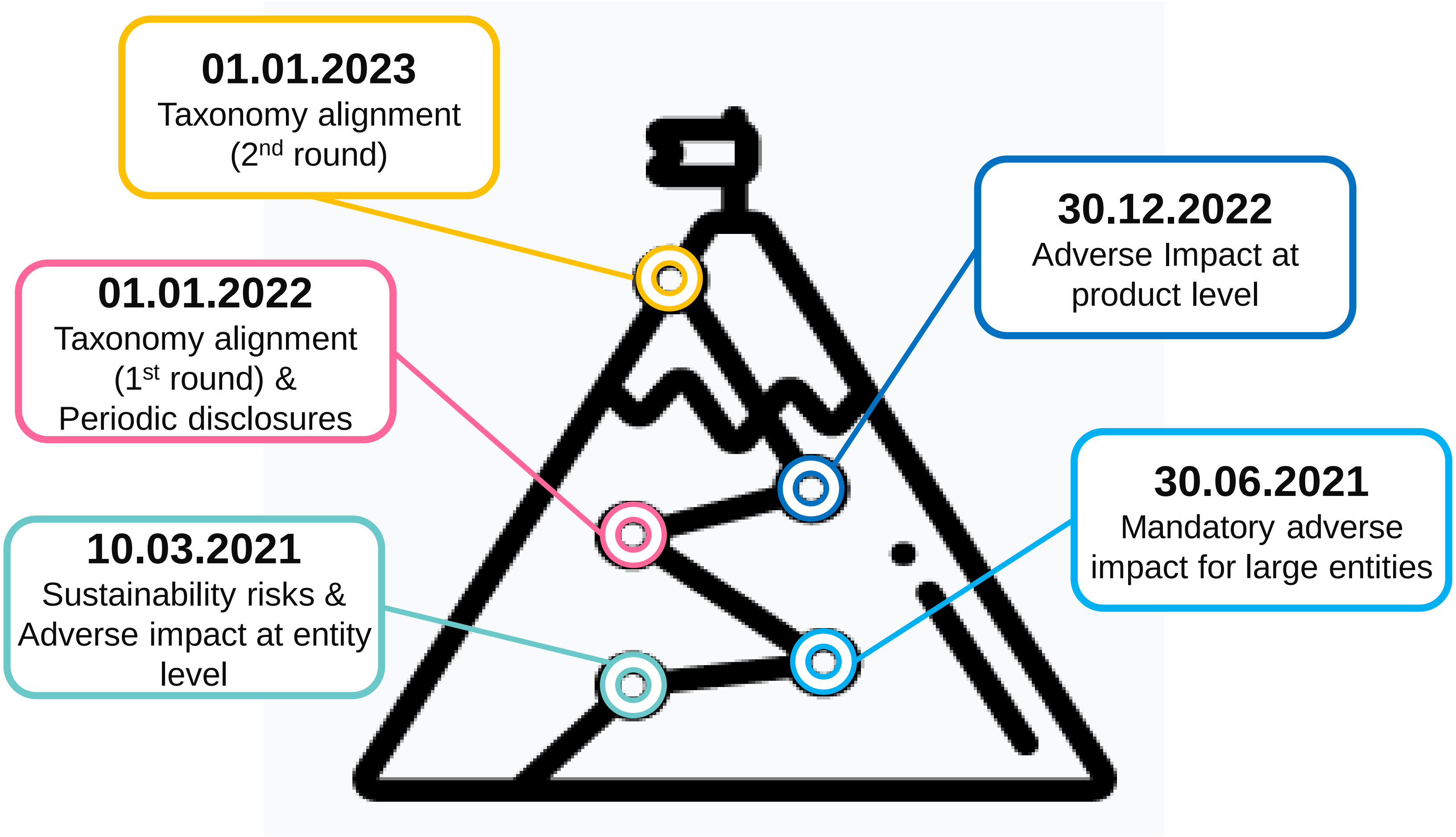
Key concepts



Context

A plan

The road ahead



Step 1
Sustainability risks
Adverse impacts

10/03/2020

Regulation (EU) 2019/2088
on sustainability-related disclosures in the financial services sector (SFDR)

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Objectives:

- Harmonised EU rules on sustainability disclosure obligations for manufacturers of financial products and financial advisers toward end-investors (website, pre- contractual and ongoing)
- End-investors can take better informed decisions on their investments

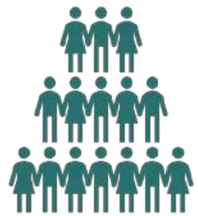
Publication: 9th December 2019 (Into force)

Applicability: 10th March 2021 (some products rules to be implemented by 30th December 2022)

In the news: 23rd April 2020, ESAs' Joint Committee issued a Joint Consultation Paper on Draft RTS (Consultation closed on 1st September 2020)

SFDR
Scope

Who?:



"Financial Market Participants"
Article 2(1)

- Insurance undertaking
- Investment firm which provides portfolio management
- Institution for occupational retirement provision (IORP)
- Manufacturer of pension product
- Alternative investment fund manager (AIFM)
- Pan-European personal pension product (PEPP) provider
- Manager of venture fund and/or social entrepreneurship fund
- UCITS management company
- Credit institution which provides portfolio management

"Financial Adviser"
Article 2(11)

- Any of the above providing insurance and/or investment advice

What?:

"Financial Product"
Article 2(12)

- Managed portfolios
- AIF
- IBIP
- Pension product
- Pension scheme
- UCITS
- PEPP

Regulation EU 2019/2088 (SFDR)
General disclosures

Financial Market Participants level

Integration of **sustainability risks** in the investment decision making or investment advice process

Opt-out

Consideration of **principal adverse impact** of investment decisions on sustainability factors

- **a statement** on due diligence policies with respect to those impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they make available; OR
- **clear reasons for why they do not do so,** including, where relevant, information as to whether and when they intend to consider such adverse impacts

Remuneration policies

Standard products

Opt-out

Integration of sustainability risks

- how sustainability risks are integrated in the investment decision; and
- the results of assessment of the likely impact or sustainability risks on the returns of the financial product.

OR

- Where financial market participants deem sustainability risks not to be relevant, **the descriptions referred above shall include a clear and concise explanation of the reasons therefor.**

Website publication and maintenance | *Pre-contractual disclosures*

Regulation EU 2019/2088 (SFDR)
Pre contractual disclosures

Products promoting environmental or social characteristics (Art. 8)

Information on how those E&S characteristics are met

Information on whether and **how the index** designated as reference benchmarks **is consistent** with those characteristics (if applicable)

An indication of **where the methodology** used for the calculation of the index designated as reference benchmark is to be found (if applicable)

Products that have an objective of sustainable investment (Art. 9)

An explanation on how the sustainable investment objective is to be attained

Information on how the index designated as reference benchmarks **is aligned with the sustainable investment objective** and how it differs from a broad market index (if applicable)

The objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement (if applicable)

An indication of **where the methodology** used for the calculation of the index designated as reference benchmark is to be found (if applicable)

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“Sustainable investment” (art. 9*)
EU Definition

Investment in an **economic activity** that contributes to:

Environmental objective

such as measured by key resource efficiency indicators

(use of energy, renewable energy, raw materials, water and land; production of waste, GHG emissions; impact on biodiversity and circular economy)

AND /OR

Social objective

(tackling inequality, foster social cohesion, social integration and labour relations, investments in human capital or economically or socially disadvantaged communities)

\+

Provided that such investments: **do not significantly harm (DNSH)** any of those objectives and that the investee companies follow **good governance practices**

* Narrow link with the taxonomy (see page 26)

Draft RTS for Article 8 and Article 9 products
Pre contractual disclosures

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Art.8

- a) Environmental or social characteristics promoted by the financial product
- b) No sustainable investment objective
- c) Investment strategy
- d) Sustainability indicators
- e) Use of derivatives
- f) Website reference
- g) Reference benchmark

Art.9

- a) Sustainable investment objective of the financial product
- b) No significant harm to the sustainable investment objectives
- c) Investment strategy
- d) Sustainability indicators
- e) Use of derivatives
- f) Website reference
- g) Sustainable investment objective attainment with a designated index
- h) Objective of a reduction in carbon emissions

Templates not available yet

Regulation EU 2019/2088 (SFDR)
Website disclosures

Products promoting environmental or social characteristics (Art. 8)

A description of the E&S characteristics

Information on **the methodologies used to assess, measure and monitor the E&S characteristics** selected for the financial product

Information referred to in pre-contractual disclosures and in periodic reports

Products that have an objective of sustainable investment (Art. 9)

A description of the sustainable investment objective

Information on **the methodologies used to assess, measure and monitor the impact of the sustainable investments** selected for the financial product

Information referred to in pre-contractual disclosures and in periodic reports

Website publication and maintenance

Draft RTS for Article 8 and Article 9 products
Website disclosures

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Art.8	Art.9
a) Summary	a) Summary
b) Environmental or social characteristics of the financial product	b) Sustainable investment objective of the financial product
c) Proportion of investments	c) Proportion of investments
d) No sustainable investment objective	d) No significant harm to the sustainable investment objective
e) Investment strategy	e) Investment strategy
f) Monitoring or environmental or social characteristics	f) Monitoring or sustainable investment objective
g) Methodologies	g) Methodologies
h) Due diligence	h) Due diligence
i) Engagement policies	i) Engagement policies
j) Data sources and processing	j) Data sources and processing
k) Limitations to methodologies and data	k) Limitations to methodologies and data
l) Designated reference benchmark	l) Attainment of the sustainable investment objective

Templates not available yet

Step 2
Periodic disclosures and Taxonomy alignment (1st round)

01/01/2022

Regulation EU 2019/2088 (SFDR)
Periodic disclosures

Products promoting environmental or social characteristics (Art. 8)

The extent to which environmental or social characteristics are met

Products that have an objective of sustainable investment (Art. 9)

The overall sustainability-related impact of the financial product by means of relevant sustainability indicators

A comparison between the overall sustainability-related impact of the financial product with the impacts of the index and of a broad market index through sustainability indicators

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Taxonomy Regulation

Objective:

- Elaborate a classification tool to help plan and report the transition to an economy that is consistent with the EU's environmental objectives.
- Establish criteria for whether economic activitiy is environmentally sustainable to establish the degree of environmental sustainability of an investment.

Timing: Published 22nd June 2020

Delegated acts expected for end of 2020 and 2021

Who has to use the Taxonomy Regulation:

1. Financial Market Participants offering financial products
2. Large companies already required to prepare NFRD report
3. EU and Member States when setting public measures, standards or labels

Taxonomy
Summary (1/3)

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To be in the taxonomy's list an economic activity must…

Contribute substantially to one or more of the environmental objectives

+

Do no significant harm to any of the environmental objectives

+

Comply with **minimum social and labour criteria**

+

Comply with quantitative or qualitative technical screening criteria for determining "*Substantial contribution*" and "*Doing No Significant Harm (**DNSH**)*"

DA due by 31/12/20

DA due by 31/12/21

Taxonomy

Summary (2/3)

Step 5	**Calculate alignment** of investments with the Taxonomy and prepare disclosures at the investment product level.
Step 4 Social risk management	Conduct due diligence to **avoid** any violation **to the social minimum safeguards** stipulated in the Taxonomy
Step 3 DNSH assessment	**Verify that the DNSH criteria are being met** by the issuer.
Step 2 TSC	For each potentially aligned activity, **assess the relevant screening criteria for a substantial contribution.**
Step 1	Identify the activities conducted by the company or issuer or those covered by the financial product (e.g., projects, use of proceeds) that could be aligned, and for which env**ironmental objective(s)**.

Example: calculating taxonomy alignment

Step 1				Step 2 TSC		Step 3 DNSH assessment	Step 4 Social risk management	Step 5 Aggregation at portfolio level	
TOTAL	TURNOVER	**Company 1: Coal powered energy**	**25%**	X Not aligned					**Taxonomy aligned turnover of the fund:** **50% x 90% = 45%** **The fund is 45% Taxonomy aligned**
		Company 2: Hydro powered energy	**25%**	✓ Aligned	**Threshold**: <100g CO2e/kWh **Data cannot be verified => Assumed not to be met**				
		Company 3: Wind powered energy generation	**50%**	✓ Aligned	No threshold	**Do no significant harm** noise, composite waste pollution, biodiversity risks for birds and baths.	**Minimum standards** related to UNGC, OECD Guidelines and ILO conventions.	Company 3 derives **90% of its revenue** from Taxonomy-aligned activities	

Taxonomy
Summary (2/3)

Duties imposed by the Taxonomy Regulation

1. Mapping of the investments into three categories :

   - Environnementally sustainable investments;
   - Investments that promote environmental characteristics;
   - Other financial products

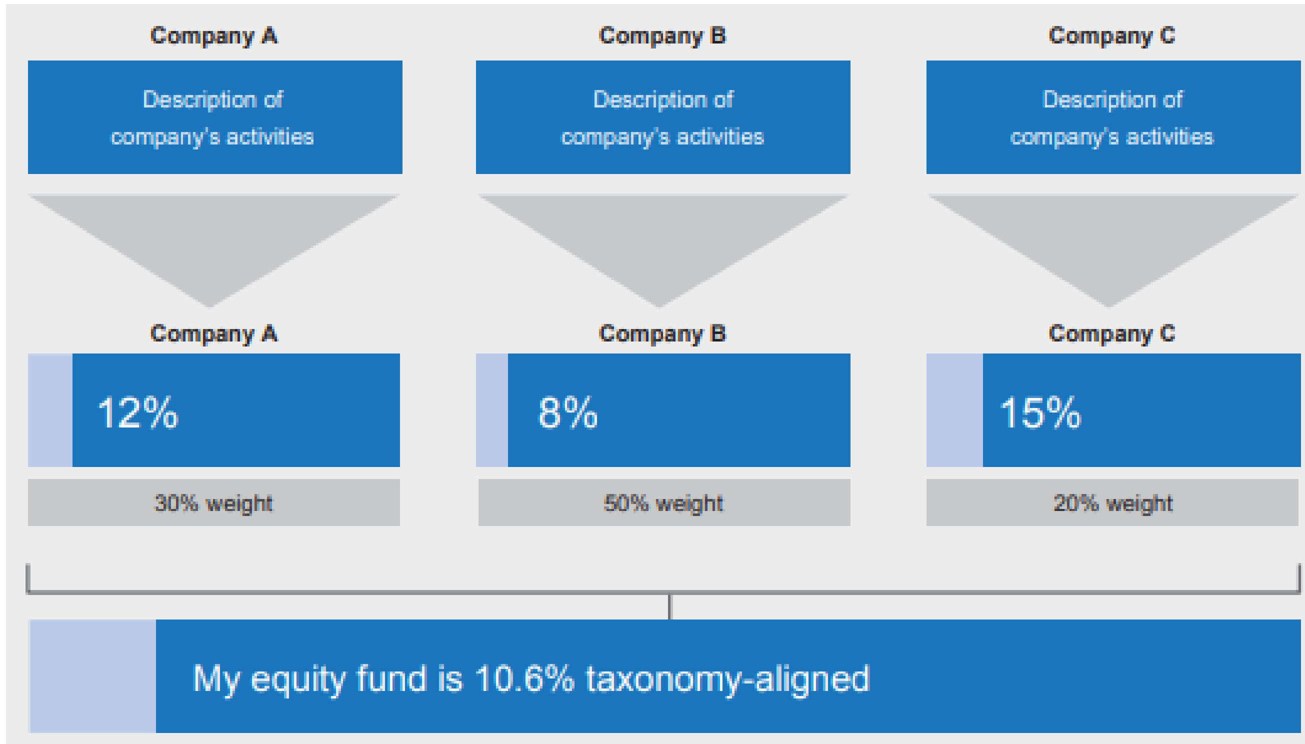
2. Disclosures

   - Of « sustainable » or « ESG-Complaint » products (from 31 December 2021/2022, depending on the objective pursued)
   - Of products with no ESG characteristics (from 31 December 2021)

Taxonomy
Summary (3/3)

Equity portfolios
Identify the percentage of **revenues** derived from Taxonomy-eligible activities

Green bond funds
Percentage of **proceeds** invested in qualifying activities



Private equity funds
Technical data needed to screen compliance with the thresholds for transitional activities, such as CO_2 emissions, will be harder to obtain. Private companies' disclosures on sustainability-related data are rarely standardized and depend on whether, and the extent to which, investors have requested such information

Step 3
Principal adverse impact indicators (product level)

30/12/2022

Regulation EU 2019/2088 (SFDR)
Adverse sustainability impact at product level

Standard products

Opt-out

Adverse impact

- Clear and reasoned explanation of whether principal adverse impacts are considered and if they are, how
- A statement that the information on principal adverse impact on sustainability factors is available in the periodic reports

OR

- **Where a financial market participant does not consider adverse impacts of investment decisions on sustainability factors, the disclosures referred to in above shall include for each financial product a statement that the financial market participant does not consider the adverse impacts of investment decisions on sustainability factors and the reasons therefor.**

Opt-out

Information on principal adverse impact on sustainability factors

Where information in periodic reports includes quantifications of principal adverse impacts on sustainability factors, that information may rely on the provisions of the regulatory technical standards adopted pursuant to the transparency requirement of adverse sustainability impacts at entity level

Periodic reports

Pre-contractual disclosures

Draft RTS
Principal adverse impacts template

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Publication on their websites in a separate section titled, ‘Adverse sustainability impacts statement’

- a) Summary
- b) Description of principal adverse sustainability impacts
- c) Description of policies to identify and prioritise principal adverse sustainability impacts
- d) Description of actions to address principal adverse sustainability impacts
- e) Engagement policies
- f) Reference to international standards

Draft RTS
Principal adverse impacts template

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Adverse sustainability indicator		Metric (expressed in market value)	Impact [year n]	Impact [year n-1]	Explanation
GHG emissions	1. Carbon emissions (broken down by scope 1, 2 and 3 carbon emissions - including agriculture, forestry and other land use (AFOLU) emissions - and in total)	Please see point (f) of the Draft RTS Annex I			
	2. Carbon footprint	Please see point (g) of the Draft RTS Annex I			
	3. Weighted average carbon intensity	Please see point (i) of the Draft RTS Annex I			
	4. Solid fossil fuel sector exposure	Share of investments in solid fossil fuel sectors			
Water	12. Water emissions	Weight in tonnes of water emissions generated by investee companies per million EUR invested, expressed as a weighted average			
	13. Exposure to areas of high water stress	1. Share of investments in investee companies with sites located in areas of high water stress 2. Share of investee companies with sites located in areas of high water stress			
	14. Untreated discharged waste water	Total amount in cubic meters of untreated waste water discharged by the investee companies expressed as a weighted average			

Draft RTS Template

(g) ‘carbon footprint’ shall be calculated in accordance with the following formula

$$\frac{\sum_n^i \left(\frac{current\ value\ of\ investment_i}{investee\ company's\ enterprise\ value_i} \times investee\ company's\ Scope\ 1, 2\ and\ 3\ carbon\ emissions_i\right)}{current\ value\ of\ all\ investments\ (€M)}$$

Regulation (EU) 2019/2089 amending the Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

1. Context

Since conventional benchmarks do not reflect low-carbon considerations in their methodologies and are not appropriate to measure the performance of sustainable investment strategies, over the past decade index providers have designed **hundreds of ESG and 'low-carbon' benchmarks.**

Lack of **harmonisation of the methodologies** (especially lack of consensus on how comprehensive the assessment of a carbon footprint should be) and lack of **clarity on the objectives** pursued (with regard to the impact on global warming) have affected comparability, reliability and adoption of low-carbon indices. Furthermore, the varying degrees of reporting hinders market players' ability to compare indices and choose the adequate benchmarks for their environmental or climate-related investment strategy. Therefore, acceptance and adoption of low-carbon benchmarks by the market has been limited and such benchmarks' significance for overall portfolio allocation remains low.

2. Summary

Objective:

(i) allow **comparability** of climate benchmarks methodologies while leaving benchmarks' administrators flexibility
(ii) provide investors with a tool aligned with their investment strategy;
(iii) increase **transparency** on investors' impact, specifically with regard to climate change and the energy transition;
(iv) disincentive **greenwashing**

Timing:

Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks, published in December 2019

Practical implications for UCITS ManCos and AIFMs:

- Direct implications for benchmark administrators
- Better **comparability and transparency**

Regulation (EU) 2019/2089 amending the Regulation (EU) 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks

3. New EU Benchmarks

The Regulation (EU) 2019/2089 also introduces **two new European benchmarks**:

Climate benchmarks → **EU Climate Transition Benchmarks (EU CTB)** + **EU Paris Aligned Benchmarks (EU PAB)**

Main uses

- Underlying for passive investment strategies
- An investment performance benchmark for GHG emission-related strategies
- An engagement tool
- A policy benchmark to help guide strategic asset allocation (SAA)

Main users

EU CTBs

Institutional investors such as pension funds and (re)insurance companies with the objective of protecting a significant share of their assets against various investment risks related to climate change and the transition to a low-carbon economy, labelled as transition risks by the TCFD

EU PABs

Institutional investors which aim to display more urgency than CTB investors and want to be at the forefront of the immediate transition towards a +1.5°C scenario.

Further detailed infos?

Step 4
Taxonomy alignment
(2nd round)

01/01/2023

The road ahead

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A still evolving framework…

July 2020:
End of EC consultation on Sustainable finance strategy 2.0

1 Sept. 2020
End of EASs public consultation on ESG Disclosures RTS

Q3 2020
Sustainable finance strategy 2.0
or “New action plan on sustainable finance” or “renewed strategy”

Q4 2020
Revision of NFRD

30 December 2020
ESAs draft RTS on:

- adverse impacts on the climate and other environment-related adverse impacts (entity level)
- E/S characteristics (pre-contractual, website and periodic reports)
- Sustainable investment (pre-contractual, website and periodic reports)

End 2020
1st set of TSC for climate change mitigation and adaptation

01January 2021
EC Delegated act excluding sectors for PABs

10 March 2021
Applicability of SFDR (partial)

30 June 2021
Adverse impact at entity level mandatory for large entities

December 2021
TSC for other environmental objectives

30 December 2021
Joint Committee draft RTS on adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters

31 December 2021
Applicability of TSC for climate change mitigation and adaptation

01 January 2022
Applicability of new disclosure in annual reports

Significant benchmark providers to provide 1 or more EU CTB

30 December 2022
Adverse impact at product level

31 December 2022
Applicability of TSC for other environmental objectives

Administrators of EU CTBs to select, weight, or exclude underlying assets issued by companies that follow a decarbonization trajectory

TEG extended mandate until end of September 2020 to be replaced by the **EU Platform on Sustainable Finance** once the taxonomy regulation has been published

Review of **NFRD** and EC support to development of standardized natural capital accounting practices -> Course of 2020 (end of consultation on roadmap: 27/02/2020)

AIFM/UCITS | Taxonomy | Disclosures | Benchmarks


Q&A

Contact

Philippe-Emmanuel PARTSCH

EU Financial and Competition Law Partner
Professor of EU Banking and Financial Law (Liège – Paris II (vis. prof.))

Email : philippe-emmanuel.partsch@arendt.com
Tel : +352 40 78 78 544

Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

EU Action Plan on sustainable finance

EU Action Plan on sustainable finance

Timeline and key milestones (not exhaustive list)

Association des Banques et Banquiers, Luxembourg
The Luxembourg Bankers' Association
Luxemburger Bankenvereinigung

Significant acceleration of EU agenda on sustainable finance

2016 - 2017

December 2016 - launch of the High-Level Expert Group on Sustainable Finance (HLEG)

June 2017 - Publication of NFRD guidelines

2018

January - Publication of the HLEG final report

March - Adoption of the EU Action Plan on SF + TEC/MSEG launch

May - Legislative proposals on Taxonomy, Disclosure and Benchmarks

July – Start of TEC works on EU Taxonomy, ET GB standards, , EY Climate Benchmarks

Dec – Publication of 1st TEG report on Taxonomy

2019

March - Publication of 1st TEG report on EU GB standard

April - EP approval of CMU foundations

June – Publication of NFRD new guidelines

September – TEG final report on Benchmarks

December
- TEG Handbook on climate benchmarks & benchmarks' ESG disclosures
- EU Green Deal launch
- EC/EP agreement on Taxonomy Regulation
- SFDR published on OJ
- EC conclusions on CMU

2020

January
- Consultation on NFRD
- EFRAG mission to propose EU standard for non-financial reporting

February – EFRAG report n companies reporting on climate

March
- TEG final report on Taxonomy and EU GBS guide
- EU Climate Law proposal
- Consultation on EU Green Deal, ESG factors integration in Benchmarks

April
- Consultation on renewed sustainable finance strategy
- ESAs consultation on disclosure regulation

June - July – publication of and consultation on draft amendments to MiFID II

October 2020 - Publication of the draft DA on climate change mitigation and adaptation under the Taxonomy Regulation

EU Action Plan on Financing Sustainable
3 main objectives - 10 key actions

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1. Reorienting capital flows towards a more sustainable economy

1. Establishing an EU classification system for sustainable activities (Taxonomy)
2. Creating standards and labels for sustainable financial products
3. Fostering investment in sustainable projects
4. Incorporating sustainability in financial advice (sectorial legislation)
5. Developing sustainability benchmarks (Benchmark regulation)

2. Mainstreaming sustainability into risk management

6. Better integrating sustainability in ratings and market research
7. Clarifying asset managers' and institutional investors' duties regarding sustainability (SFDR)
8. Introducing a 'green supporting factor' in the EU prudential rules for banks and insurance companies

3. Fostering transparency and long-termism

9. Strengthening sustainability disclosure and accounting rule-making (NFRD review)
10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

EU Action Plan on Financing Sustainable
Navigating the new legislative changes

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Regulatory initiatives accelerate the need for action…

- Changes to existing regulations (e.g. MiFID II, UCITSD, AIFMD)
- New regulations (e.g. Taxonomy, Disclosure)
- Publications / discussion Papers / Reports (NFDR, Sustainable Corporate Governance, Incorporation of ESG and climate-related risks, stress testing,…)

… and it will stay with us for years

- Not all areas have been implemented in full.
- Renewed Sustainable Finance Strategy to be published soon (i.e. EU Green Bond Standard and Ecolabel for retail investment products)

EU Action Plan on Financing Sustainable
The role of Banks, challenges and opportunities

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" In Europe, banks have a special responsibility that comes from being in the centre of our financial system" - Valdis Dombroskis

The role of financial institutions is key in the EU Sustainable Finance Strategy

- Key role in international coalition/initiatives (Paris Agreement, NGFS)
- Banks as investors, capital providers and intermediaries
- Dialogue and engagement with counterparties
- Addressing the need/expectations from investors/clients/EU/civil society

Challenges

- Regulatory pressure
- New clients' expectations
- Significant strategic & operational impact
- Entire value chain affected
- Huge data challenge
- ESG risks integration
- New expertise / knowledge

Opportunities

- New products / services / solutions
- Brand / reputation
- Improved risk management
- New investment opportunities
- Enhanced dialogue with clients and counterparties

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Sustainable Finance Disclosure Regulation

Sustainable Finance Disclosure Regulation
Letter from ESAs to European Commission

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Update - On 7 January 2021, the Joint Committee of the ESAs sent a letter to EC to share priority issues raised by stakeholders during the consultation process relating to the draft RTS that would require urgent clarification to facilitate an orderly application of SFDR:

- Application of SFDR to non-EU AIFMs and registered AIFMs;
- Application of the 500-employoess threshold for principal adverse impact reporting on parent undertaking of a large group;
- The meaning of "promotion" in the context of products promoting environmental or social characteristics;
- The application of Article 9 of SFDR; and
- The application of SFDR product rules to MiFID portfolios and other tailored funds.

Note that ESAs have indicated that they are currently finalizing the draft RTS.

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Amendments to MiFID II

Key amendments to MiFID II framework
Legislative developments

Key milestones

8 June 2020
Publication draft amendments to MiFID II regulatory framework*

6 July 2020
End of the 4-weeks consultation period

Q3/Q4 2021
Drafts to come into law by late Q3 or early Q4 2021

End 2022
Entry into force within 12 (or 18 months) after coming into law

2020 | **2021** | **2022**

Principle

- No new organisational rules or conduct requirements
- Amendment of existing applicable organisational and governance rules as well as conduct of business obligations
- Requirement for firms to expressly take into account sustainability risks as part of compliance with the existing rules
- Changes reflective of changing investor perspectives and that sustainable investment is more than a binary choice between financial return and ESG preferences
- Supplementing/align with SFDR requirements (disclosure and suitability assessment)

Key amendments to MiFID II framework
Overview of key provisions

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2 delegated acts will – once implemented – amend the MiFID regime :

- **A draft delegated regulation,** to amend the MiFID Delegated Regulation (EU) 2017/565 in relation to the integration of sustainability risks into organisational requirements, and the integration of sustainability factors into the suitability assessment.
- **A draft delegated directive,** to amend the MiFID Delegated Directive (EU) 2017/593 in relation to the integration of sustainability preferences into product governance requirements

New definitions (Art. 2 of the MiFID II Delegated Regulation)	- **Sustainability preferences** - "means, in summary, a client's choice as to whether either: (a) a financial instrument that has sustainable investment as its objective, or (b) a financial instrument that promotes environmental or social characteristics, should be integrated into their investment strategy - **Sustainability factors** - "environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters (SFDR art.2) - **Sustainability risks** - "an environmental, social or governance event or condition that, it occurs, could cause an actual or a potential material negative impact on the value of the investment“ (SFDR art. 2)

Key amendments to MiFID II framework

New definitions and risk management

Organisational requirements (Art. 21(1) of the MiFID II Delegated Regulation)	▪ Requirement to take into account sustainability risks in existing governance and organisational structures, including firms' processes, systems and internal control mechanisms
Risk management (Art. 23 of the MiFID II Delegated Regulation)	▪ Requirement to take into account sustainability risks in risk management policies and procedures
Identification of conflicts of interest (Art. 33 of the MiFID II Delegated Regulation)	▪ Requirement to include client sustainability preferences in conflicts of interest identification and management rules (e.g. greenwashing, mis-selling practices)
Suitability assessment (Art. 52 and 54 of the MiFID II Delegated Regulation)	▪ Extension of existing suitability assessment requirement for investment advice or portfolio management decisions to how a recommendation or decision meets client sustainability preferences
Product governance (Art. 9(9), 9(11), 9(14), 10(2), 10(5) of the Delegated Directive)	▪ Update of existing rules for manufacturers and distributors of financial instruments in terms of identifying a relevant target market to also take account of the sustainability preferences of the target market

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ESG risks for credit institutions and investment firms

ECB guide on climate related & environmental risks

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- **Published in November 2020** (107 SIs and 18 LSIs)
- **Objective**: Help institutions to better identify, manage and monitor climate-related and environmental risks - Climate risk sensitivity analysis as forward-looking tool
- Clear positive trend but still need for significant improvement on disclosures - Banks will have to **improve disclosures significantly**: 97 % do not meet ECB expectations
- **Applicable immediately** (to both Significant institutions directly supervised by the ECB and the less significant institutions supervised by NCAs)
- **Not binding** but serves as a **basis for supervisory dialogue and identify/address gaps in risk coverage** as environmental factors are risk drivers of existing prudential risk categories (credit, market, operational and liquidity (2021)
- **Significant institutions (SIs)** are expected to use the guide, taking into account the materiality of their exposures to climate-related and environmental risks
- **Expectations from less significant institutions (LSIs)** - proportionality applies
- As from end-2020, SIs will be asked to inform ECB of any divergences of their practices from the supervisory expectations described in the ECB guide.
- **2022** → full supervisory reviews and follow up measures

European Banking Authority Action Plan
EBA mandates

In December 2019, the EBA has issued its action plan which covers ESG related factors and ESG risks as set out in the following legislative acts:

- Amended **EBA Regulation** (EU) No 1093/2010
- Revised **Capital Requirements Regulation** (EU) No 575/2013 (CRR 2) and **Capital Requirements Directive** (EU) 2019/2034 (CRD 5)
- New **Investment Firms Regulation** (EU) 2019/2033 (IFR) and **Investment Firms Directive** (EU) 2019/2034 (IFD)
- **Commission's Action Plan**: Financing Sustainable Growth and related legislative packages

The EBA work covers **4 main areas**:

- Strategy and risk management;
- Key metrics and disclosure;
- Stress testing and scenario analysis ; and
- Prudential treatment.

It is expected from EBA to deliver much of this work between **now and 2025.**:

European Banking Authority Action Plan
Sequencing and possible next steps

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1 Proactive strategy and risk management	2 Key metrics and disclosure requirements	3 Prudential treatment
Pillar II – supervisory review	Pillar III – disclosure requirements	Pillar I – Capital requirements
Art 98 (8) of CRD 5 & and article 35 of the IFD	Art 434(a) and 449(a) of CRR2 + Article 8 Taxonomy Regulation – EBA Advice to EC + ESAs RTS on sustainability under SFDR	Art 501(c) of CRR2
Possible legislative changes Updated or new EBA guidelines: 2021-2022 SREP Guidelines for IF: 2022-25	Final Report: June 2021 Applicable from June 2022	Discussion Paper: 2022-2024 Final Report : 2025

Scenario analysis and stress testing

EBA discussion Paper
Scope of the document

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Common definitions

- ESG factors
- ESG risks
- Transmission channels (physical, transition and liability risks)

Indicators, metrics and methods to evaluate ESG risks

- E, S and G indicators and metrics
- Tools and methods to evaluate, estimate and incorporate ESG risks

ESG risks supervision

- ESG factors as drivers of financial risks
- Extension of time horizon in supervisory review

ESG risks management

- Business strategy and business processes
- Governance and risk management
- Policy recommendations

Source: EBA work on sustainable finance and use of taxonomy

EBA discussion Paper
ESG factors and risks, transmission channels

- **ESG factors** = environmental, social or governance characteristics that may have a **positive or negative impact** on the financial performance or solvency of an entity, sovereign or individual.
- **ESG risks -** risks of **any negative financial impact** to the institution stemming from the **current or prospective** impacts of ESG factors on its counterparties (Indirect impact). Impact of ESG risks materializes in the form of **existing prudential risk categories.**

Transmission channels of environmental risks

- **Physical risk channels -** exposure to counterparties that may potentially be negatively affected by **the physical effects of climate change** or other environmental factors
- **Transition risks** - exposure to counterparties that may potentially be negatively affected by the **transition to a low-carbon, climate-resilient or environmentally sustainable economy**
- **Liability risks** - exposure to counterparties that may potentially be held **accountable for the negatively impact** through their activities on the environment, the society and their governance factors

EBA discussion Paper
Assessment of ESG risks

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1. IDENTIFICATION	2. EVALUATION	3. ACTION
Classification of exposures according to ESG characteristics	**Estimation of ESG risks based on methodological tools**	**Proportional incorporation of material ESG risks**
• Asset class • Sector, • Counterparty • Geography • Maturity	• Portfolio alignment method • Risk framework method (including climate change stress tests) • Exposure method	• Business strategy • Governance • Risk management

Challenges

- Level of uncertainty
- Insufficient data
- Methodological constraints
- Time-horizon mismatch
- Multi-point impact of ESG risks
- Non-Linearity

EBA discussion Paper
Methodological tools (non-exhaustive list)

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Alignment Method Global sustainability targets	**Risk Framework Method** Climate change scenarios / sensitivity analysis	**Exposure methods** ESG factors - performance
• How aligned is an institution's portfolio relative to global sustainability targets? (e.g., PACTA,, PCAF, PRB) • Results-oriented • Portfolio view Vs individual exposures	• How will sustainability-related issues affect the risk profile of a bank's portfolio and its standard risk indicators? • Risk driven approach • Stress model/test • (Climate) sensitivity analysis	• How do individual exposures and clients perform in terms of ESG risks ? (ESG scoring/ rating, internal or external evaluation) • Indicators typically at company level; basis for dialogue with clients
• What would be the "value" of such methodology with regards to prudential regulation as no explicit correlation between sustainability targets and changing risk characteristics ?	• Uncertainty, complexity, time horizon of climate stress test • Would the use of external provider methodologies be acceptable from a regulatory / supervisory perspective ?	• Lack of consistency and method transparency/comparability from rating providers • there is a risk that some methodologies would not be acceptable by regulators

Up to the Bank to design its own risk management strategy depending on size, complexity and business model, strategy and overall approach - each method has Pro's and Con's, and combinations are possible

ESG Risk Management

Business strategy, governance, risk framework

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BUSINESS STRATEGIES AND PROCESSES

- Monitor the changing business environment and evaluating long-term resilience (10 years)
- Set strategic ESG risk-related objectives and/or limits
- Engage with customers and other relevant stakeholders
- Consider the development of sustainable products

INTERNAL GOVERNANCE

- Allocate ESG risk responsibility to management body
- Consider ESG risk in existing or specialized committees
- Include ESG risks in the internal audit function/review
- Adequate skills/capabilities
- Link remuneration policies to ESG objectives/limits
- Manage conflict of interest

RISK MANAGEMENT

- Manage ESG risks as drivers of existing risk categories
- Collect data at loan origination, include sensitivity analysis in creditworthiness assessment
- Review risk appetite framework
- Consider ESG scoring
- Develop monitoring metrics at exposure, CP and portfolio level
- Reflect ESG risk materialisation in both ICAAP and ILAAP frameworks

Investment firms-specific considerations

- ESG risks materialization through different metrics monitored under the IFD
- No direct impact on firms' B/S
- Some adjustments needed depending on the IF assessment

Promotion of the EU taxonomy and its use for ESG risk management

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No mandatory use of the EU Taxonomy for risk management / internal models

However, the Taxonomy might be used on a voluntary basis:

- When developing internal **ESG indicators and criteria for categorisation of assets** from sustainability perspective
- When **setting strategic objectives and targets**
- When **designing sustainable products** – green bonds, green loans, taxonomy-aligned deposits as a benchmark for their funding side.
- When collecting/classifying data for **scenario analysis and stress testing** – pilot sensitivity analysis will indicate readiness for using EU taxonomy

Source: EBA work on sustainable finance and use of taxonomy

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EU Taxonomy interlinked initiatives

Focus on four main pieces of the EU Action Plan on Sustainable Finance

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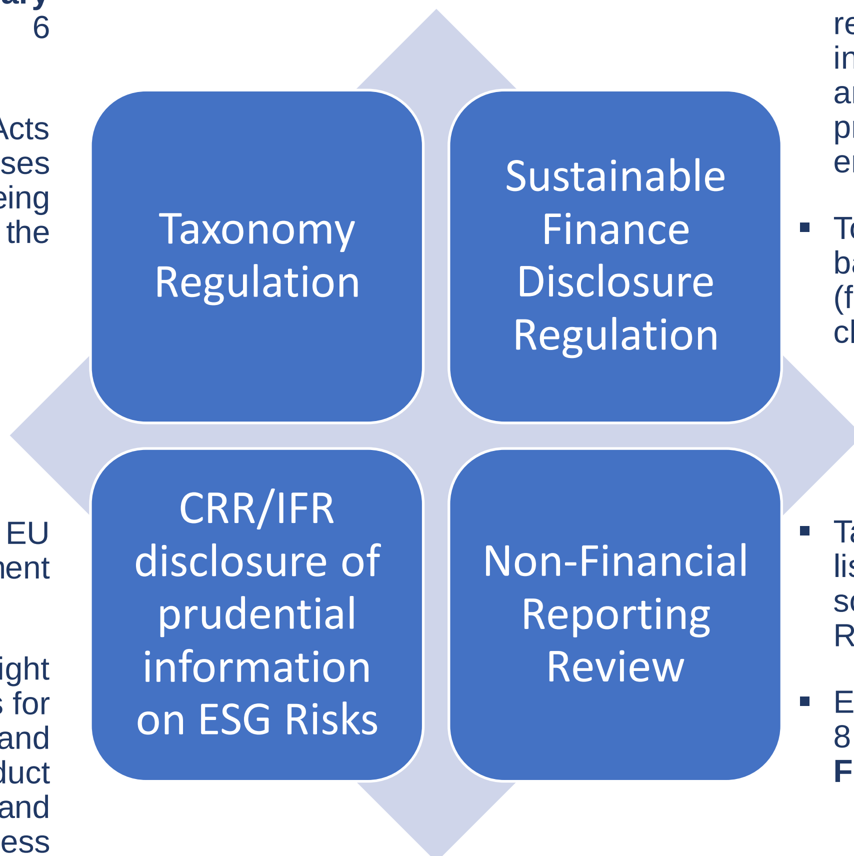
- Take effect as from **1st January 2022 (**for 2 out of 6 environmental objectives)
- Taxonomy Delegated Acts pending – 46,000+ responses to the consultation being reviewed before issuing the final draft

- Taxonomy Regulation art. 5 & 6 require additional transparency in pre-contractual disclosures and periodic reports for FMPs promoting a product with environmentally credentials
- To be applied on a staggered basis as from **1st January 2022** (for climate adaptation and climate mitigation)



- No mandatory use of the EU Taxonomy for risk management / internal models
- However, the Taxonomy might be used on a voluntary basis for ESG risks indicators and criteria definition, product design, objectives settings and scenario analysis and stress testing

- Taxonomy also applies to large listed companies falling in the scope of the Non-Financial Reporting Directive.
- ESMA final advice on the Article 8 to be provided by the **end of February 2021**.

Forthcoming EU legislative developments and initiatives

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- **The review of the Non-financial Reporting Directive** (NFRD, Directive 2014/95/EU) **is expected by Q1 2021,** with two objectives: first, improve the disclosure of climate and environmental information by companies to better inform investors about the sustainability of their investments and, give effect to changes required by the forthcoming Sustainable Finance Disclosure Regulation and the Taxonomy Regulation.
- A consultation is opened since October 26 on **Sustainable Corporate Governance** and aims to improve the EU regulatory framework on company law and corporate governance and then enable companies to focus on long-term value creation rather than short-term benefits. This initiative is **complementary to the review of the Non-Financial Reporting Directive**. Whilst the NFRD Is based on incentives to report ESG/due diligence policies, the sustainable corporate governance initiative aims to introduce concrete measures to set adequate corporate and director duties.
- The **EU Renewed Sustainable Finance Strategy** expected will come with new proposals and measures to reinforce and accelerate the EU agenda.
- **On December 2020**, the Dutch Authority for the Financial Markets ('AFM') and the French Financial Markets Authority ('AMF') called for a European regulatory framework for **sustainability-related service providers** .

Conclusion
What banks should focus on first ?

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Luxembourg Banks must start taking action now…

- Short term need for action with regards to SFDR
- Bank's objectives setting and sustainable/ESG strategy design
- Detailed assessment of product and service offering, portfolios and exposure to climate and ESG-related risks

… and ensure a progressive and phased-approach to keep integrating ESG considerations into their business models and risk management

- Integration and step-by-step implementation of the extended risk management framework
- Development of sustainable corporate culture and training across the entire organization
- Definition/clarification of governance aspects (roles and responsibilities, oversight and internal control, organisational structure)
- Put in place appropriate project plan to review the amendments proposed by the delegated acts (MiFID II, SFDR, Taxonomy) and assess impacts and alternative solutions that could be implemented

Stay tuned…

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As a member of the ABBL, your can join our ***Sustainability Community*** and stay tuned for more information – Your contact at the ABBL:

froumouth@abbl.lu

EU Sustainable Finance Package – Investment Funds Relevance

Linklaters

Martin Mager, Investment Funds Partner

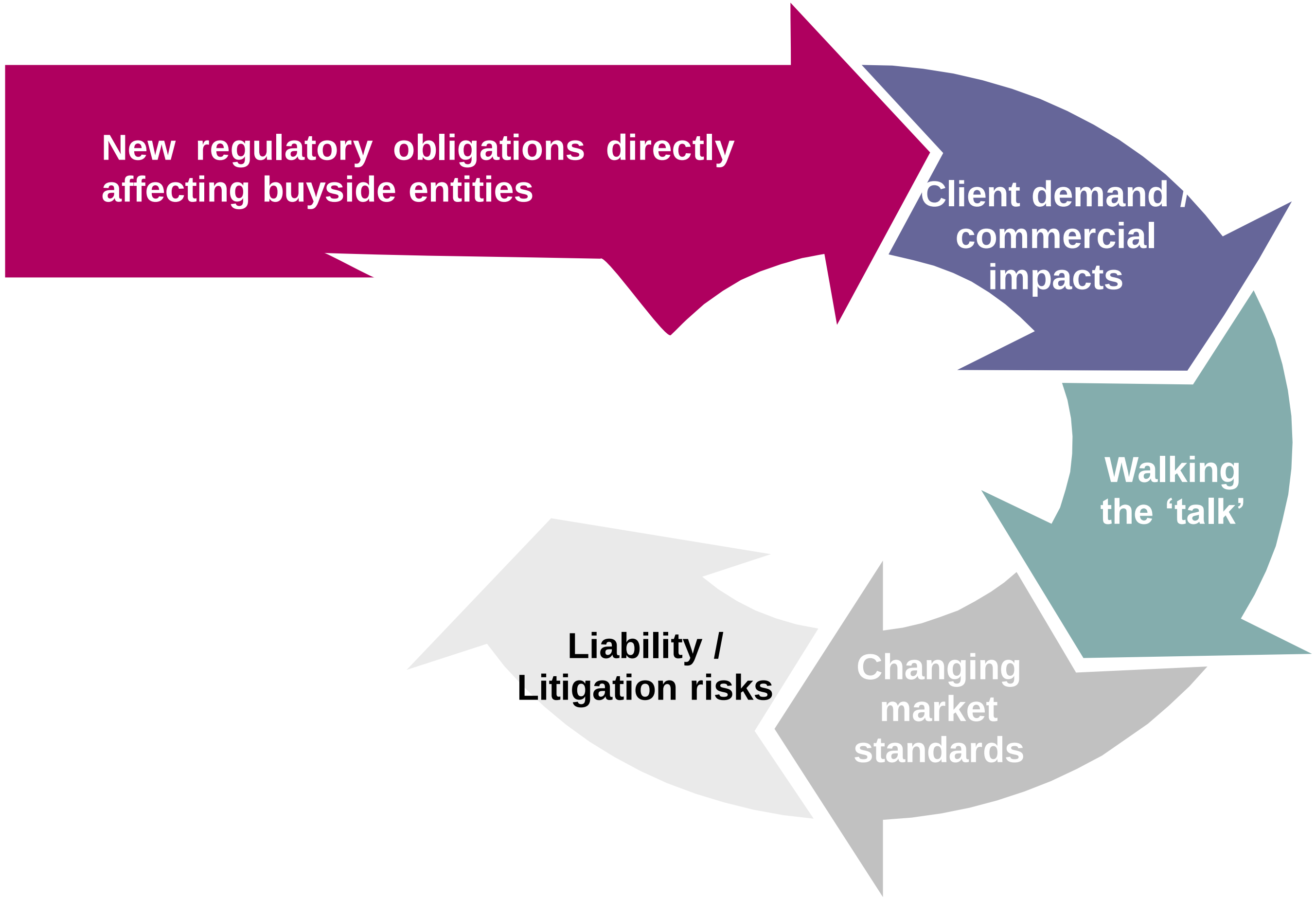
20 January 2021

What it is all about…

"The aim of the SFDR product level disclosures is to prevent greenwashing and to provide end-investors with "accurate, fair, clear, not misleading" product-specific information.

The detail and level of disclosures required vary depending on which SFDR category the product falls within (which will depend on the sustainability aims of the product). The SFDR product categorisation is key, as it will impact on how the product can be promoted/described within the EU as well as what investments the product is permitted / required to make."

Why does it matter?



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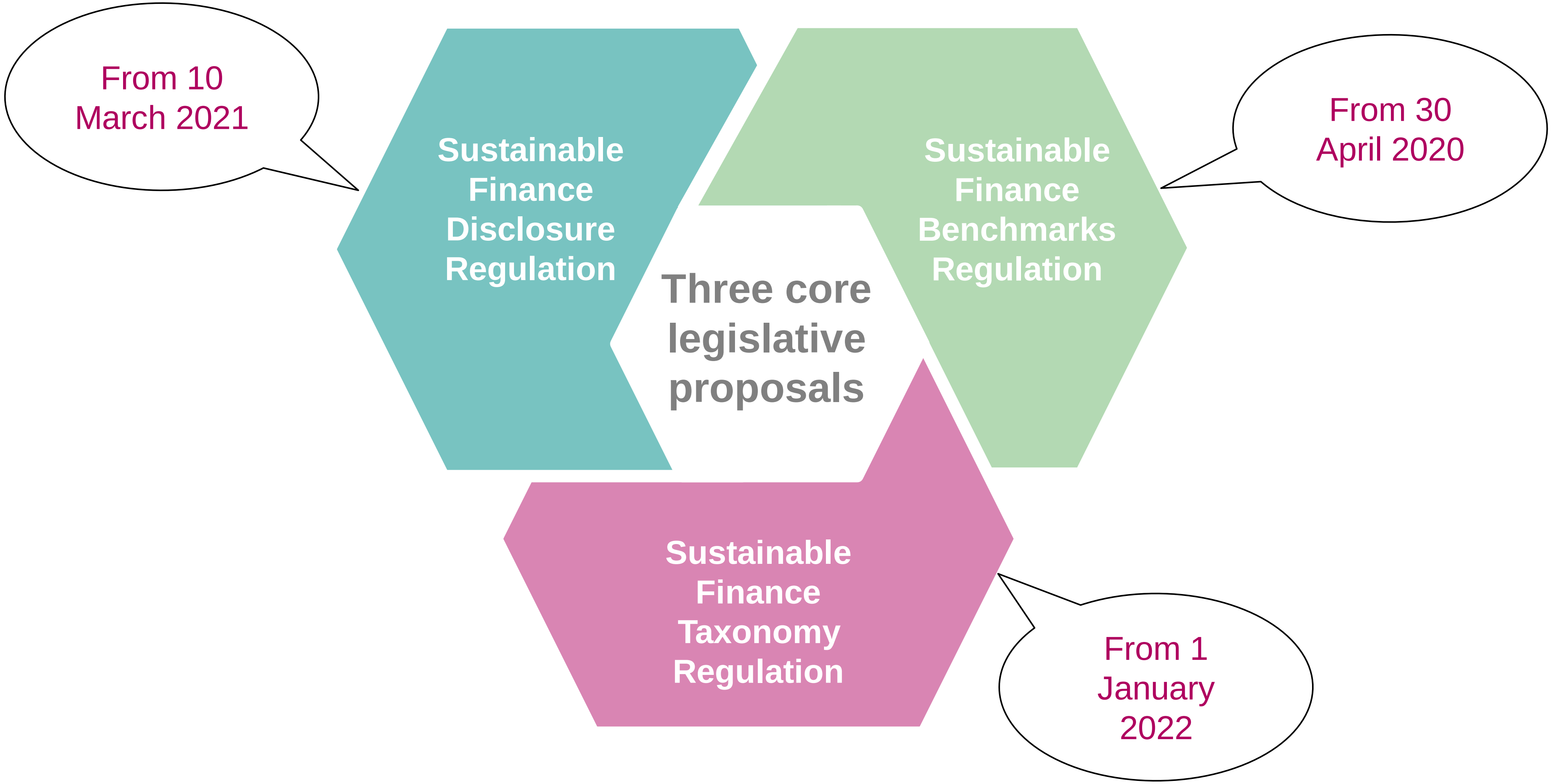
Overview of the EU (and UK) reforms

EU and UK reforms aimed at regulated firms - in some cases have direct or indirect global reach

Focus is on preventing green-washing, encouraging investments into sustainable activities and managing sustainability risks

Part of a wider EU package including EU Green Deal, Climate Law, and EU Rescue Package

EU Sustainable Finance Package – Overview



SFDR – What is it about?

In-scope entities and products

> Entities:

> financial market participants (firms conducting investment decision-making activities on behalf of clients / beneficiaries, e.g. any investment firm providing portfolio management, AIFMs and UCITS ManCos); and

> financial advisers (e.g. investment firms, AIFMs and UCITS ManCos providing investment advice).

> Products: financial products (e.g. separate accounts, AIFs and UCITS).

What do the disclosures relate to?

1. Integration of **Sustainability Risks** into investment decision-making or advice (*Sustainability Risk means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investments*)

2. Consideration of adverse impacts of investment decisions or advice on **Sustainability Factors** (*Sustainability Factors mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters*)

3. **Product-specific disclosures** for Article 8 funds ("light green") and Article 9 funds ("dark green")

Timing

Requirements will generally apply from **10 March 2021** (note that drafts of detailed Level 2 standards have been delayed)

SFDR – Scope

> "financial market participants" (FMPs) – include (among others):

- ✓ AIFMs & UCITS ManCos;
- ✓ investment firms providing portfolio management; and
- ✓ institutions for occupational retirement provision ("**IORP**"), manufacturers of pension products and pan-European personal pension product ("**PEPP**") providers.

> "financial advisers" – include (among others):

- ✓ credit institutions, investment firms, AIFMs and UCITS ManCos to the extent they provide investment advice (not just in relation to "financial products")

> "financial products" (<u>NOT</u> 'financial instruments') – include (among others):

- ✓ separate accounts, AIFs and UCITS funds;
- ✓ portfolios; and
- ✓ pension products/schemes and PEPPs.

SFDR – Overview

Entity-level obligations

Explain how **sustainability risks** are factored into investment decisions – *mandatory*

Explain how **remuneration policies** are consistent with the integration of sustainability risks – *mandatory*

Explain how **adverse impacts** on ESG matters are built into due diligence – *comply or explain*

Product-level obligations

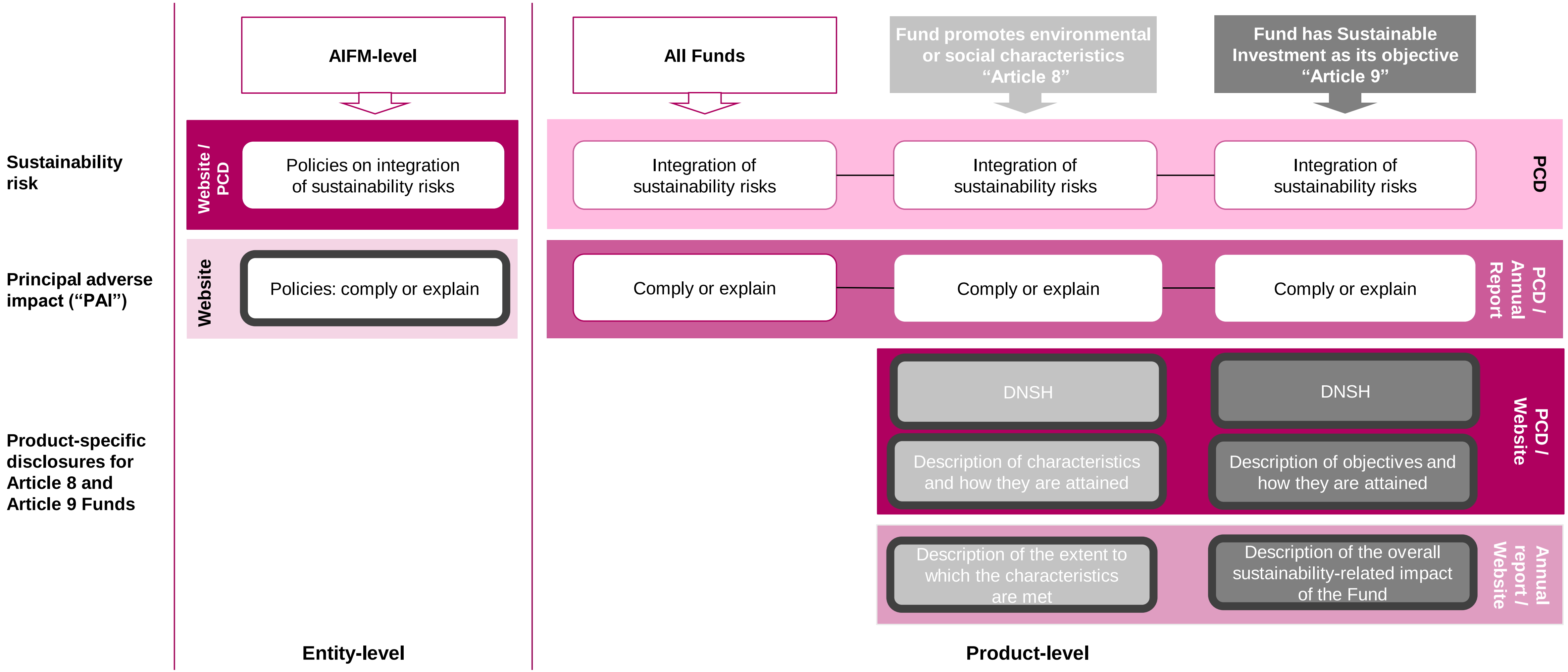
Explain how **sustainability risks** are likely to impact returns – *comply or explain*

Explain **adverse impacts** of investments on ESG matters – *comply or explain*

Explain how products are light green (Art 8) – *mandatory*

Explain how products are dark green (Art 9) – *mandatory*

SFDR – Overview



SFDR – Expected timings

Medium	Disclosures	Level	Timing
Website	Integration of sustainability risk	Entity-level	By 10 March 2021
	Consideration of principal adverse impacts on sustainability factors	Entity-level	Comply or explain by 10 March 2021 (mandatory for large AIFMs from 30 June 2021)
	Funds with "E" or "S" characteristics / "sustainable investment" objective (i.e. Art. 8 and Art. 9 funds)	Product-level	By 10 March 2021
Pre-Contractual	Integration of sustainability risk	Entity- and product-level	Comply or explain by 10 March 2021
	Consideration of principal adverse impacts on sustainability factors	Product-level	Comply or explain by 30 December 2022 (but mandatory for large AIFMs and, for ESG funds, by 10 March 2021 due to DNSH)
	Funds with "E" or "S" characteristics / "sustainable investment" objective (i.e. Art. 8 and Art. 9 funds)	Product-level	By 10 March 2021
Periodic reports	Funds with "E" or "S" characteristics / "sustainable investment" objective (i.e. Art. 8 and Art. 9 funds)	Product-level	1 January 2022

EU Commission confirmed delay to SFDR Level 2 rules until January 2022

Taxonomy Regulation – What is this about?

- Taxonomy Regulation establishes an **EU-wide classification system** or ‘framework’ intended to provide businesses and investors with a common language to identify to what degree economic activities can be considered **environmentally sustainable**.
- It represents a key step towards the objective of achieving a carbon-neutral Union by 2050 (“Net Zero”).

Purposes

> Foster private investments in environmentally sustainable activities

> Provide clarity, transparency on environmental sustainability

> Avoid green-washing

> Enable informed decision-making

> Develop uniform criteria to facilitate cross-border investments

Where are we now?

- **Taxonomy Regulation published in the EU Official Journal on 22 June 2020**
- **Entered into force on 12 July 2020**
- **First obligations shall apply from 1 January 2022**

> **First Delegated Acts not expected before 31 December 2020**

Taxonomy Regulation – What is an environmentally sustainable investment?

Scope: applies to FMPs, large public interest entities such as credit institutions and listed issuers and, in due course, green bond issuers.

To be environmentally sustainable, an **economic activity** must:

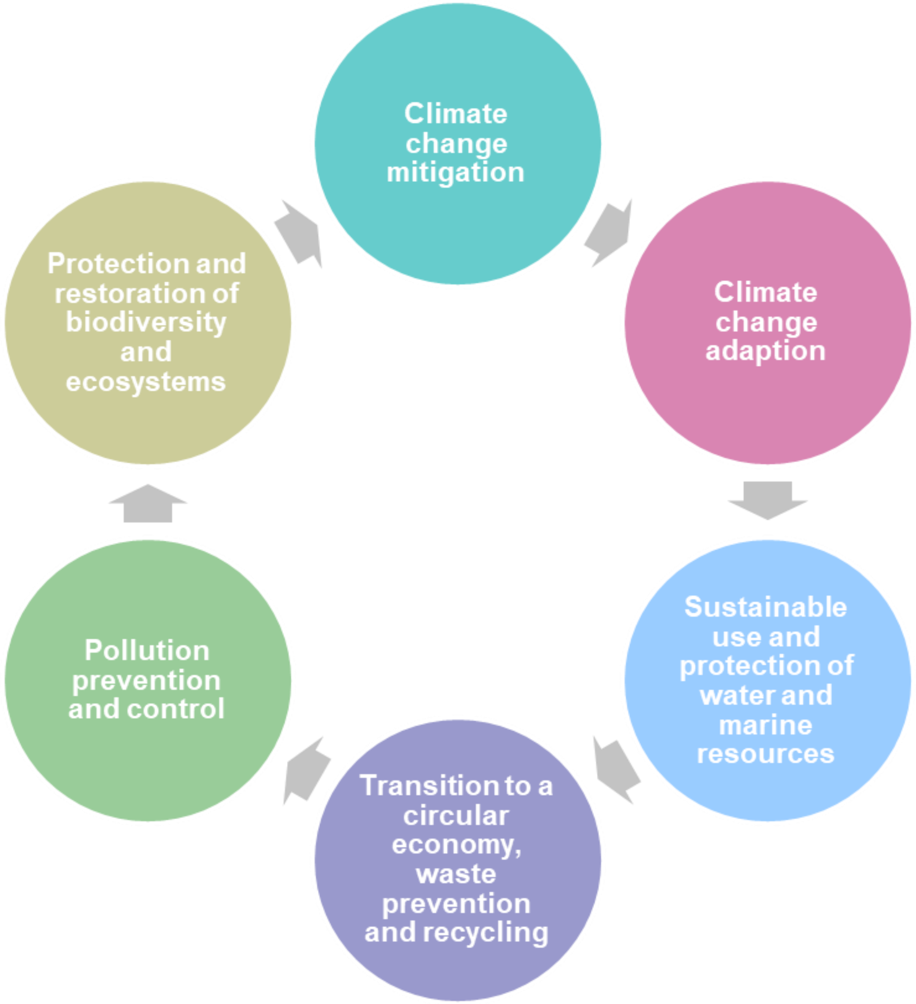
> contribute substantially to at least one of six specified environmental objectives on the right (lifecycle approach);

AND

> not significantly harm any of the (other) six environmental objectives;

> be carried out by the economic operator/investee company in compliance with certain minimum social and governance safeguards; and

> comply with additional qualitative and quantitative technical screening criteria, developed in Level 2 rules.



Taxonomy Regulation – Required Disclosures

Where?	What?	When?
Pre-contractual disclosure	**For products that are not Article 8 or Article 9 –** *"The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities."*	By 1 January 2022
Pre-contractual disclosure	**For Article 8 products –** *"The "do not significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities.* *The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities."*	By 1 January 2022
Pre-contractual disclosure	**For Article 9 products –** Disclosures on the proportion of underlying investments that are environmentally sustainable as a percentage of the investment, financial product or portfolio (including respective proportions of enabling and transition activities)	By 1 January 2022

> How comfortable would you be with making the above required disclaimers for your "non-ESG" and Article 8 funds?

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SFDR – Entity-level obligations

Explain how **sustainability risks** are factored into investment decisions – *mandatory*
Article 3(1) SFDR

Explain how **remuneration policies** are consistent with the integration of sustainability risks – *mandatory*
Article 5 SFDR

Explain how **principal adverse impacts** on ESG matters are considered in investment decisions – *comply or explain* unless large FMP

Article 4 SFDR; Articles 4-10 and Annex I RTS

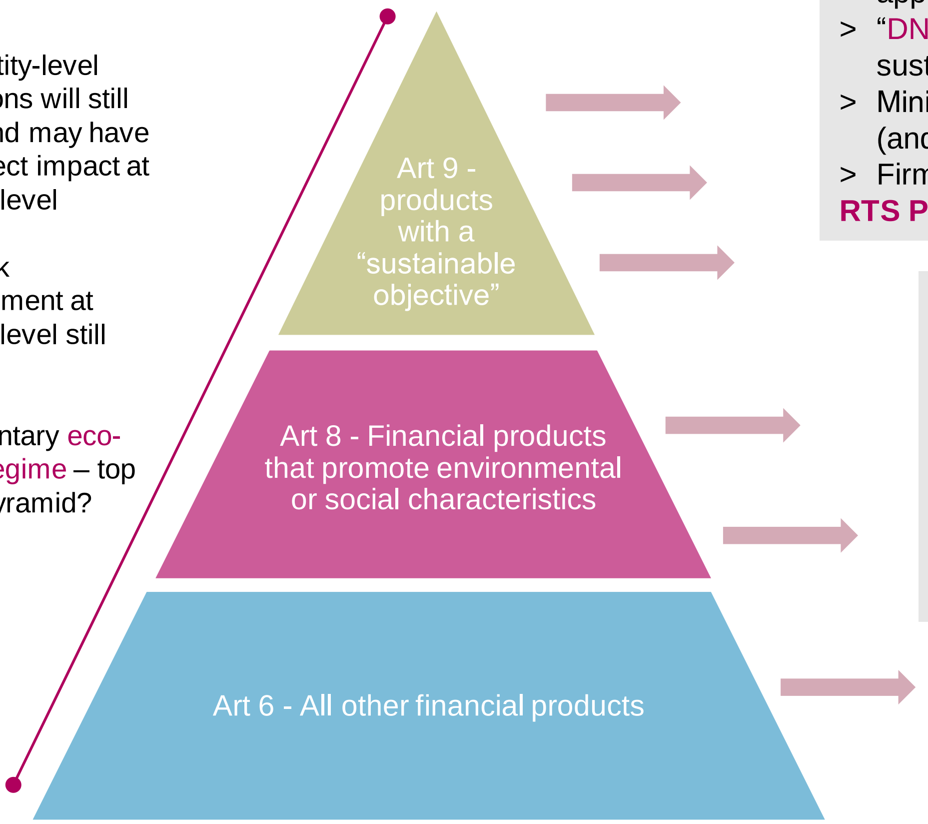
SFDR – Product Scoping

Note:

> ESG entity-level obligations will still apply and may have an indirect impact at product level

> ESG risk management at product level still relevant

> EU voluntary eco-labels regime – top of the pyramid?



> Objective must be to invest in activities contributing to E or S objectives (Taxonomy Regulation will apply in due course to E objectives – “substantial contribution”)

> “DNSH” test under Taxonomy Regulation (“E”) and SFDR applies (“E” and “S” objectives) to sustainable investments **AND** principal adverse impact (“**PAI**”) disclosures

> Minimum “S” and “G” criteria apply – investee companies must follow good governance practices (and under Taxonomy Regulation, ILO and human rights standards)

> Firms must provide pre-contractual and periodic disclosures to evidence/validate the above

RTS PROPOSES TEMPLATES/MINIMUM QUANTITATIVE + QUALITATIVE DISCLOSURES

> Must be able to evidence and validate “E” and “S” features – under SFDR (“E” and “S”) and in due course under Taxonomy (“E”)

> Must also comply with DNSH tests if it has any sustainable investments

> Minimum “G” criteria – investee companies with good governance practices

> Principal adverse impact (“**PAI**”) disclosure obligations will apply

> Need disclaimers to flag they don’t have a sustainable objective (only feature) and also (in due course) flag if not Taxonomy compliant

RTS PROPOSES TEMPLATES/MINIMUM QUANTITATIVE + QUALITATIVE DISCLOSURES AND IMPOSES DNSH STANDARD

> **Note:** principal adverse impact (“**PAI**”) disclosure obligations will apply – if no PAIs considered then may be difficult to distribute under proposed MiFID II ESG rules

> In due course will need disclaimers stating they are not Taxonomy compliant.

RTS PROPOSES TEMPLATES/MINIMUM CRITERIA ON PAIs AND STATES THAT THESE PRODUCTS MAY HAVE BASELINE ‘E’ OR ‘S’ SAFEGUARDS BUT THOSE SHOULD BE DISCLOSED

SFDR – Product Scoping

When does a product promote E or S features?

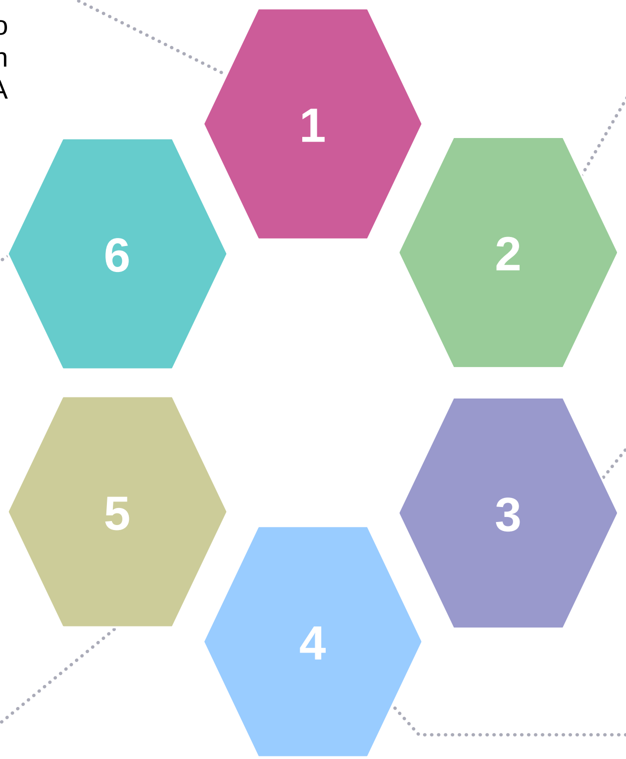
RTS indicates this is the case when info provided to clients references sustainability factors that are taken into consideration when allocating capital or, (ESA public hearing) if product de facto has such features

Be mindful of different ways of promoting E/S features

> Products don't need to be explicitly promoted as targeting sustainable investments – they are in scope if they claim to account for sustainability factors in investment decisions
> E.g. ESG strategies focussed on best in class, based on exclusionary criteria or better than the rest are also caught and must give transparency on methodologies – unless exclusions to comply with applicable law

What about products that consider sustainability risks?

> RTS states that broad concept of 'ESG integration' is not enough to justify that a product promotes E or s characteristics
> Firms can adopt baseline E / S safeguards also but they should be explained



Fair, clear and not misleading

FMPs should not disclose excessively on sustainability, including through product categorisation or product naming / labelling

Disclosure limited to binding ESG selection criteria

To prevent greenwashing and over-disclosure, FMPs must not disclose selection criteria they can disapply or override on discretion

Marketing Communications

Must be consistent with and must not contradict SFDR disclosures

SFDR – Product Scoping

> Practical Implications:

- Scoping exercise needs to consider all disclosures made to investors – in carrying out your scoping exercise, did you consider all pre-contractual disclosures made to investors, including not only prospectuses, offering memorandums and IMAs, but also for example, side letters, PRIIPs KIDs and any website disclosures?
- Application to legacy products – the extent to which the Disclosure Regulation applies to products that are no longer marketed as at 10 March 2021 remains a grey area.
- Investor demand – what feedback have you been getting from investors in terms of demand for ESG products? Have they specifically called out Article 8 products, Article 9 products or Taxonomy-compliant products?
- ESG-related statements – how much do you value being able to make ESG-related statements across your entire portfolio of products (rather than having to be careful to ensure that such statements are made only in respect of specific products, but not others)?
- Obligations for Article 8 and Article 9 products – to what extent do you already set and monitor "sustainability indicators" (i.e. positive KPIs) of your portfolio companies? Do you have a policy to assess the good governance of portfolio companies (e.g. sound management structures, employee relations, remuneration of staff, tax compliance)?

SFDR – Product Scoping

Scenario	Article 6?	Article 8?	Article 9?
Fund A is called “ESG investment fund” - its objective is to invest in technology companies that are best in class on ESG in their sector.			
Fund B is an impact fund that invests in renewable businesses.			
The manager of Fund B discovers that two of the companies it invests in are reported to have committed severe human rights breaches.			
Fund C’s prospectus states that the manager will prioritise ESG considerations when making investment decisions and engaging with investee companies but does not say or commit anything else regarding ESG.			
Fund C is sold to an investor as a sustainable fund because overall the portfolio is likely to have a better ESG profile than the FTSE because of the good stewardship track record of the manager.			
Fund D’s prospectus states that the portfolio will exclude any companies that derive revenue from tobacco as a baseline safeguard.			

´SFDR – Overview of the product-level obligations

Explain how **sustainability risks** are likely to impact returns – *comply or explain*

Describe in your PPM (i) how you integrate sustainability risks when making investment decisions and (ii) the results of the assessment of the likely impacts of sustainability risks on the returns of the fund

(Article 6 SFDR)

Explain **adverse impacts** of investments on ESG matters – *comply or explain*

(i) Explain in your PPM whether, and, if so, how the fund considers PASI and (ii) include a statement in your PPM that information on PASI is available in the fund's annual report

(Article 7 SFDR)

Explain how products meet E / S features (catch-all category)
(Art 8) – *mandatory*

Explain how products meet SI objective
(Art 9) – *mandatory*

SFDR – Additional disclosures for Article 8 funds

Pre-contractual disclosure	Website	Annual report
(a) Environmental or social characteristics (b) No sustainable investment objective (c) Investment strategy (d) Sustainability indicators (e) Use of derivatives (f) Website reference (g) Reference benchmark (where applicable). **In a prescribed form – still to come***	(a) Summary (b) Environmental or social characteristics (c) Proportion of investments (d) No sustainable investment objective (e) Investment strategy (f) Monitoring of environmental or social characteristics (g) Methodologies (h) Due diligence (i) Engagement policies (where applicable) (j) Data sources and processing (k) Limitations to methodologies and data (l) Designated reference benchmark (where applicable)	(a) Attainment of the environmental or social characteristics promoted by the financial product (b) No significant harm of sustainable investment objectives (c) Top investments of the financial product (d) Sustainable performance of the index designated as a benchmark (where applicable) (e) Proportion of sustainability-related investments (f) Actions taken to attain environmental or social characteristics **In a prescribed form – still to come***

* The European Supervisory Authorities propose to standardise disclosures by requiring the use of specific templates, which recognises the need for standardisation of disclosures to promote comparability of different financial products in different Member States with respect to ESG information, in line with Recital 9 of the SFDR. Three preliminary and illustrative mock-ups of templates have been created for the ESAs survey seeking feedback on presentational aspects of product templates. Please find the relevant documents here: https://ec.europa.eu/eusurvey/runner/ESGtemplatesSFDR

SFDR – Additional disclosures for Article 9 funds

Pre-contractual disclosure	Website	Annual report
(a) Sustainable investment objective (b) No significant harm to the sustainable investment objective (c) Investment strategy (d) Sustainability indicators (e) Use of derivatives (f) Website reference (g) Sustainable investment objective attainment with a designated index (where applicable) (h) Objective of a reduction in carbon emissions. **In a prescribed form – still to come**	(a) Summary (b) Sustainable investment objective (c) Proportion of investments (d) No significant harm to the sustainable investment objective (e) Investment strategy (f) Monitoring of sustainable investment objective (g) Methodologies (h) Due diligence (i) Engagement policies (where applicable) (j) Data sources and processing (k) Limitations to methodologies and data (l) Attainment of the sustainable investment objective	(a) Attainment of the sustainable investment objective (b) No significant harm of sustainable investment objectives (c) Top investments of the financial product (d) Sustainable performance of the index designated as a benchmark (where applicable) (e) Objective of a reduction in carbon emissions (where applicable) (f) Proportion of sustainability-related investments (g) Actions taken to attain the sustainable investment objective **In a prescribed form – still to come**

Luxembourg Aspects

- CSSF Fast Track Procedures – On 16 December 2020, the CSSF press release 2020/12 was published to inform the investment fund managers of a CSSF fast track procedure to facilitate the submission and approval of the prospectus/issuing document updates regarding the SFDR.
  - IFMs must submit to the CSSF the relevant documents by 28 February 2021 at the very latest.
  - Relevant documents: Updated prospectus, confirmation letter, investor notice (if applicable)
  - Updates must be limited to reflect changes required under SFDR. In case modifications to the investment policy and restrictions are material according to CSSF Circular 14/591, the use of the fast track procedure is not available
- Reduced Subscription Tax Rate – On 23 December 2020, the Luxembourg Budget Law was published in the Mémorial. The Law introduces reduced subscription tax rates for undertakings for UCITS and Part II Funds when investing in activities which qualify as environmentally sustainable economic activities under the Taxonomy Regulation*.
  - if the UCI invests at least 5% of its net assets in Qualifying Activities, it will benefit from a tax rate of 0,04% p.a.
  - if the UCI invests at least 20% of its net assets in Qualifying Activities, it will benefit from a tax rate of 0,03% p.a.
  - if the UCI invests at least 35% of its net assets in Qualifying Activities, it will benefit from a tax rate of 0,02% p.a.
  - if the UCI invests at least 50% of its net assets in Qualifying Activities, it will benefit from a tax rate of 0,01% p.a.

Questions

Linklaters LLP

35 Avenue John F. Kennedy
L-1855 Luxembourg
Tel: +352 2608 1
Fax: +352 2608 8888