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Irish Funds: SFDR Compliance Publication

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In 2018, the European Commission introduced legislative measures to improve sustainable finance and environmental social and governance ("ESG") integration in financial products. The measures adopted include the Taxonomy Regulation, the Low Carbon Benchmarks Regulation, and the Sustainable Finance Disclosure Regulation ("SFDR").

The SFDR applies from 10 March 2021 and requires UCITS ManCos and AIFMs (together "Managers") to consider the adverse sustainability impacts in their investment processes and the provision of sustainability?related disclosures in relation to UCITS and AIFs (each a "Product" and together "Products") under management, respectively.

Whilst Regulatory Technical Standards ("RTS") were to apply from 10 March 2021, these have been delayed. However, on 18 January 2021, Irish Funds released a publication to help Managers prepare for compliance with the SFDR (the "Publication").

This note sets out the key information from the Publication to assist Managers with their SFDR compliance.

Application

The SFDR applies to "financial market participants" which includes Managers in respect of their Products. Non-EU asset managers managing EU domiciled funds or marketing non-EU domiciled funds into the European Union will also be impacted by requirements under the SFDR.

Managers are required to comply with the high level and principles-based requirements of the SFDR from 10 March 2021. Managers will also have to comply with RTS at a later stage (Irish Funds has advocated for 1 January 2022 applicability date). The final version of the RTS will be published near the end of January 2021.

Disclosures at Entity Level

At entity level Managers will need to address three main requirements under the SFDR by way of publication on their websites:

1. Information on the integration of sustainability risks ("Sustainability Risks");
2. Consideration of principal adverse impacts on sustainability ("Principal Adverse Impacts"); and
3. A remuneration policy that is consistent with the integration of sustainability risks ("Remuneration").

Sustainability Risks

Managers will need to provide information on their websites about their policies in relation to the integration of sustainability risks in their investment decision-making process by 10 March 2021. Both the Task Force on Climate-related Financial Disclosures or the UN Principles for Responsible Investing could be useful to develop or enhance sustainability risk policies.

The publication on the website should include either the full policy or a summarised version thereof. The disclosures on the website should also be consistent with the disclosures included in the prospectus of a Product as discussed further below.

Managers must decide for themselves the information to be disclosed to investors and how sustainability risks are integrated into the investment decision process. Multi-managers, for instance, may draft a policy that provides a link to a policy for each underlying fund manager where each fund manager integrates sustainability risks into their investment decision making process differently.

Principal Adverse Impacts

The obligation for Managers to consider the principal adverse impacts on sustainability requires Managers to assess how underlying investee companies impact on specified sustainability factors.

Managers are required to publish and maintain on their website this information or explain otherwise by 10 March 2021. Managers that do consider principal adverse impacts will have to make a statement annually in their due diligence policies with respect to those impacts. Where Managers do not consider principal adverse impacts then they must provide 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.

From 30 June 2021, Managers with more than 500 employees or which are parent undertakings of large groups with more than 500 employees must publish and maintain on their websites a statement of their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors.

Remuneration

Managers must include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks and publish this information on their websites by 10 March 2021. This information should be included in remuneration policies that Managers are required to establish and maintain in accordance with the UCITS IV Directive and AIFMD.

Disclosures at Product Level

In addition to the entity level disclosures discussed above, Managers have responsibility for ensuring that the disclosures they make are appropriate to their Products based on the below categories:

1. Non-ESG Products.
2. Products that promote ESG; or
3. Products that have a sustainable investment objective.

As SFDR requires certain “pre-contractual disclosures” to be made to investors, a fund that is no longer available for subscription (a closed-ended fund, for example) then the disclosures set out below will not be applicable to that fund.

In respect of a UCITS, there is no requirement to update the UCITS KIID. However, where changes are being made to the investment objective or policy of the UCITS to classify it as a particular ESG product then changes to the KIID may also have to be made.

Non-ESG Products

This category includes Products that either do not promote ESG or have a sustainable investment objective. In respect of this category, Managers must disclose in the prospectus of each Product:

1. the manner in which sustainability risks are integrated into their investment decisions or where the Manager deems sustainability risks not to be relevant a clear and concise explanation of the reasons therefor; and
2. the results of the assessment of the likely impacts of sustainability risks on the returns of the financial

products they make available.

Managers should review the prospectus of each Product to see whether it contains any language that could deem it a product that promotes ESG and thus bring it within a different category. Likewise, Managers should review prospectuses for any statements that indicate “green washing” as this too may change the category that the Product falls within.

Products that Promote ESG

This category includes Products that promote, among other characteristics, ESG, provided that the companies in which the investments are made follow good governance practices. This includes Products that may have ESG characteristics that focus on, for example, exclusions, screening, best in class, positive tilt, or certain thematic investing, etc. In assessing whether a Product falls in this category, emphasis is placed on the binding nature of the ESG characteristic.

In respect of this category, Managers must disclose in the prospectus of each Product:

1. information on how ESG characteristics are met;
2. if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics; and
3. where the methodology used for the calculation of the index is to be found.

Products that have a Sustainable Investment Objective

This category includes Products that have sustainable investment as its objective, such as Products that aim to have a positive and measurable impact on an environmental or social objective. This category accordingly includes Products that focus on sustainability themed investing or impact investing.

In respect of this category, Managers must disclose in the prospectus of each Product:

1. information on how the designated index is aligned with that objective;
2. an explanation as to why and how the designated index aligned with that objective differs from a broad market index;
3. where a Product has sustainable investment as its objective and no index has been designated as a reference benchmark, an explanation on how that objective is to be attained; and
4. information as to where the methodology used for the calculation of the reference index can be found.

Principal Adverse Impacts at Product Level

The assessment of principal adverse impacts on sustainability factors also applies at Product level on a comply or explain basis, but not until 30 December 2020. However, Managers may find that they have to conduct the assessment at Product level in order to make an assessment at entity level.

Managers that consider principal adverse impacts of investment decision on sustainability factors, are required to disclose in the prospectus of a Product, the following:

1. A clear and reasoned explanation of whether, and if so, how each Product considers principal adverse impacts on sustainability factors; and
2. A statement that information on principal adverse impacts on sustainability factors is available in the annual report.

Central Bank of Ireland Fast Track Process

In order to facilitate the filing of a prospectus for each Product, the Central Bank of Ireland (the “CBI”) has created a fast-track procedure whereby Managers can file updated prospectuses and self-certify compliance with the SFDR before 10 March 2021. Filings may be made from 11 January 2021 to the e-mail address: SFDR@centralbank.ie.

It is important to note that this fast-track facility can only be used for the purposes of self-certification pursuant to the SFDR. The CBI has stated that changes unrelated to SFDR will have to be made via the normal post authorisation review procedure.

Looking Ahead

Managers should approach compliance with the SFDR as an evolutionary process with greater consistency and standardisation increasing over time. As noted above, finalised RTS will be published near the end of January 2021 which may change the granular detail of compliance required and will become applicable at a later stage.

The European Supervisory Authorities have also written to the European Commission regarding certain uncertainties in respect of the applicability of the SFDR. Further clarifications on the SFDR may accordingly change approaches to compliance with the SFDR.

If you require assistance in relation to compliance with the SFDR, please do not hesitate to contact a member of the Financial Services Team team.

About the Authors

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