

# Important ESG developments for asset managers (Part 1)

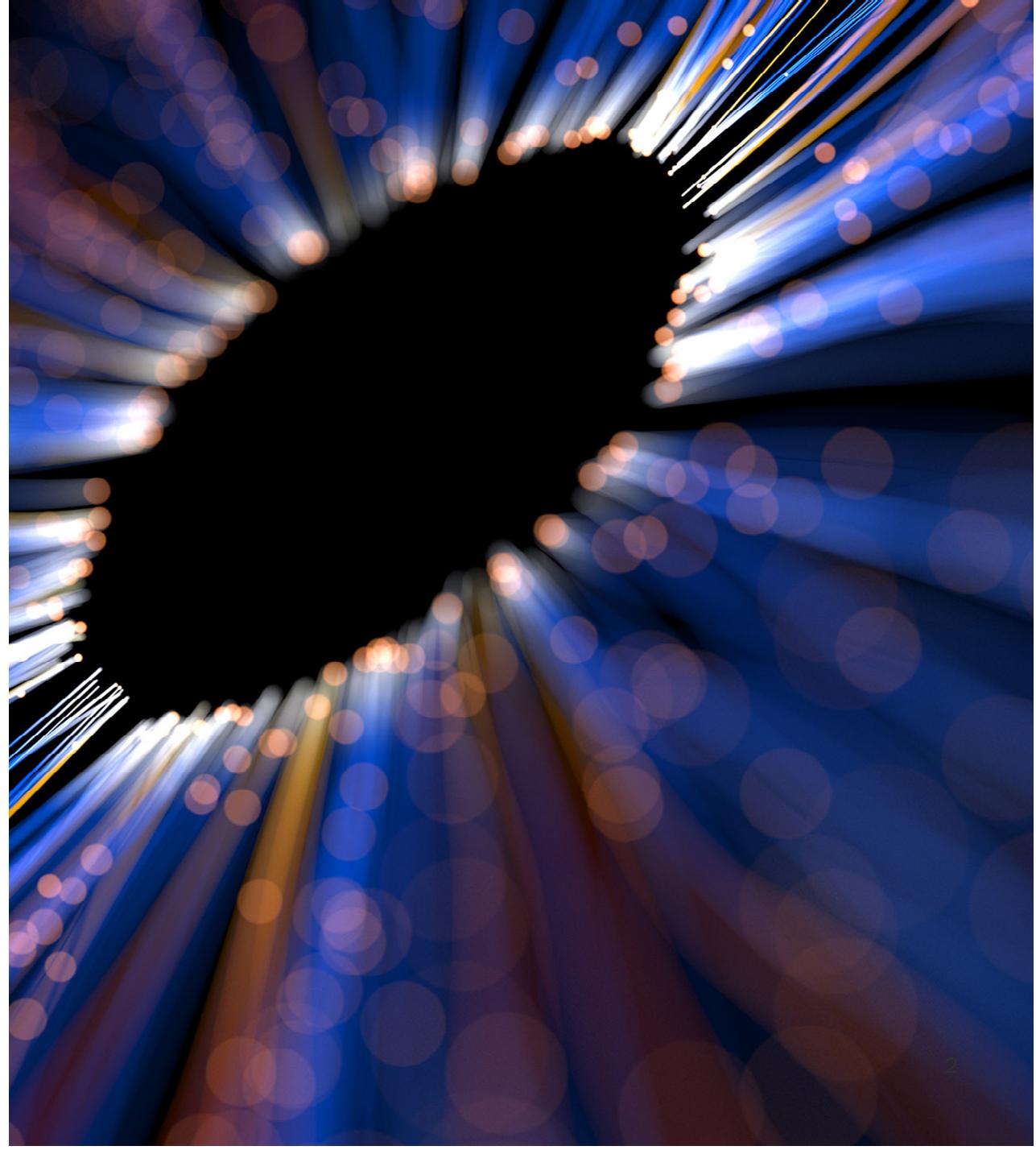
Financial Markets Legal Update  
– the webinar series

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# Agenda

- 1 Introduction and overview
- 2 Sustainable Finance Disclosure Regulation (SFDR) – in overview only
- 3 Framework Regulation (**Taxonomy**)
- 4 Changes to MiFID2, UCITS and AIFMD

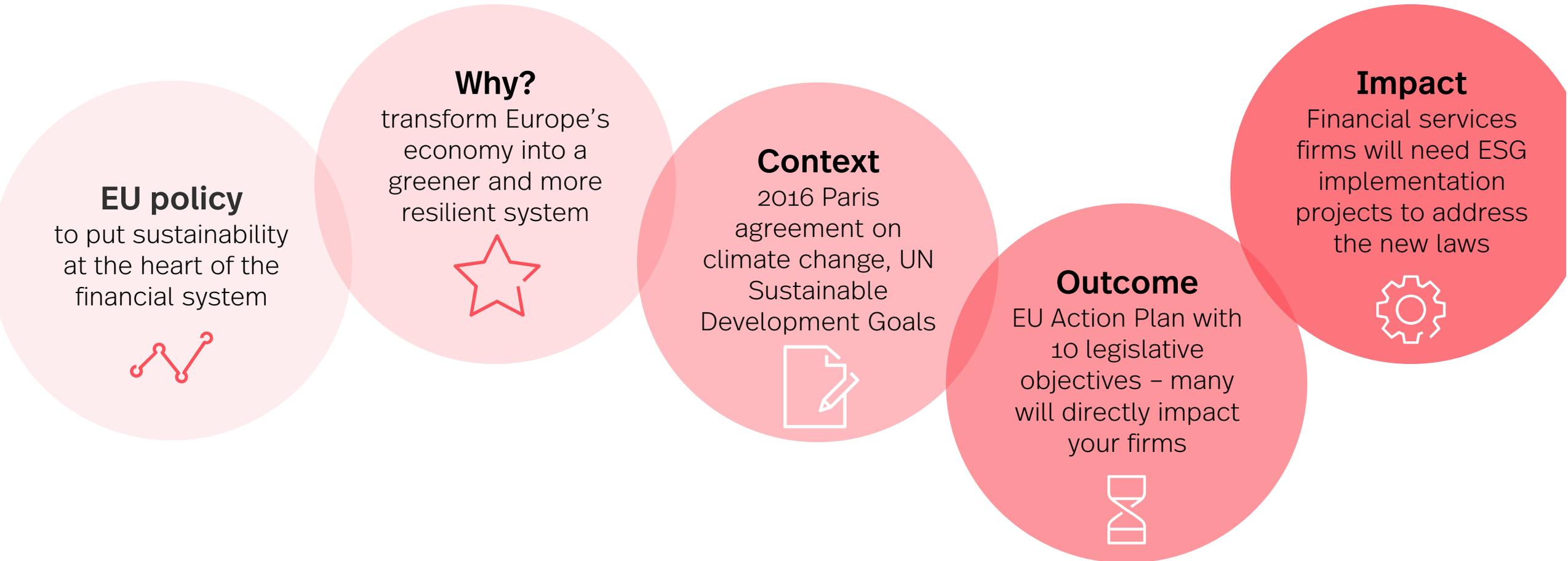


# Part 1

Introduction  
and overview



# What's the context to all of this?



# Key pillars



## Sustainable Finance Disclosure Regulation (SFDR)

New disclosure obligations for financial market participants in respect of sustainability matters

*In force: March 2021 (some transitionals)*

## Framework Regulation (Taxonomy)

Taxonomy to assess environmental sustainability of economic activities

*In force: January 2022 (climate change) and January 2023 (other objectives)*

## Delegated Acts amending MiFID2, UCITS and AIFMD

Amendments to existing regimes to require sustainability to be part of organisational structure and investment decision making

*In force: still in draft but expected Q3 / Q4 2021 [TBC]*

## Prudential rules for banks, investment firms and insurers

CRD4 and Solvency2 already accommodate ESG risks, particularly in Pillar 2

CRD5 and IFD will flesh out identification of ESG risks in the SREP.

# Practical considerations



## ESG within a firm today:

- Some firms already have very well-developed ESG investing processes and public disclosures
  - For these firms: ESG regulation will be more of an “upgrade” project
  - Focus on gap analysis
- Equally, some firms have not yet considered ESG in detail (and some don't want to!)

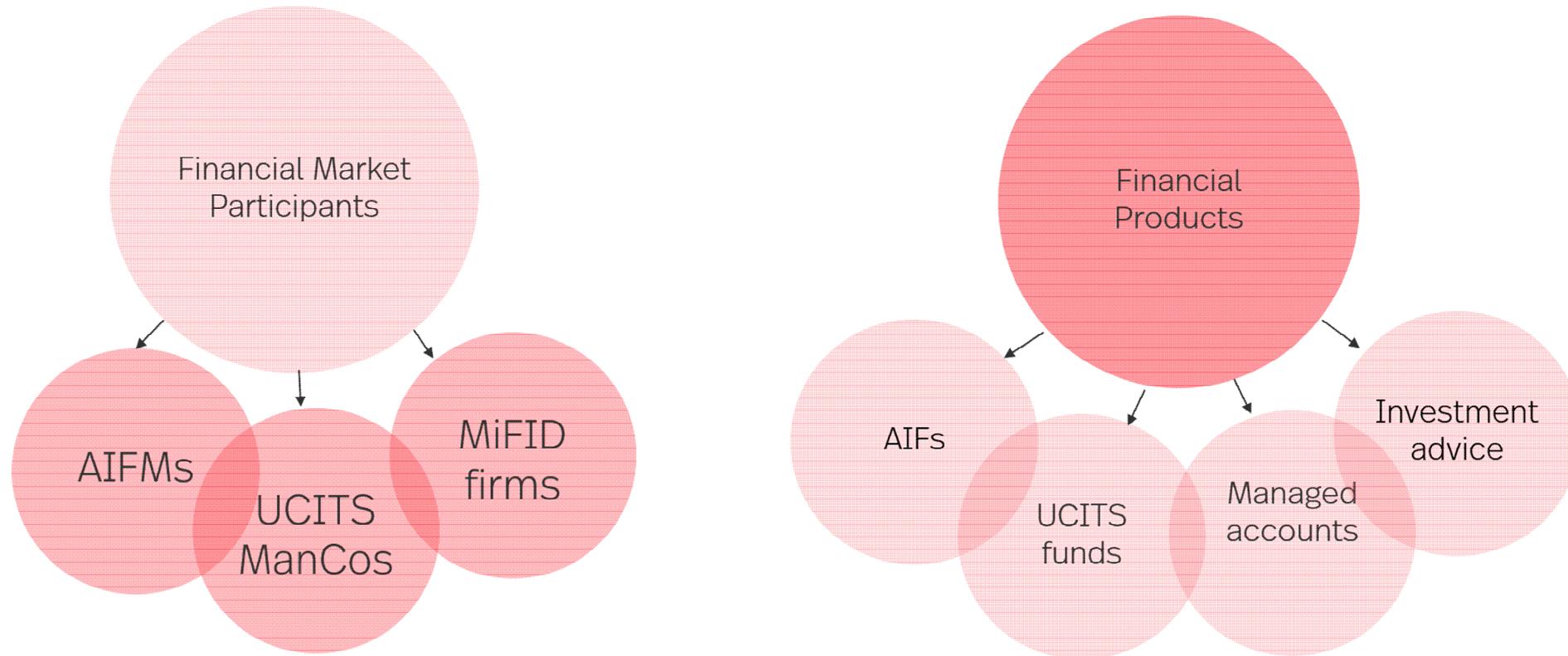
## ESG as a regulatory project:

- Who in an organisation is responsible for ESG regulation?
- What working group / project plan is required? What budget?
- How is a firm engaging senior management and other stakeholders internally?
- What involvement will be needed from external service providers?

## Updates to fund documentation/managed account agreements:

- Will investor notification / consent be required?
- Will regulatory notification / consent be required?
- What process will you need to follow?
- How much time will you need to build in?

# Who is subject to the ESG rules?

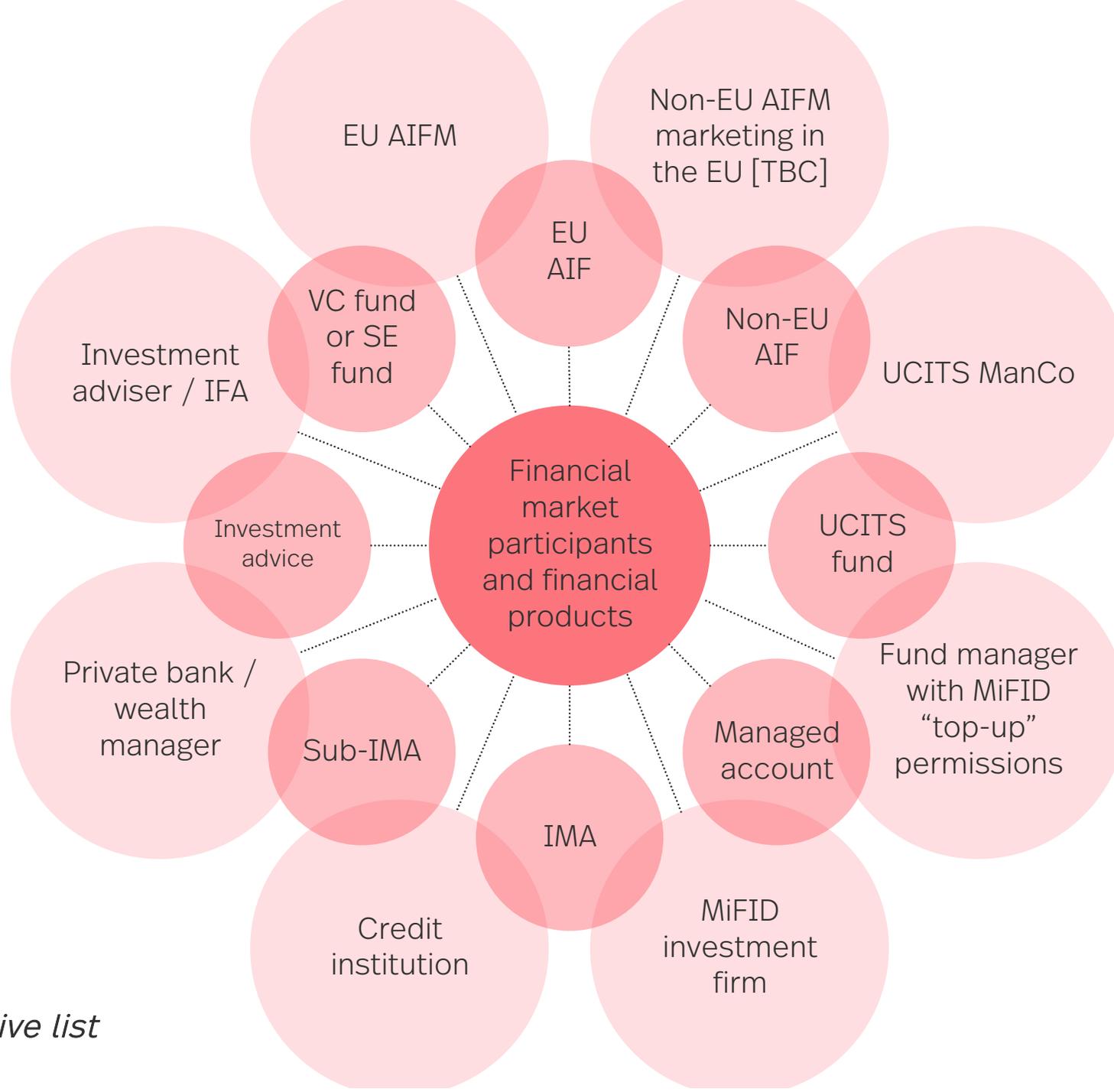


## Other firms in scope

- Certain insurance companies and pension funds
- Managers of venture capital and social entrepreneurship funds

*NB – not an exhaustive list*

# Which financial firms could be caught?



*NB – not an exhaustive list*

## Part 2

Sustainable  
Finance

Disclosure

Regulation

(SFDR)

in overview only

# What is the SFDR?



## Where are we in the implementation process?

- EU regulation on **sustainability-related disclosures** in the financial services sector
- Published in the Official Journal on 27 November 2019
- Comes into force on **10 March 2021** (mostly)
- Consultation on draft Level 2 RTS published by ESMA on 23 April 2020

## What does the SFDR cover?

- Creates **new disclosure obligations** relating to ESG / sustainability
- Applies widely across financial services sector, including to asset managers / financial advisers
- Applies at level of the **management entity**
- Also applies at level of **each fund or other financial product** offered by the manager
- Many obligations apply to firms or funds whether or not they have an express ESG focus

# Key themes of SFDR



## Three key sustainability themes

1. **Internal within a firm:** integration of sustainability risks in investment decision-making processes
2. **External to the market:** consideration of **potential adverse impacts** of investment decisions on sustainability factors
  - *Commercial decisions* will need to be made (or existing decisions updated) on points 1 and 2
  - Firms will then need to *disclose* policy decisions
  - Relevant to all firms and funds (even those without an express ESG focus)
3. **Financial products with an express ESG focus:** additional technical disclosures for funds which either promote sustainability or have sustainability as an objective

## These rules are not....

- Mandatory restrictions on what firms can or cannot invest in (i.e. not a “whitelist” or a “blacklist”)
- Concerned about a firm’s own ESG initiatives as a business (e.g. a firm’s own diversity policy is not in scope)

# What and how to disclose



## Manager's public website:

- Policy on integration of sustainability risks
- Sustainability DD policy – manager level (or explanation of why not implemented)
- Information on remuneration policy

## Prospectus for fund (or T&Cs for managed account):

- Policy on integration of sustainability risks
- Results of impact assessments on investment returns (or explanation of why not relevant)
- Sustainability DD policy – fund level (or explanation of why not implemented)
- Express negative disclosure on environmental sustainability [*unless expressly in-scope – see below*]

## Funds with an express sustainability focus:

- Additional pre-contractual, public and periodic disclosures

*Much more to come on the SFDR in Part 2*

# Part 3

Framework  
Regulation  
(Taxonomy)



# Framework Regulation (Taxonomy)



## Establishes a taxonomy for determining whether an economic activity is environmentally sustainable

An economic activity will be considered “**environmentally sustainable**” where it:

- “contributes substantially” to one or more of the 6 **environmental objectives**
  - a) climate change mitigation*
  - b) climate change adaptation*
  - c) sustainable use and protection of water and marine resources*
  - d) transition to a circular economy*
  - e) pollution prevention and control*
  - f) protection and restoration of biodiversity and ecosystems*
- “**does not significantly harm**” any of the others
- complies with **minimum social safeguards** (OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights)
- complies with performance thresholds (known as “**technical screening criteria**”) - these will be developed as Level 2 measures in due course

# Framework Regulation (Taxonomy)



## Application of taxonomy:

- Vast majority relevant only to asset managers who make available financial products with an **express environmental sustainability focus**, but
- **All asset managers** need to include a short negative disclosure in products which do not follow taxonomy

Managers of in-scope products will need to ensure that the pre-contractual documentation and periodic reports for in-scope products **contain additional disclosures** to:

- Identify the relevant **environmental objective(s)**
- explain how, and to what extent, **the product's investments comply with the taxonomy** (substantial contribution, DNSH, minimum safeguards, technical screening)

## Timing

- Rules for climate change objectives (a) and (b) come into force on **1 January 2022**
- Rules for remaining objectives (c) to (f) come into force on **1 January 2023**

## Part 4

Changes to  
MiFID2,  
UCITS and  
AIFMD



# Changes to MiFID2, UCITS and AIFMD



## Overall approach:

- Amendments to **existing obligations** under MiFID2, UCITS and AIFMD, to expressly include **sustainability** via four new **Delegated Acts**
- Currently in **draft** (latest consultation draft published by Commission on 6 June 2020)
- Our best guess – these might come into force in **Q3 / Q4 2021**

## Changes to all three regimes – organisational rules

- Sustainability to expressly form part of **systems and controls rules** (decision making procedures, organisational structure, reporting lines, control mechanisms, etc)
- **Senior management** expressly responsible for integration of sustainability
- New requirement to **retain necessary resources and expertise** for integration of sustainability
- **Managing conflicts** of interest expressly to include sustainability

## AIFMD and UCITS

- Investment **due diligence** rules updated to expressly include sustainability risks
- For firms in-scope of “principal adverse impact” disclosure under SFDR, **adverse impacts** must also be part of investment due diligence

# Changes to MiFID2 only



## Suitability assessment under MiFID:

- Firms must expressly obtain information on client's **sustainability preferences**, for the suitability assessment
- Firms must **understand sustainability factors** for products and services recommended
- If required to produce a **suitability report**: must explain how recommendation meets the client's sustainability preferences

## Product governance under MiFID:

- **Manufacturers** and **distributors** must take into account sustainability preferences, when determining **target market** for financial instruments
- When examining if products meet the **needs of a target market**, must expressly include assessment of product's sustainability factors
- Product governance **reviews** must take into account sustainability

# How Simmons & Simmons is helping clients



- Scoping, advising on decision making and advising on application
- Project plans
- Preparing policies
- Templates for our clients

## Recent briefing notes:

1. [An overview of the EU ESG initiative](#)
2. [A detailed breakdown of the key obligations under the EU Sustainable Finance Disclosure Regulation \(SFDR\)](#)
3. [A summary of the key things to know about the Level 2 proposals for the SFDR](#)
4. [A client alert on the key requirements of the Taxonomy for asset managers](#)
5. [A briefing note on the changes proposed to MiFID, AIFMD and UCITS, to require the integration of sustainability](#)

Please see our [Sustainable Finance and ESG microsite](#)



# Thank you for joining

For further information, please contact us or visit our website [simmons-simmons.com](https://simmons-simmons.com).



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