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Update to ESG regulatory developments for asset and fund managers – including SFDR

Up to date as of 1 May 2021

1. Speed read

The Environmental, Social and Governance (**ESG**) agenda continues to be a focal point for the European Commission and other bodies, with a number of updates to the initiatives currently in the pipeline. This briefing gives a summary of new developments as well as updates to the key developments discussed in the previous briefing, including any relevant next steps.

2. Key developments

Subject	Summary	Timing and next steps (if any)
Sustainable Finance Disclosure Regulation (**SFDR**) – ESA delivered Final Report on Level 2 requirements	Under SFDR, the European Supervisory Authorities (**ESAs**) have been mandated to develop various Level 2 measures, to take the form of Regulatory Technical Standards (**RTS**). The ESAs published their final report on a draft RTS on 4 February 2021.[1] The RTS provides guidance on certain points of interpretation in relation to SFDR, and greenwashing risk. It also sets down detailed "rules of the road" for certain SFDR disclosure requirements, such as principal adverse impacts disclosures and product level disclosures required by Articles 8, 9, 10 and 11. For further information on the guidance provided in the RTS, see our briefing **here**. As the Level 2 measures are still to be endorsed by the EC, firms are required to comply with the SFDR's "high level and principle-based requirements" from 10 March 2021. On 25 February 2021, the ESAs published a supervisory statement[2] made by the Joint Committee of the ESAs on the application of the SFDR. The statement recommends that the draft RTS should be used as a reference by NCAs, financial market participants and financial advisers when applying the provisions of the SFDR in the interim period between the application of the SFDR and the application of the RTS at a later date. In an Annex to the statement, the Joint Committee sets out specific guidance on the application of timelines of some specific provisions of the SFDR, in particular on the application timeline for entity-level principal adverse impact disclosures and for financial products' periodic reporting.	SFDR (Level 1) began to apply from 10 March 2021. Financial market participants with more than 500 employees will be required to consider principal adverse impacts by 30 June 2021. Periodic reporting will be required from 1 January 2022. Some of the additional requirements added to the SFDR by the Taxonomy Regulation will begin to apply from 1 January 2022, while other additional requirements in relation to certain environmental objectives will only begin to apply from 1 January 2023.[3]

SFDR – UK implementation (or not)	While SFDR has not been onshored as part of UK law, we note that: – EU firms that delegate to the UK are likely to look to the UK team to help them comply with EU SFDR. It is therefore likely to remain front and centre for a lot of UK asset managers; – certain large institutions may wish to contractually require their UK portfolio managers to comply with EU SFDR, even if it does not apply as a matter of law; and – there is a risk the European Commission will consider EU SFDR to apply to UK and other third country firms doing business cross-border into the EU (e.g. selling funds, or providing portfolio management or advisory services), although this is unclear.[4]	In relation to the Level 2 requirements, the European Commission is expected to endorse the RTS within three months of their publication. The ESAs have proposed that the draft RTS be applicable from 1 January 2022.
SFDR – Updates from various Member States	SFDR-related developments continue to be a focal point for Member States, some of which are highlighted below. **Belgium** On 9 March 2021, the FSMA published a communication in relation to the SFDR Level 1 requirements applicable to in-scope Belgian entities. This communication sets out guidance from FSMA in relation to how Belgian firms can ensure compliance with the Level 1 requirements while the draft RTS is being finalised. For further detail on this communication, please see our publication **here**. **Luxembourg** On 12 March 2021, following the Supervisory Statement published by the ESAs in relation to compliance with the SFDR Level 1 requirements ahead of the finalisation of the draft RTS, the CSSF published a similar communique on compliance with the SFDR Level 1 requirements during the interim period[5] to that published by FSMA in relation to Belgian entities (see above). In the communique, the CSSF encourages financial market participants and financial advisers to use the draft RTS as a reference for the purposes of applying the provisions of Articles 2a, 4, 8, 9, and 10 of the SFDR in the interim period until the draft RTS are adopted by the European Commission. **Denmark** The Financial Supervisory Authority has set up a unit to monitor investors' sustainability disclosures under SFDR and to combat greenwashing. The new unit will reportedly have powers to issue injunctions, warning notices and police reports to in-scope firms that fail to comply with their obligations under the SFDR, subject to firms being afforded leniency initially as they get to grips with the new rules. **France** In France, ESG continues to be a key focus area for Treasury and various regulatory bodies. The French government recently launched a consultation on updating its official SRI label for investment funds in an effort to tighten up the criteria for the label. The French central bank has also set up a Climate Change Centre to act as a hub to for its climate initiatives. Most recently, the French government unanimously passed a vote to amend its consumer code in order to introduce sanctions directly targeted at greenwashing. It has been reported that persons found guilty could be fined up to 80% of the cost of the false promotional campaign, be required to publish a correction on billboards or in the media, and post a 30-day clarificatory statement on their website. **Germany** Germany's Sustainable Finance Committee recently published a report[6] which includes, among others, a recommendation that all financial products are given a rating from 1 (being the lowest rating, indicating there is an "increased ESG risk due to a lack of information") and 5 (being the highest rating, indicating there is "evidence of a sustainability effect") based on how well they integrate sustainability standards. This rating would apply to all financial products sold in Germany which are in-scope for SFDR. Another key recommendation included in the report is for the German government to expand the scope of NFDR reporting obligations to cover all firms with more than 250 employees in order to increase the flow of sustainability-related information to investors and stakeholders (currently the rules apply to just 6,000 large firms in Europe).	N/A

SFDR – ESA letter to the European Commission	In a letter dated 7 January 2021,[7] the ESAs identified a number of questions relating to key areas of uncertainty in the interpretation of the SFDR during the course of their work on the draft RTS. The priority areas requiring clarification from the European Commission as set out in the letter are: – the application of the SFDR to non-EU AIFMs and registered AIFMs; – application of the 500-employee threshold for principal adverse impact reporting on parent undertakings in a large group; – the meaning of "promotion" in the context of products promoting environmental or social characteristics; – the application of Article 9 of the SFDR; and – the application of SFDR product rules to portfolios and dedicated funds.	The European Commission is yet to provide responses to the questions raised in the letter.
AIFMD Review – ESMA proposals	As mentioned in our previous briefing, ESMA suggested various changes to AIFMD, including an update to the current AIFMD reporting template to include fields on ESG in a letter dated 18 August 2020.[8] This would be done to increase transparency on environmental impacts and social and governance matters, "*in line with [the] "EU Commission action plan on sustainable finance*"[9] *and ESMA developed* "*Strategy on sustainable finance*".[10] ESMA also considers that it will assist local regulators in their monitoring – although precisely what they would be monitoring is unclear. ESMA has also requested a mandate to develop technical standards. There have been no further updates in this regard.	Unclear, although see below
AIFMD Review – European Commission Public Consultation	The European Commission has now closed the public consultation on AIFMD.[11] The consultation included a significant section on "Sustainability/ESG", including the following types of questions: – Should AIFMs quantify sustainability risks? – Should an AIFM's investment decision making process include potential principal adverse sustainability impacts? – Should adverse impacts on sustainability factors be integrated in the quantification of sustainability risks? – Should AIFMs, when making investment decisions, be required to take account of sustainability-related impacts beyond what is currently required by EU law (e.g. environmental pollution and degradation, climate change, social impacts, human rights violations); i.e. alongside the interests and preferences of investors? – Should the EU taxonomy play a role when AIFMs are making investment decisions; in particular regarding sustainability factors? – Should other sustainability-related requirements or international principles beyond those in the SFDR be considered by AIFMs when making investment decisions? Another question is whether the AIFMR supervisory reporting template should provide a more comprehensive portfolio breakdown; in particular, to require more details on sustainability-related information, e.g. risk exposure and/or impacts. There have been no further updates in respect of consultation on AIFMD.	The European Commission's consultation closed on 29 January 2021. If the European Commission decides to propose changes to the existing legislation, these are unlikely to be published until mid-2021.
Changes to UCITS, AIFMD, and MiFID II for ESG	On 8 June 2020, the European Commission launched a consultation on proposed changes to the UCITS,[12] AIFMD[13] and MiFID II[14] regimes for ESG. Among other things, this included an express requirement to integrate sustainability risks into firms' processes, to consider the principal adverse impacts of investment decisions on sustainability factors within the due diligence process, incorporate ESG in product governance, and capture a client's ESG preferences before providing advice or portfolio management. As part of the package of measures adopted on 21 April 2021 aimed at improving the flow of money towards sustainable activities across the European Union, the European Commission adopted a number of amending Delegated Acts which formalise the changes described above. These amending Delegated Acts are also intended to strengthen the EU's fight against greenwashing.[15] For further detail in this regard, please contact us for a copy of our publication.	The six amendments to the Delegated Acts will be scrutinised by the European Parliament and the Council (for a period of three months which is extendable by a further three months) and are expected to apply as of October 2022.

CSRD Proposal	Also as part of the package of measures adopted on 21 April 2021 aimed at improving the flow of money towards sustainable activities across the European Union, the European Commission published a proposal for a new Corporate Sustainability Reporting Directive (**CSRD**).[16] The CSRD proposal will strengthen the existing rules introduced by the Non-Financial Reporting Directive (**NFRD**) and will make sustainability reporting by companies more consistent, comparable and reliable. The CSRD will apply the EU's sustainability reporting requirements to all large companies and all listed companies. In terms of next steps, the European Parliament, and the Member States in the Council, will need to negotiate a final legislative text for the CSDR proposed by the European Commission. The European Financial Reporting Advisory Group will also begin work on a first set of draft sustainability reporting standards which can be considered once the legislative text is agreed.	EFRAG aims to have the first set of draft reporting standards ready by mid-2022. In terms of a final timetable, if agreement is reached on the legislative text for the CSRD by H1 2022, and the Commission adopts the first set of reporting standards by the end of 2022, in-scope companies will need to apply the standards to reports in respect of the 2023 financial year.
Financial Data Exchange Templates (**FinDatEx**)	FinDatEx is a joint structure established by representatives of the EU financial services sector to support the development and use of standardised technical templates to facilitate the exchange of data between stakeholders in the application of EU financial markets legislation. FinDatEx had initiated a review of its European MiFID Template (**EMT**) for the integration of ESG target market criteria[17], as required by the European Commission's proposed changes to the MiFID II regime (see above). The EMT V3.1 was finalised and published on 12 February 2021. EMT V3.1 is a 'high-level' interim version intended to address the demand of distributors and producers to cope with the implementation of MiFID ESG and SFDR principles.[18]	The final interim version of the EMT was published on 12 February 2021 and was made available from 10 March 2021.
Taxonomy Regulation	On 26 February 2021, ESMA published its final report entitled "*Advice on Article 8 of the Taxonomy Regulation*", which sets out ESMA's advice to the Commission in respect of certain aspects of Article 8 of the Taxonomy Regulation[19]. In addition to providing advice on various matters relating to firms subject to NFRD, section 4 concerns asset managers specifically and deals with the question of how asset managers that report under NFRD should disclose the ways in which their activities are directed at funding environmentally sustainable economic activities. ESMA advises (in the context of this question) to interpret an asset manager's activities to be the investments of the investment funds that they manage, as these are used to fund underlying economic activities of investee companies. In the context of the Article 8 obligation, ESMA believes that asset managers merit a framework for reporting how and to what extent their activities are associated with economic activities that qualify as environmentally sustainable. Please refer to our **client bulletin** for more information on what asset and fund managers need to know about the Taxonomy Regulation.	Following the consultation period ending on 4 December 2020, ESMA published its final advice on 26 February 2021.
Taxonomy Regulation – Climate Technical Screening Criteria	Following a consultation process which generated over 46,000 replies (which resulted in a delay to the publication of the final proposal – initially intended to be 1 January 2021), the European Commission published the final version of the delegated act on 21 April 2021.[20] The delegated act defines the technical screening criteria for economic activities that can make a substantial contribution to climate change mitigation and climate change adaptation. The Commission has indicated that draft is expected to be formally adopted after the completion of translations into all EU languages, expected to be at the end of May. For further detail on the technical screening criteria set out in the delegated act, please see our publication **here**.	Once formally adopted, the Delegated Act will be scrutinised by the European Parliament and the Council (for a period of four months, and extendable by a further two months). The Level 2 requirements will be applicable from 1 January 2022.
ESG ratings and assessment tools – ESMA letter to the European Commission	In a letter dated 28 January 2021,[21] ESMA shared its views on the "unregulated and unsupervised nature of the market for "ESG" ratings and ESG assessment tools" and the need to match the growth in demand for these products with regulatory requirements to ensure their quality and reliability. ESMA highlighted the increased risks of greenwashing, capital misallocation and product mis-selling; and proposed a common legal definition of ESG ratings that covers the broad spectrum of possible ESG assessments currently on offer. ESMA also proposed that any rating agency issuing ESG ratings and assessments should be required to be registered and supervised by a public authority.	N/A

HM Treasury-led Asset Management Taskforce – Stewardship	On 24 November 2020, the HM Treasury-led Asset Management Taskforce published a report entitled "Investing with Purpose: Placing stewardship at the heart of sustainable growth" which outlined a series of 20 recommendations in relation to stewardship, to assist market participants, such as investment managers and asset owners, to expand their stewardship activity across different asset classes.[22] The Taskforce has sought to connect investment decisions more closely with climate change and sustainability considerations.	N/A
AMF, France	Mindful of the increasing number of funds integrating ESG criteria, the AMF has published a policy document setting out its expectations in relation to the provision of information to investors in the context of funds incorporating such criteria.[23] A key goal is to ensure "the proportionality between the reality of non-financial (ESG) criteria taken into account in the fund's asset management and the prominence and explanation of such criteria in investor communications". The policy is not applicable to French-domiciled collective investment products which are only marketed abroad and whose subscription and acquisition of units or shares are reserved for non-French-resident investors. There have been no further updates in this regard.	The policy applied immediately for the creation of collective investment products, products modifications and notification of cross-border marketing of a foreign-based UCITS. For products in existence as at 11 March 2020, the policy must be complied with by 10 March 2021 at the latest. In relation to the creation of collective investment products, products modification and notifications to the AMF of cross-border marketing of a foreign based UCITS between 12 March 2020 and 22 July 2020, the policy must be complied with from 30 September 2020 at the latest.
IOSCO	As previously mentioned, the International Organization of Securities Commissions (**IOSCO**) launched a sustainable finance network in October 2018, and has been progressing a programme of work since that date including building upon previous IOSCO initiatives in this area. This work has included publishing a report in April 2020 on sustainable finance,[24] covering asset and fund management, among other sectors. IOSCO has established a Board-level Sustainability Task Force. One of its key aims is to improve sustainability-related disclosures made by issuers and asset managers; in particular, it will identify and develop categories of disclosure which are material for investors ("decision useful"). It will also prepare case studies and an analysis on transparency, investor protection, greenwashing and other relevant issues. On 25 February 2021, IOSCO reported on progress made by the Sustainable Finance Task Force in its work on securities issuers' sustainability disclosures, asset managers' disclosures, and the role of ESG data and ratings providers. IOSCO sees an urgent need to improve the consistency, comparability, and reliability of sustainability reporting, with an initial focus on climate change-related risks and opportunities, which would subsequently be broadened to other sustainability issues.	Ongoing
UK BEIS – directors' liability for company financial statements	On 18 March 2021, the UK Department for Business, Energy and Industrial Strategy (**BEIS**) published a consultation which is focused on strengthening the UK's framework for the governance and audit of major companies.[25] In terms of this white paper, it is proposed that directors' accountability be sharpened in the key management areas of internal controls, dividend and capital maintenance decisions, and resilience planning. In particular, the paper proposes to impose new reporting requirements for directors of public interest entities, including an annual resilience statement which sets out how directors address challenges posed to its business model of the short, medium and long term, including risks posed by climate change.	The consultation period closes on 8 July 2021.

UK TCFD-disclosure requirements for listed issuers	On 21 December 2020, the FCA published a Policy Statement on its proposals to enhance climate-related disclosures by UK premium listed commercial issuers and clarification of existing disclosure obligations, including setting out its final rule, guidance and Technical Note in this regard.[26] In terms of the final rule, listed companies will be required to include a statement in their annual financial report, which sets out whether their disclosures are consistent with the recommendations of TCFD, or explain why they have not complied. The FCA have also noted that they are planning to issue a consultation paper in H1 2021 on proposals to extend the application of this rule to a wider scope of listed issuers as well as consider consulting on strengthening the compliance basis of the rule. For further information please refer to our article which can be accessed **here**.	The new rule applies for accounting periods beginning on or after 1 January 2021, with the first annual financial reports subject to the final rule published in spring of 2022. The Technical Note applied immediately from 21 December 2020.
UK TCFD-aligned disclosures for asset managers & pension schemes	The FCA has indicated an intention to consult on implementing client-focused TCFD-aligned disclosures for asset managers and contract-based pension schemes in H1 2021.[27] The FCA commented that: "*Institutional and retail investors increasingly demand information on how their asset managers take climate into account in their investment decisions, and the outcomes they achieve*." In terms of the SFDR, the letter does not make clear on its face whether their proposal would be a substitute for the SFDR or something added on top. There have been no further updates on this at this stage.	Consultation H1 2021 Rules finalised – end 2021 New obligations in force in 2022 (possibly on a phased basis)
UK TCFD – consultation on requiring mandatory climate-related financial disclosures	On 24 March 2021, the BEIS published a consultation paper on proposals to mandate climate-related financial disclosures by publicly quoted companies, large private companies and limited liability partnerships.[28] The proposals contained in the consultation paper build on the Government's 2019 Green Finance Strategy which expects that all listed companies and large asset owners should make disclosures in line with the TCFD recommendations by 2022. For further information please refer to our bulletin which can be accessed **here**.	The consultation period closed on 5 May 2021.
FCA – Appointment of new Director of ESG	The FCA demonstrates its commitment to developing its approach to sustainable finance with the appointment of a Sacha Sadan to the newly created role of Director of Environment, Social and Governance.[29] This role will be aimed at developing the FCA's approach to sustainable finance both domestically and internationally and will also be tasked with the development of policy which ensures "the long-term safety and soundness of firms, the proper function of markets and the protection of consumers".	N/A
Singapore consultation paper – proposed green taxonomy	On 28 January 2021, Singapore's Green Finance Industry Taskforce (the **Taskforce**) launched a consultation on a proposed green taxonomy that will largely be aligned with the EU Taxonomy Regulation.[30] The consultation paper follows on from the Guidelines on Environmental Risk Management which was issued by the Monetary Authority of Singapore and which applies to asset managers, insurers and banks.[31] While the proposed taxonomy largely aligns with the EU Taxonomy Regulation, the Taskforce has proposed developing the Singapore taxonomy in order to ensure relevance to the ASEAN region, including in relation to the specification of industry sectors to be covered by the proposed taxonomy. Another key difference in the proposed Singapore taxonomy is that it includes a traffic light classification system of green, yellow and red activities, where yellow will indicate transition activities for which more granular thresholds and requirements will be developed during the next phase. For further detail on the proposed Singapore taxonomy, see our publication **here**.	The consultation closes on 11 March 2021.

References

01_See https://www.eba.europa.eu/three-european-supervisory-authorities-publish-final-report-and-draft-rts-disclosures-under-sfdr

02_See: https://www.eba.europa.eu/esas-issue-recommendations-application-regulation-sustainability-related-disclosures

03_See Art 28(2) of the Taxonomy Regulation – for example, only financial products that contribute to or promote either (a) climate change mitigation or (b) climate change adaptation will have additional requirements added to the SFDR by the Taxonomy Regulation from 1 January 2022. Financial products that contribute to or promote the other four objectives in Art 9(c)-(f) of the Taxonomy Regulation will only have additional requirements added to the SFDR by the Taxonomy Regulation from 1 January 2023.

04_This is not clear, but is possible based on views stated by the European Commission in relation to the Taxonomy Regulation, which draws on the same defined terms and concepts: Q: "What extra-territorial reach will the Taxonomy Regulation have? What will be its effect on non-EU companies? And on EU companies' activities located outside the EU? • A: The disclosure obligations for financial market participants in the Taxonomy Regulation ***apply to anyone offering financial products in the EU, regardless of where the manufacturer of such products is based***. … This approach is not different to other … financial product disclosure obligations already in place in the EU. [Possibly this is a reference to PRIIPs, which also has extra-territorial reach."] See https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200610-sustainable-finance-teg-taxonomy-green-bond-standard-faq_en.pdf

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