

GREAT FUND INSIGHTS

New ESG Disclosure Regulation

What fund and asset managers need to know

Up to date as of 11 December 2019

As a further development in the roll-out of its green agenda, the EU has finalised a new disclosure regulation. This will require certain firms, including fund and asset managers, to comply with new rules on disclosure as regards to sustainable investments and sustainability risks. This briefing gives further detail on the new requirements and when they will come into effect.

How did we get here?

The EU Council adopted the Disclosure Regulation (2018/0179) on 8 November 2019 (for a copy see [here](#)).¹ It is still to be finalised when the new requirements will come into effect, but the current expectation is c.Q1 2021.

Will it apply to fund and asset managers?

Yes, the new regulation applies to investment firms that provide portfolio management, as well as alternative investment fund managers (AIFMs) and UCITS management companies, among others.

What are the new requirements?

There are new ESG-related rules for relevant firms on transparency, disclosure, internal policies and reports. To navigate the new rules, you need to know three key concepts:

“Sustainability factors”

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

A “sustainability risk”

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

A “sustainable investment”

An investment in an economic activity that:

- contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or

- contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that:

- such investments do not significantly harm any of those objectives, PLUS the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

In short, a “sustainable investment” must therefore advance either a specific “E” OR “S” objective, PLUS it must “do no significant harm” as regards any such objective and involve “G”.

¹ <https://data.consilium.europa.eu/doc/document/PE-87-2019-INIT/en/pdf>

Summary of the key points

The new requirements for fund and asset managers include the following:

- You may need certain new due diligence disclosures
- You may need certain new policies
- You need to update certain existing policies
- You need to make certain new pre-contractual disclosures to investors and clients
- You need to make certain new pre-contractual disclosures for ESG portfolios and funds
- You need to prepare new disclosures for ESG portfolios and funds
- You need to publish certain documents on your website and maintain them on an ongoing basis

An overview of some of the detailed requirements is as follows:

(1) You may need certain new due diligence disclosures

For firms with more than 500 employees during the financial year:

- Preliminary analysis – Decide where you will vs where you will not consider the principal adverse impacts of your investment decisions on sustainability factors
- Where the answer is “yes” – Prepare a disclosure explaining the due diligence policies you will use on this front. This should also include:
 - information about your policies on identifying and prioritising principal adverse sustainability impacts and indicators
 - a description of the principal adverse sustainability impacts and any actions you have taken or planned on them
 - summaries of your engagement policy
 - any responsible business conduct codes and internationally recognised standards for due diligence and reporting you adhere to, and how much they align with the Paris Agreement objectives
- Where the answer is “no” – Prepare a disclosure giving clear and concise reasons why, including information as to whether and when you intend to consider such impacts

To be clear, on the face of the regulation, it is possible for a firm to decide “no” here and not have a relevant due diligence policy. But a regulator may challenge this unless it is clear that ESG is simply not appropriate given the nature of the manager’s portfolios and funds.

18 months after the date the new regulation enters into force

(2) You need new policies

- Prepare a policy on how you integrate sustainability risks in your investment decision-making process
- Basically this means a policy on how you consider what could go wrong in terms of ESG when making investment decisions, and how you deal with those risks.

15 months after the new regulation is published in the Official Journal of the EU

(3) You need to update certain existing policies

- Include in your remuneration policies information as to how they are consistent with the integration of sustainability risks.

15 months after the new regulation is published in the Official Journal of the EU

(4) You need to update your pre-contractual disclosures to all customers and investors

- Sustainability risks – Include a description as to:
 - how you integrate sustainability risks into your investment decisions – ie how an ESG event or condition may have a material adverse impact on the value of an investment, and how you consider and deal with those risks
 - the likely impacts of sustainability risks on returns

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or if you decide (for a particular portfolio or fund) that sustainability risks are not relevant, explain why.

- Sustainability factors – if you decide “yes” in (1) above
 - include a clear and reasoned explanation of whether (and, if so, how) your portfolio or fund considers principal adverse impacts on sustainability factors – ie environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters
 - state that information on principal adverse impacts on sustainability factors is available in the information to be disclosed in periodic reports
- Sustainability factors – if you decide “no” in (1) above

36 months after the date the new regulation enters into force

If this relates to all your portfolios/funds OR just specific ones, you must include a statement in relevant pre-contractual disclosures that you do not consider the adverse impacts of investment decisions on sustainability factors and the reasons why.

(5) You need to update your pre-contractual disclosures for certain ESG badged products

- E/S portfolios/funds – If a portfolio/fund “promotes” environmental or social characteristics:
 - include information as to how those characteristics are met
 - if you have designated an index as a reference benchmark, include information on whether and how this index is consistent with those characteristics
 - indicate where the methodology used for the calculation of that index can be found

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- Sustainable investment portfolios/funds – Extra requirements apply if the portfolio/fund has sustainable investment as its objective. As above, “sustainable investment” basically means the portfolio’s/fund’s objective is a specific environmental OR social objective, PLUS it must “do no significant harm” as regards any such objective and investee companies must have good governance. The new regulation allows for two options here:

Option 1 – If an index has been designated as a reference benchmark. In this case, the relevant pre-contractual disclosure must:

- include information on how that index is aligned with that objective
- explain why and how that index differs from a broad market index

Option 2 – If no index has been designated as a reference benchmark. In this case, the relevant pre-contractual disclosure must:

- explain how (instead) the fund’s sustainable investment objective is going to be met

NB: If no index is referenced because no EU Climate Transition or EU Paris-aligned Benchmark is available under the Benchmarks Regulation, you must include a detailed explanation as to “how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement”.

- “Reduction in carbon emissions” objective – In this case, the relevant pre-contractual disclosure must include the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement.

(6) You need to prepare new disclosures for ESG portfolios and products

Extra requirements apply if you have a portfolio or fund that:

- promotes environmental or social characteristics, or
 - has sustainable investment as its objective, or
 - has a reduction in carbon emissions as its objective
- Disclosure document – You need to prepare and maintain a new disclosure containing:
- a description of the environmental or social characteristics or the sustainable investment objective
 - information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the portfolio or fund
 - the pre-contractual disclosures mentioned above in (5)
 - the information referred to in the next paragraph.
- Periodic report – In your periodic reports:
- for a portfolio/fund that promotes environmental or social characteristics – report on the extent to which environmental or social characteristics are met
 - for a portfolio/fund that has sustainable finance as its objective or has a reduction in carbon emissions as its objective – report on the overall sustainability-related impact of the portfolio/fund by means of relevant sustainability indicators, OR if an index has been designated as a reference benchmark, compare the overall sustainability-related impact of the portfolio/fund with the impacts of the index and of a broad market index through sustainability indicators.

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(7) Website – Publish and maintain on your website:

- The disclosures on your due diligence policies as mentioned above.
- Information on your policies on the integration of sustainability risks as mentioned above
- The information on remuneration mentioned above – ie an explanation as to how your remuneration policies are consistent with the integration of sustainability risks
- The disclosure mentioned above.

18 months after the date the new regulation enters into force

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Next steps

ESMA, the EBA and EIOPA have been mandated to develop draft regulatory and implementing technical standards to give further detail on the prescribed requirements. This includes standards to determine the standard presentation of information on the promotion of environmental or social characteristics and sustainable investments.

As a final point, on the UK side, the current UK Government has clarified that, even if there is a “hard” Brexit, the Disclosure Regulation will be “onshored”, and current expectations are that any new Government will carry forward this position.

Recommendations

In terms of what firms should be doing now:

- Get up to speed on the new disclosure regulation and establish an internal team to consider the impact on your business
- Ensure you are “plugged in” to industry work on ESG
- Look out for the consultations expected to be published in due course on the technical standards

If you have any questions on the new requirements mentioned above or ESG generally, please get in touch with your usual A&O contact.

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