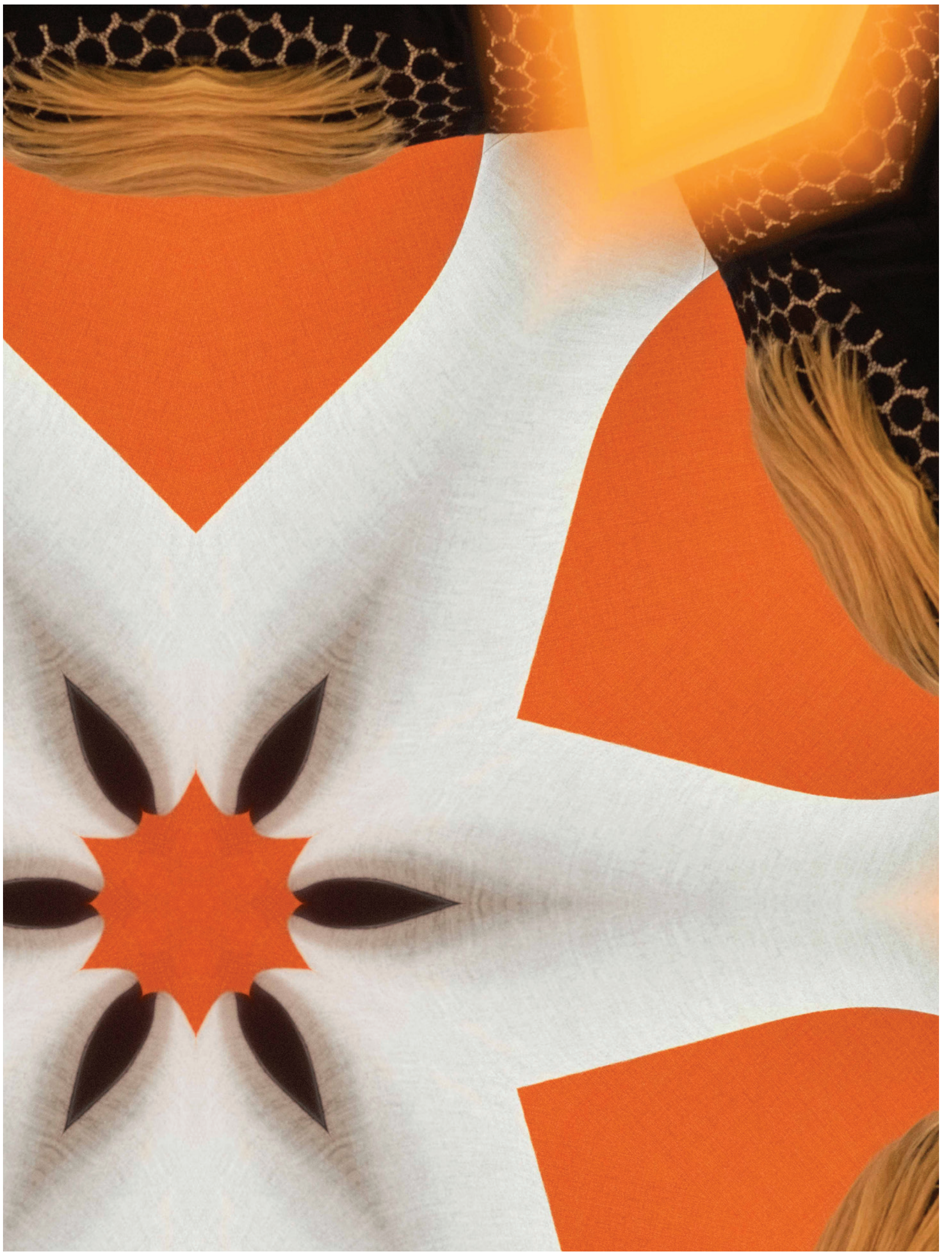
ARTHUR COX



ASSET MANAGEMENT AND INVESTMENT FUNDS

Sustainable Finance – What the ESG legislative measures mean for asset managers

Investors have been driving the ESG agenda for some time and products labelled as ESG have been growing as a result. With that growth comes questions around whether investors are getting what they think they are and how do they benchmark ESG products against each other. These questions, together with a commitment to use the financial sector to direct investment into sustainable activities, are key drivers of new legislative developments that will impact all asset managers.

Sustainability has also become a focus for governments and regulators. In 2015, the UN adopted the UN 2030 Agenda and Sustainable Development Goals to promote sustainable growth and sustainable consumption. Following this, representatives from 195 nations came together with the objective of strengthening the response to climate change by making finance flows consistent with a pathway toward low greenhouse gas emissions in the Paris Agreement. The EU followed this with the establishment of its own high level expert group with the aim of identifying how sustainability could be integrated into its regulatory and financial policy framework. This resulted in the publication of the EU Action Plan on financing sustainable growth, which has at its core a belief that financial services can play a key role in the transition to a more sustainable economy by redirecting capital flows towards sustainable investments.

The resulting legislative package will set a common understanding of what constitutes sustainability, will require sustainability to be considered in the investment process, require sustainability considerations to be included in operational and risk considerations and drive transparent disclosures to investors. Asset managers will have to consider environmental, social and governance factors when investing, with the aim of achieving tangible results in the fight against climate change and social inequality.

The EU Action Plan identifies 10 key points but asset managers and management companies need to focus on the proposals that relate to the:

1. establishment of an agreed classification of sustainable activities;
2. creation of standards for green financial products;
3. incorporating sustainability as part of financial advice;
4. developing sustainability benchmarks and better integrating sustainability into ratings; and
5. enhanced disclosure required by asset managers and financial advisors to their clients.

All of these lead to a development of the understanding of sustainable finance.

Sustainable finance is the provision of finance to investments, or other forms of financial services, taking into account environmental, social and governance considerations

While there is a strong focus on green/environmental measures, there has also been increased emphasis placed on general transparency and appropriate governance

ESG

Environment

The quality and functioning of the natural environment and natural systems such as climate change, pollution, waste and circular economy

Social

Rights, well-being and interests of people and communities such as human rights and conduct, culture and ethics

Governance

Governance of companies and other investee entities such as board effectiveness and shareholder protection and rights

With the aim of furthering sustainable finance and ESG integration, the European Commission has put together a package of legislative initiatives that include three key Regulations, together with corresponding changes to UCITS and AIFMD

Taxonomy Regulation

A unified EU classification system of sustainable economic activities designed to prevent "green washing"

Disclosures Regulation

Disclosure on the integration of ESG factors and sustainability risks into the risk investment processes of financial market participants, including UCITS management companies and alternative investment fund managers

Low Carbon Benchmarks & Positive Impact Benchmarks Regulation

Creating new forms of benchmarks that have less carbon emissions or create carbon savings

UCITS & AIFMD

Amendments to integrate sustainability into organisational and operational requirements and risk management.

WHO DOES IT IMPACT?

While much of the impact of these measures will be on the managers that promote products offering impact investing, all UCITS management companies and AIFMs will be impacted and so need to consider the impacts of these measures on their policies, procedures, disclosures and reporting.

To support the required ESG data being available to asset managers and institutional investors in addressing these new requirements, additional non-financial reporting disclosures are also required from underlying invester companies.

TIMELINE OF IMPACTS

2020

30 December 2020

Disclosures Regulation
Draft technical standards on disclosures to investors in relation to adverse impacts on the climate and other environment-related adverse impacts to be prepared

2021

10 March 2021

Disclosures Regulation
Application date of many requirements of the Disclosures Regulation

30 June 2021

Taxonomy Regulation
Website publication of a statement of due diligence processes with respect to the principal adverse impacts of investment decisions on sustainability factors

30 December 2021

Disclosures Regulation
Draft technical standards on disclosures in relation to adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery to be prepared

2022

1 January 2022

Taxonomy Regulation
Delegated Acts for activities that substantially contribute to climate change mitigation and adaptation apply

1 January 2022

Disclosures Regulation
Requirements relating to periodic reports of ESG-focused products apply

1 June 2022

Taxonomy Regulation
Draft technical standards on activities that substantially contribute to environmental objectives other than climate change mitigation and adaptation (water, circular economy, pollution, biodiversity to be prepared

30 December 2022

Disclosures Regulation
Disclosure on the consideration of principal adverse impacts of investment decisions on sustainability factors

2023

1 January 2023

Taxonomy Regulation
Activities that substantially contribute to environmental objectives other than climate change mitigation and adaptation

Legislative Developments | **Key Dates for Asset Managers**

Regulation	Status	Key Elements	Action Required
Disclosures Regulation	Adopted Joint consultation on level two measures relating to the content and presentation of required disclosures closed on 1 September 2020. Applies to all UCITS ManCos, AIFMs and MiFiD firms. Action required ahead of 10 March 2021 See our detailed briefing here.	The Disclosures Regulation seeks to harmonise existing provisions in relation to sustainability-related disclosures to investors. The provisions apply to financial market participants ("FMPs"). **Pre-Contractual Disclosures** FMPs will need to integrate into fund documents by 10 March 2021 pre-contractual disclosures explaining how sustainability risks are integrated into investment decisions and the likely impacts of sustainability risks on the returns of financial products. Additional disclosure will need to be added where financial products promote environmental or social characteristics ("ESG Products"). **Website Disclosures** FMPs will need to make website disclosures by 10 March 2021 about the integration of sustainability risks into decision-making processes for investments or investment advice, as applicable, as well as an assessment of the likely impacts of sustainability risks on the returns of the relevant financial products. FMPs will also need to consider due diligence policies and decide whether they will consider adverse impacts. Additional disclosure to be added where financial products promote environmental or social characteristics. **Remuneration Policies** FMPs will need to include information in their remuneration policies on how they are consistent with the integration of sustainability risks and to publish this information on their website. **Periodic Reporting Requirements** Promotors of ESG products from 1 January 2022 will need to disclose in financial statements the extent to which environmental or social characteristics have been attained or the overall sustainability-related impact of a product using sustainability indicators. Where an index is used, a comparison between the impact of the designated index and a broad market index is required.	• Consider the current approach to sustainability risks and adverse impact assessment against the requirements. • Prepare prospectus disclosure. • Prepare website disclosure. • Review due diligence policies. • Review remuneration policies. • Consider if any products are 'ESG Products' and, if so, review additional requirements.

Regulation	Status	Key Elements	Action Required
		ESG Products Products that have social characteristics or sustainable investment as an objective need to include on their website a description of the ESG characteristics and objective information on the methodologies used to assess, measure and monitor the characteristics or impact, including data sources, screening criteria and sustainability used for measurement. **Adverse Impacts Statement** The EU ESG objectives mean it is essential that adverse impacts on these are identified and disclosed. The requirement to publish an annual statement in a mandated form is part of the level 2 consultation. Small scale FMPs may publish a statement that do not consider these impacts. **RELEVANT DEFINITIONS** “financial market participant” Includes UCITS management companies, AIFMs and MiFID investment firms providing portfolio management “financial advisers” Includes AIFMs providing investment advice in accordance with AIFMD and UCITS Management Companies providing investment advice in accordance with the UCITS Directive and MiFID investment firms providing investment advice. “financial product” Includes an AIF or a UCITS “sustainability risk” 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.	

Regulation	Status	Key Elements	Action Required
		RELEVANT DEFINITIONS CONTD. "sustainability factors" Environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters. "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 an investment in an economic activity that 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 and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance. The provision of the disclosures regulation have been enhanced by the taxonomy regulations, however different timings and terminology apply.	
Low Carbon Benchmarks & Positive Impact Benchmarks Regulation	Adopted Entered into force on 10 December 2019 Action required by 30 April 2020 but 'no action' letter issued by ESMA as the relevant delegated acts not yet adopted.	This regulation does not have a direct impact on most FMPs, but there are various implementation deadlines for benchmark administrators, including: • disclosure of how ESG factors are incorporated to be made by 30 April 2020; and • inclusion in benchmark statements by 31 December 2021with an explanation of how the methodology aligns with the target of carbon emission reductions or attains the objectives of the Paris Agreement.	• For products aligned to these benchmarks, additional disclosure will be required.

Regulation	Status	Key Elements	Action Required
Taxonomy Regulation	Adopted by European Council on 15 April 2020, and by the European Parliament on 18 June 2020. Entered into force on 2 July 2020. The taxonomy for climate change mitigation and climate change adaptation should be established by the end of 2020 in order to ensure its full application by the end of 2021. For the four other ESG objectives, the taxonomy should be established by the end of 2021 for application by the end of 2022. Action required by 1 January 2022. See our detailed briefing [here].	The Taxonomy Regulation establishes the criteria for determining whether an economic activity is sustainable. It applies to all FMPs, principally to those that either have products that promote environmental sustainability or environmental objectives. Where an [FMP] does not take into account criteria for environmentally sustainable investments they need to provide a statement to this effect. This Regulation sets out that activities are considered "sustainable", if they: 1. contribute substantially to at least one of six environmental objectives: • Climate change mitigation; • Climate change adaptation; • Sustainable use and protection of water and marine resources; • Transition to a circular economy; • Pollution prevention and control; and • Protection and restoration of biodiversity and ecosystems; 2. do not significantly harm any of the environmental objectives; 3. are carried out in compliance with minimum social safeguards, and 4. comply with specific 'technical screening criteria. Each criteria is detailed with further technical screening criteria to be developed and regularly updated to stay in line with scientific and tecnological developments. Firms will be required to disclose the extent of environmental sustainability of funds and pension products that are promoted as being environmentally sustainable or include disclaimers where they do not. Firms falling under the scope of the Non-Financial Reporting Directive will need to disclose information on the extent to which the undertaking's activities are environmentally sustainable. The European Commission expects to publish detailed reporting requirements by 1 June 2021.	• Consider if any products are ESG products and, if so, assess them against the new classifications. • Consider disclosure requirements. • Negative statement required in pre-contractual documentation where a product does not take account of the taxonomy's criteria.

Regulation	Status	Key Elements	Action Required
Delegated Regulation amending existing UCITS and AIFMD rules to integrate sustainability and risk factors	The European Commission published draft texts of the Delegate Acts seeking stakeholder feedback and this consultation closed on 6 July 2020. The European Commission will now adopt the Acts. In general, Parliament and Council have two months to formulate any objections. Where there are none, the Draft Delegated Acts will enter into force on the twentieth day following their publication in the Official Journal of the EU and will become applicable 12 months after publication. See our detailed briefing here.	These will apply to UCITS ManCos and AIFMs. 'Sustainability Risk' and 'Sustainability Factors' in the draft acts are defined by reference to the definitions in the Disclosures Regulation. The new legislation incorporates the following key changes: • UCITS ManCos and AIFMs must take into account sustainability risks when complying with organisational requirements and ESG considerations should be integrated into organisational requirements when looking at structure and decision making processes and when considering the adequacy of resources. • There should be expertise for the effective integration of sustainability risks and senior management's responsibility includes the integration of sustainability risks; • Sustainability risks are to be included in the identification of any conflicts of interest; • There is a need to consider principle adverse impacts of investment decisions on sustainability factors; • Integration of sustainability risks are to be included into the investment due diligence process; and • Risk management policies need to be updated to set out procedures relating to sustainability risks. The principal of proportionality, taking account of nature, scale and complexity can be applied.	• Review risk framework and due diligence policies. • Review organisational requirements • Review expertise at board level • Consider conflicts policy

ARTHUR COX & ESG

Arthur Cox is very mindful of its own ESG responsibilities. We have actively reduced our carbon footprint through energy efficiency, waste management and sustainable procurement. Our Dublin HQ was awarded the highest energy efficiency standard ISO 50001:2018, which we only retain through a continuing reduction of energy use each year. We address our social and governance responsibilities though active CSR and D&I programmes. We aim to achieve improvements in all these aspects each year.

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