

ESG - sustainable finance update

In the last weeks and months, the European Commission and the European supervisory authorities have published guidance in order to clarify certain concepts concerning the application of SFDR and the Taxonomy Regulation.

These include the SFDR RTS (adopted by the European Commission on 6 April 2022 but not yet published in the OJEU) which should become applicable on 1 January 2023, a Commission FAQ on SFDR (25 May 2022), a Supervisory Statement (31 May 2022) from ESMA on EU convergence in the supervision of investment funds with sustainability features and another from the ESAs (2 June 2022) with clarifications on the SFDR RTS.

In terms of next steps, as of 2 August 2022, MiFID firms that provide portfolio management services and investment advice to their clients will have to include in the suitability test specific questions relating to the sustainable investment preferences of those clients (Delegated Regulation (EU) 2021/1253).

In addition to the sustainability preferences, the product governance rules under MiFID have been amended and will become applicable in November 2022.

Compliance with the new MiFID provisions on sustainability preferences will be particularly challenging for the asset management industry due to several elements, such as:

- The fact that the SFDR RTS will not become applicable until 1 January 2023;
- ESMA has yet to publish guidelines on the scope of these new MiFID ESG obligations.

The European investment fund industry has taken steps to anticipate as much as possible the imminent application of the new MiFID sustainability preference requirements. This is notably reflected in the publication of a European ESG Template (EET), which is a cross-sectoral template comprising the views of the banking, asset management, structured product, insurance, and pensions industries. It is designed to standardise SFDR/Taxonomy-related data exchange between these industry participants. The EET notably includes the information from the manufacturer of financial products (i.e. investment funds) that distributors and advisors need to fulfil their new MiFID obligations.

In spite of all these efforts and initiatives, the lack of ESG data in the market continues to be a major obstacle regarding the effective application of the various sustainable finance rules. Examples include:

- the information concerning environmentally sustainable economic activities to be

disclosed by undertakings subject to the Non-Financial Reporting Directive (Directive [2014/95/EU](#)) in accordance with the delegated act supplementing the Taxonomy Regulation (Commission Delegated Regulation [\(EU\) 2021/2178](#)) will not be fully available until 2024; and

- the proposed [Corporate Sustainability Reporting Directive](#) which will notably broaden the scope of entities subject to the Non-Financial Reporting Directive has not yet been finalised.

In parallel to the MiFID changes, Directive 2010/43/EU (UCITS level 2 - [link](#)) and Regulation 231/2013 (AIFM level 2 - [link](#)) have also been amended to reflect the new SFDR requirements. The new measures which apply to AIFMs and UCITS management companies from 1 August 2022 are briefly described below:

- Asset selection process (due diligence): sustainability risks must be taken into account.
- Human resources: necessary ESG resources and expertise are required in order to effectively integrate sustainability risks in processes and procedures as well as to ensure effective oversight.
- Conflict of interest: an assessment of any conflicts of interest that may arise as a result of the integration of sustainability risks in the processes and policies.
- Risk management: the risk management process and policy will need to be reviewed to make sure they cover sustainability risks.
- Organisational systems and controls: sustainability risks must be taken into account in the organisational procedures, control mechanisms and reporting.
- Senior management responsibilities: the senior management is responsible for the integration of sustainability risks in the following points:
 - the implementation of the investment policies;
 - overseeing the approval of the investment strategies;
 - the valuation policies and procedures;
 - the compliance function;
 - what is done to ensure and verify on a periodic basis that the investment policy, investment strategies and risk limits are properly and effectively implemented and complied with;
 - the approval and review on a periodic basis of the adequacy of the internal procedures for undertaking investment decisions, to ensure such decisions are in line with their respective investment strategies;
 - the risk management policies and procedures, including the risk limits for each of the fund that they manage; and
 - (for AIFMs) the remuneration policy.

Finally, there have also been recent developments as regards gas and nuclear activities and in particular the EU Commission proposal for a Taxonomy Complementary Climate Delegated Act which includes a list of criteria that classifies investments in nuclear or gas power generation as "sustainable" ("[Taxonomy Complementary Climate Delegated Act](#)"). The deadline to object to the Commission's proposal was 11 July 2022. On 6 July 2022, the

EU Parliament rejected a motion to oppose the inclusion of nuclear and gas as environmentally sustainable economic activities. As the scrutiny period (i.e. objection period) has now expired, the Taxonomy Complementary Climate Delegated Act will be published in the Official Journal and will apply as of 1 January 2023.

For any further information please contact us or visit our website at www.elvingerhoss.lu.

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