



## New ESG Disclosure Obligations

Posted by Anna Maleva-Otto and Joshua Wright, Schulte Roth & Zabel LLP, on Tuesday, March 24, 2020

**Editor's note:** Anna Maleva-Otto is a partner and Joshua Wright is an associate at Schulte Roth & Zabel LLP. This post is based on their SRZ memorandum.

The EU regulation on Sustainability-Related Disclosures (“Disclosure Regulation”) <sup>1</sup> will take effect on March 10, 2021. Its aim is to enhance transparency regarding integration of environmental, social and governance matters (“ESG”) into investment decisions and recommendations. Many of the requirements of the Disclosure Regulation will apply to investment managers that do not focus on ESG mandates.

The Disclosure Regulation forms part of a package of legislative initiatives designed to promote the engagement of financial services providers in building a sustainable economy of the future. These legislative initiatives also include the draft Taxonomy Regulation <sup>2</sup> which establishes a framework for classifying financial products as “sustainable investments”—a measure directed at tackling so-called “greenwashing” of financial products. Other elements of the package include proposed amendments to MiFID II, <sup>3</sup> AIFMD and UCITS <sup>4</sup> that will require asset managers to integrate ESG considerations into their organisational and operational controls, and risk management processes.

### Key Requirements

The Disclosure Regulation will require AIFMs, UCITS management companies, as well as portfolio managers and investment advisers authorised under MiFID, to implement policies and make certain disclosures (on a “comply or explain” basis) with regards to sustainability risks and sustainability factors relevant to their investment activities.

A “sustainability risk”, as defined in the Disclosure Regulation, means an environmental, social or governance event or condition that, if it occurs, could cause a negative material impact on the value of an investment. “Sustainability factors” are environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

### Application to UK and Other Non-EU Managers

Despite the UK’s withdrawal from the EU, both the Disclosure Regulation and Taxonomy Regulation have been added to the list of EU legislation which will be “onshored” by the UK. This

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<sup>1</sup> Regulation (EU) 2019/2088, available here.

<sup>2</sup> Proposal for a Regulation on the Establishment of a Framework to Facilitate Sustainable Investment, latest text available here.

<sup>3</sup> Draft Commission Delegated Regulation amending Regulation (EU) 2017/565, available here.

<sup>4</sup> ESMA Technical Advice on Sustainable Finance, available here.

means that both regulations will be implemented in the UK and will apply to UK AIFMs, UCITS management companies and portfolio managers authorised under MiFID.

The Disclosure Regulation covers alternative investment fund managers (as defined in AIFMD)<sup>5</sup> without specifying the territorial scope or status of such AIFMs under AIFMD. The pre-investment disclosure obligations (see below) require AIFMs to include information on ESG considerations in the disclosures mandated under Article 23(1) of AIFMD. Article 23(1) of AIFMD applies to EU/UK managers of EU AIFs (e.g., Irish or Luxembourg structures), as well as managers of non-EU AIFs if they market their funds in the EU/UK under the national private placement regimes through cross-references in Articles 36 and 42 of AIFMD (that establish such regimes). Subject to any further clarifications or guidance which may be published in the future, this could mean that the pre-investment disclosure obligations will apply not only to EU/UK AIFMs who market their EU or non-EU funds, but also to non-EU AIFMs (e.g., US or Swiss investment managers) who market their Cayman and other non-EU funds under Article 42 private placement regimes in the UK or any EU jurisdictions.

## What Are Managers Expected to Do?

Asset managers and investment advisers will be required to take the following steps to comply with the Disclosure Regulation:

- *Policies and Procedures.* To produce the required disclosures, in-scope firms will need to consider and document the relevance of ESG to their investment policies. In addition, when preparing or updating their staff remuneration policies (including, where required, public or investor disclosures with regards to their remuneration practices), managers will be required to specify how these policies are consistent with the integration of sustainability risks. This will involve making a series of strategic business and investor relations decisions.
- *Website Disclosures.* All managers will be required to publish on their websites information about their policies on integration of sustainability risks in their investment decision-making processes. Additional public disclosure obligations will apply to larger firms (with 500 employees or more) and will include descriptions of investment due diligence processes for assessing adverse impacts of investment decisions on sustainability factors, a description of the principal adverse sustainability impacts, policies on their identification and prioritisation, any action taken or planned with regards to such sustainability impacts, as well as information on the manager's shareholder engagement policies. Firms that choose not to take sustainability risks into account when making their investment decisions will be required to provide clear reasons for their decision.
- *Pre-Contractual Disclosures.* Disclosures on the manner in which sustainability risks are integrated into investment decisions and advice and the results of the manager's assessment of the likely impacts of sustainability risks on the returns must also be included in the "pre-contractual disclosures", such as the investment management agreement relating to a separately managed account, or the private placement memorandum or prospectus of a fund. If a manager does not consider sustainability risks to be relevant, the pre-contractual disclosures must include a clear explanation of the manager's rationale.

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<sup>5</sup> Legal persons whose regular business is managing one or more alternative investment funds.

- *Sustainable Investments.* Additional detailed disclosure obligations will apply to investments that are marketed as sustainable investments (meeting the requirements of the Taxonomy Regulation) or other products that promote specific ESG characteristics.

Against the background of an increased investor demand for ESG-related focus, regulators on both sides of the Atlantic are concerned with the adequacy and accuracy of ESG disclosures and the “greenwashing” of financial products, with the SEC’s OCIE already conducting exams reviewing ESG disclosures.<sup>6</sup> Managers should take note of this scrutiny and allow time to formulate ESG policies and practices that are tailored to their businesses and investment approaches ahead of the requirements of the Disclosure Regulation taking effect next year.

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<sup>6</sup> See 2020 Examination Priorities, available here.