

# Investment funds and your managers – are you ready for ESG?

*Deadline: 10.03.2021*





## 1. Background

Within the frame of new global sustainable development framework adopted on 2015 by the UN General Assembly which has at its core the Sustainable Development Goals (“**SDGs**”), the European Union (EU) has decided to take the SDGs on board at the outset.

Consequently, in order to strengthen the response to climate change by, inter alia, making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development, the European Parliament and the Council have adopted the sustainability-related disclosures in the financial services sector (**SFDR**) on 27 November 2019. The global target is to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1,5°C above pre-industrial levels.

The European Parliament and the Council have subsequently adopted the Taxonomy Regulation (Regulation 2020/852), which entered into force on **12 July 2020**. The Taxonomy Regulation has supplemented and amended certain provisions in SFDR.

## 2. Objectives

The purpose of SFDR is to strengthen protection for end investors and improve disclosures to them.

Hence SFDR imposes to Financial Market Participants<sup>1</sup> (which include the investment fund managers of undertakings for collective investment in transferable securities (“**UCITS ManCos**”) and alternative investment funds (“**AIFMs**”)) disclosures to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or on the promotion of environmental or social characteristics so that the investors make take informed investment decisions. In a nutshell, it is about to “green” the finance flows. The intention is to ensure that potential investors obtain relevant information to encourage them to choose firms and products that are “ESG-friendly”.

## 3. To whom this ESG Regulation shall apply?

In practice, Luxembourg regulated investment funds (SIFs, SICARs, UCITs and UCI part II funds) (the “**Regulated Investment Funds**”), RAIFs and others AIFs managed by an authorised AIFM (the “**AIFs**”) (Regulated Investment Funds and AIFs are referred together as the “**Investment Funds**”) fall within the scope of SFDR.

The question whether SFDR shall apply to non-EU AIFMs and registered AIFMs (referred to as sub-threshold AIFMs) has been raised at European Union level by an ESAs letter addressed to the European Commission on 7 January 2021.

## 4. Date of application

The SFDR shall apply from 10 March 2021.

It was expected that ESAs<sup>3</sup> develop, through a joint committee Regulatory Technical Standards (“**RTS**”) by 31 December 2020 to enable the Financial Market Participants to meet their disclosure obligations.

However, in a letter dated on 20 October 2020, the European commission stated that due to COVID-19 crises, these rules could not be drawn up by the date initially planned. On the other hand, the European commission added that this does not prevent Financial Market Participants from complying with SFDR since the latter is not conditional on the formal adoption and entry into force or application of the RTS.

The latter has been confirmed by the CSSF in a press release dated on 6 November 2020.

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1. As per Article 2 of SFDR and CSSF communication on November 6, 2020, Financial Market Participants include notably the following entities established in Luxembourg subject to CSSF supervision: alternative investment fund managers (AIFMs), UCITS management companies, managers of a qualifying venture capital fund or a qualifying social entrepreneurship fund, credit institutions or investment firms which provide portfolio management and institutions for occupational retirement provision (IORP).

2. Specialized Investment Funds are referred to as SIFs, Investment Companies in Risk Capital are referred to as SICARs, undertakings for collective investment in transferable securities are referred to as UCITS, undertakings for collective investment subject to part II of the law of 17 December 2010 relating to undertakings for collective investment are referred to as UCI part II funds, Reserved Alternative Investment Fund (RAIFs) and Alternative Investment Funds are referred to as AIFs.

3. ESAs shall refer to EBA, EIOPA and ESMA

## 5. Requirements: What and How to disclose?

The requirements under SFDR impose to Financial Market Participants new disclosures, update of certain existent policies, new policies, to make certain new pre-contractual disclosure to investors, and update their website.

The brief summary of the detailed requirements is as follows:

- the first table is related to all Investment Funds managers (i.e. AIFMs and UCITS ManCos); and
- the second one is related to Investment Funds managers (i.e. AIFMs and UCITS ManCos) in respect of Investment Funds which promote environmental or social characteristics or a combination of those characteristics or have a sustainable investment objective.

### a- Requirements applicable to all Investment Funds Manager (i.e. AIFMS and UCITS ManCos)

Support	Requirements		Scope
<b>Website</b>	Publish and maintain information on policies regarding the integration of sustainability risks in their investment decision-making process.		Art 3 of SFDR: Transparency of sustainability risk policies
	<b>Preliminary question: Do you have the intention to consider principal adverse impacts of investment decisions on sustainability factors?</b>	If <b>yes</b> ("opt in decision" <sup>4</sup> ): Publish and maintain a statement on due diligence policies with respect to those impacts.	Art 4 of SFDR: Transparency of adverse sustainability impacts
		If <b>no</b> ("opt out decision" <sup>5</sup> ): Publish and maintain clear reasons for why do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts.	
<b>Remuneration policy</b>	Include in remuneration policies information on how those policies are consistent with the integration of sustainability risks and publish this information on the website.		Art 5 of SFDR: Transparency of remuneration policies in relation to the integration of sustainability risks
<b>Pre-contractual disclosures</b>	<b>Preliminary question: Do you deem sustainability risks to be relevant?</b>	If <b>yes</b> , describe: 1. the manner in which sustainability risks are integrated into the investment decisions; and 2. the results of the assessment of the likely impacts of sustainability risks on the returns of the investment funds they make available.	Art 6 of SFDR: Transparency of the integration of sustainability risks
		If <b>no</b> , the descriptions referred to above shall include a clear and concise explanation of the reasons therefor.	

4. See below point 7. Practical aspects

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Support	Requirements		Scope
Pre-contractual disclosures	<b>Preliminary question:</b> <b>Do you have the intention to consider principal adverse impacts that investment decisions may have on sustainability factors?</b>	<b>If yes (“opt in decision”<sup>6</sup>),</b> by 30 December 2022, the information to be included shall contain among other for each investment fund: 1. a clear and reasoned explanation of whether, and, if so, how the investment fund considers principal adverse impacts on sustainability factors; and 2. a statement that information on principal adverse impacts on sustainability factors is available in the information to be disclosed pursuant to Article 11(2) of SFDR (i.e. in the annual report).	Art 7 of SFDR: Transparency of adverse sustainability impacts at investment funds level
		<b>If no (“opt out decision”<sup>7</sup>):</b> The information to be included shall among other contain for each investment fund a statement that the AIFM/UCITS ManCo does not consider the adverse impacts of investment decisions on sustainability factors and reasons therefor.	

**b- Additional requirements applicable to the investment Funds managers in respect of Investment funds which promote environmental or social characteristics or have a sustainable investment objective**

Support	Requirements	Scope
Website	Publish and maintain: 1. description of the environmental or social characteristics or the sustainable investment objective of each investment fund; 2. 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 Investment Funds; 3. information requested for the transparency of the promotion of environmental or social characteristics /sustainable investments in pre-contractual disclosures; and 4. information requested to be disclosed in the annual reports.	Art 10 of SFDR: Transparency of the promotion of environmental or social characteristics and of sustainable investments related to Investment Funds

<sup>6</sup>. See below point 7. Practical aspects

<sup>7</sup>. See below point 7. Practical aspects

Support	Requirements		Scope
<b>Pre-contractual disclosures</b>	<p>Information to be disclosed where a financial product promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices:</p> <ol style="list-style-type: none"> <li>1. information on how environmental or social characteristics are met; and</li> <li>2. If an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics and indication of where the methodology used for the calculation of the index is to be found.</li> </ol>		Art 8 of SFDR: Transparency of the promotion of environmental or social characteristics in pre-contractual disclosures
<b>Pre-contractual disclosure</b>	<p>Information to be disclosed where the investment fund has <b>sustainable investment</b> as its objective</p>		Art 9 of SFDR: Transparency of sustainable investments in pre-contractual disclosures
	<p><b>Preliminary question: has an index been designated as a reference benchmark?</b></p>	<p>If yes, the information to be published shall be accompanied along with others information of:</p> <ol style="list-style-type: none"> <li>1. information on how the index is aligned with the sustainable investment objective and indication of where the methodology used for the calculation of the index or the benchmark, if any are to be found; and</li> <li>2. an explanation as to why and how the designated index aligned with that sustainable investment differs from a broad market index.</li> </ol> <p>If no, an explanation on how the sustainable investment objective is to be attained.</p> <p>Where a financial product has a reduction in carbon emissions (CO<sub>2</sub>) as its objective, the information to be disclosed shall include among others the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement.<sup>8</sup></p>	

8. Paris Agreement adopted under the United Nation Framework Convention on Climate Change entered into force on 4 November 2016

Support	Requirements	Scope
<b>Periodic reports</b>	<p>Some information needs to be disclosed in the periodic reports when AIFMs/UCITS ManCos make available an Investment Fund having environmental or social characteristics or sustainable investment as its objective.</p> <ol style="list-style-type: none"> <li>Investment Funds having environmental or social characteristics objectives: the extent to which environmental or social characteristics are met.</li> <li>Investment Funds having sustainable investment objectives: <ul style="list-style-type: none"> <li>the overall sustainability-related impact of the Investment Funds by means of relevant sustainability indicators; or</li> <li>where an index has been designated as a reference benchmark, a comparison between the overall sustainability- related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators</li> </ul> </li> </ol>	Art 11 of SFDR: Transparency of the promotion of environmental or social characteristics and of sustainable investments in periodic reports

## 6. Taxonomy Regulation: Additional requirements for Investment Funds managers in respect of investments funds which promote environmental characteristics or has sustainable investment or a reduction in carbon emissions objectives

Taxonomy Regulation adds additional requirements for financial products that promote environmental characteristics or has sustainable investment or a reduction in carbon emissions as their objectives and the portfolio invests in an economic activity that contributes to an environmental objective within the meaning of the Taxonomy Regulation.

In particular, the pre-contractual disclosure and the periodic reports will need to contain the following information:

a- the information on the environmental objective or environmental objectives set out in the Taxonomy Regulation to which the investment underlying the financial product contributes;

b- a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable within the meaning of the Taxonomy Regulation; and

c- where investment fund promotes environmental characteristics a statement that:

- “the “do no significant harm” principle applies only to those investments underlying the Investment Fund that take into account the EU criteria for environmentally sustainable economic activities.
- the investments underlying the remaining portion of the Investment Fund do not take into account the EU criteria for environmentally sustainable economics activities”.

## 7. Practical aspects

In order to be fully prepared and maintain quality of services, AIFMs and UCITS ManCos should undertake substantial work including reviewing and adapting issuing documentation, website, policies and contracts or service level agreements with the Investment Funds they manage. They will also need to review the agreements with the investment manager in charge of the investment management decisions, should they have the intention to integrate ESG factors into the investment decision process.

Although it will entail additional costs due to the regulatory burden, it is likely expected that the demand from investors to invest into ESG compliant investment products will increase significantly and give new opportunities to the Luxembourg investment fund industry.

Please find below an overview of the practical steps to undertake to be SFDR compliant.

## a- AIFMs/UCITs ManCos

Support	What to do
<p><b>Corporate Resolutions</b></p> <ul style="list-style-type: none"> <li>the decision to opt in or opt out is only available for companies up to 500 employees</li> <li>for the bigger one companies with more than 500 employees, the opt out decision is only available until 30 June 2021 (from 30 June 2021, they have to apply the opt in decision)</li> </ul>	<p><b>OPT IN</b> decision when the AIFMs/UCITs ManCos decide to take into consideration any adverse impact that their investment decisions may have on sustainability factors</p> <p><b>OPT OUT</b> decision when the AIFMs/UCITs ManCos decide NOT to take into consideration any adverse impact that their investment decisions may have on sustainability factors and need to justify such decision</p>
<p><b>Corporate Resolutions</b></p> <p>Decision to be taken to integrate ESG into investment fund strategy:</p> <ul style="list-style-type: none"> <li>either promotion, among others, of environmental or social characteristics</li> <li>or integration of the objective of sustainable investment into their investment strategy.</li> </ul>	<p>AIFMs/UCITs ManCos shall consider whether they would like to offer ESG Investment Funds products taking into consideration the costs and benefits for such integration into their products as it will add regulatory requirements when they will promote ESG.</p>
<p><b>Website update</b></p>	<ol style="list-style-type: none"> <li>Information about the update of the risk management policy (RMP) to evidence the integration of sustainability risks in the investment decision-process</li> <li>Information about the update of the remuneration policy to evidence how it is consistent with the integration of sustainability risks in the investment decision-process</li> <li>Information about the update of the conflict of interest policy to integrate any conflicts that may arise with the integration of sustainability risks in the investment decision process</li> <li>Information whether the investment decisions actually take adverse impacts on sustainability factors into consideration by 10 March 2021 or by 30 June 2021 where Art 4(3) or (4) is applicable (i.e. “opt in” or “opt out” decision to be published and to be justified in case of opt out decision)</li> <li>Statement on due diligences policies with respect to the adverse sustainability impacts (when “opt in” decision has been taken)</li> <li>Additional information for Investment Funds which promote environmental or social characteristics or sustainable investment as objective: <ol style="list-style-type: none"> <li>description of the environmental or social characteristics or the sustainable investment objective of each investment fund;</li> <li>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 Investment Funds</li> <li>information requested for the transparency of the promotion of environmental or social characteristics /sustainable investments in pre-contractual disclosures</li> <li>information requested to be disclosed in the annual reports</li> </ol> </li> </ol>

Support	What to do
<b>Review and amendment to the policies and procedures</b>	<ol style="list-style-type: none"> <li>1. RMP to include the sustainability risks and their potential impacts</li> <li>2. Remuneration policy to demonstrate how it is consistent with the integration of the sustainability risks</li> <li>3. Conflict of interest policy to integrate any conflicts that may arise with the integration of sustainability risks in the investment decision process</li> <li>4. Due diligence policies when “opt in” decision has been taken</li> </ol>
<b>Review and amendments to the AIFM/UCITS ManCo agreements and investment management agreements</b>	Review and where relevant, amendments to the agreements and procedures to implement SFDR:
<b>All Investments Funds</b>	SFDR implementation within the investment decision process to integrate sustainability risks and assess what could be the likely impact of such risks on the return of the Investment Funds
<b>Investment funds which promote environmental or social characteristics or have a sustainable investment objective</b>	<p>Promotion of the environmental or social characteristics in the investment process where it is applicable</p> <p>OR</p> <p>Sustainable investment as its objectives where it is applicable</p>

## b- Investment Funds

Support	What to do
<p><b>Review and amendments to the issuing document/ prospectus</b></p> <p>Review of the investment fund strategy to find out which ESG features are already included in such investment fund strategy and update of the issuing document/prospectus</p> <p>CSSF approval for regulated Investment Funds (see below fast track procedure – deadline 28 February 2021)</p> <p>The update of the issuing documents/prospectus requires a prior categorization of the Investment Funds where they promote environmental or social characteristics or integrate sustainable investment in their objective, including the Investment Fund name and shall not mislead the end-investors by excessively disclosing on the way in which sustainability is given effect in the investment policy of the Investment Funds</p>	<ol style="list-style-type: none"> <li>1. Disclosure on sustainability risks and how these are integrated into the investment decisions process, unless they are not relevant which will need to be explained. It shall include the result of the assessment of the likely impacts of sustainability risks on the returns of the Investment Funds</li> <li>2. Disclosure in case the AIFMs/UCITS ManCos have decided to take into consideration the principal adverse impacts on sustainability factors in their investment decisions process (“opt in”) by 30 December 2022 and statement that such information is available in the annual report or by 28 February 2021 for regulated investment funds or by 10 March 2021 for other Investment Funds a disclosure that this is not being done, including a justification thereof (“opt out”)</li> <li>3. Additional disclosures in case the relevant Investment Fund promotes environmental or social characteristics (i.e. explanation on how that objective is met and disclosure from Taxonomy Regulation). If an index is used as a benchmark for such characteristics, disclosure of whether and how the index is consistent with those characteristics and indication where the information of its calculation methodology can be found.</li> </ol>



Support	What to do
	4. Additional disclosures in case the relevant Investment Fund has the objective of sustainable investment to explain how such objective is to be attained and additional disclosure from the Taxonomy Regulation. If an index is used as a reference benchmark, information on how the index aligns with the sustainable investment objective, indication where the information of its calculation methodology or the benchmark if any can be found and why and how such index differs from a broad market index. Should the relevant investment fund aims to reduce the CO <sub>2</sub> emissions, additional disclosures are required.
<b>Policies and procedures</b>	Relevant policies and procedures will need to be reviewed to take into consideration SFDR
<b>Annual report</b> Investment Funds that have environmental or social characteristics or sustainable investment as their objective	1. Reporting to which extend that the environmental or social characteristics which are promoted are met.  2. Reporting for investment funds which pursue sustainable investment objective a description of the overall sustainability related impact by way of sustainability indicators or by analysing the benchmark index that is used.  3. Reporting from Taxonomy Regulation
<b>Marketing material</b>	Review of the marketing communication as well as any KIID or PRIIPS KID <sup>9</sup> where applicable to be in line with and not contradict the disclosures inserted in the issuing document/prospectus

## 8. CSSF Fast Track Procedure

On 16 December 2020, the CSSF has introduced a fast track procedure in order to facilitate the submission of the prospectus/issuing document updates to the CSSF.

Indeed, with a view to comply with SFDR, UCITS ManCos will need to submit to the CSSF, for each Luxembourg UCITS managed by them, an updated UCITS prospectus (including all the requested disclosures) by **28 February 2021**.

The said fast track procedure will also be available for AIFMs updating prospectus/issuing document of AIFs under the form of SIFs and Part II UCIs.

It is noted that the fast track procedure applies to SICARs through e-file.

AIFMs and UCITS ManCos are reminded in the communication that prospectus/issuing documents need to be filed together with the confirmation letter.

Under the responsibility of the AIFMs/UCITS ManCos/relevant Regulated Investment Funds, representatives of the relevant Regulated Investment Funds or the AIFMs/UCITS ManCos or their legal advisors are able to sign the confirmation letter accompanying the fast track submission.

<sup>9</sup> KIID shall mean the key information investor document and PRIIPS KID a key investor document for packaged retail and insurance-based investment products in accordance with the Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products

In practice,

- a conformity confirmation of the prospectus/issuing document update as well as upgrade of AIFMs/UCITS ManCos policies/processes with SFDR is requested to be evidenced, under the ultimate responsibility of the AIFMs/UCITS ManCos / Regulated Investment Funds, by means of the confirmation letter downloadable from the CSSF website duly signed by at least one representative of either the UCITS ManCos, the investment company which has not designated a management company, the AIFM or the legal advisor or another representative of the AIFMs/UCITS ManCos or the Regulated Investment Funds.
- the professional duly appointed will submit the updated prospectus/issuing document version for visa stamping by the CSSF must upload the document in clean version, in accordance with CSSF Circular 19/708 relating to the electronic transmission of documents to the CSSF alongside with the said confirmation letter duly filled out and merged with the updated prospectus/issuing document in track change version. Where a notice is foreseen to inform investors on prospectus/issuing document update, this notice shall also be uploaded and submitted as letter.

If you would like to know more about the SFDR Regulation, we invite you to consult the below direct links to the various laws and regulations, as well as our articles:

- Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision  
<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013R0231>
- Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive  
<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0565>
- Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector  
<https://eur-lex.europa.eu/eli/reg/2019/2088/oj>
- Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088  
<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R0852>
- Press release of the CSSF on November 6, 2020  
<https://www.cssf.lu/en/2020/11/application-of-regulation-eu-2019-2088-on-the-sustainability-related-disclosures-in-the-financial-services-sector-and-related-technical-standards/>
- Letter of the Commission on October 20, 2020  
[https://www.esma.europa.eu/sites/default/files/library/eba\\_bs\\_2020\\_633\\_letter\\_to\\_the\\_esas\\_on\\_sfdr.pdf](https://www.esma.europa.eu/sites/default/files/library/eba_bs_2020_633_letter_to_the_esas_on_sfdr.pdf)
- CSSF Fast track procedure on December 16, 2020  
<https://www.cssf.lu/en/2020/12/communication-on-regulatory-requirements-and-fast-track-procedure-in-relation-to-regulation-eu-2019-2088-on-the-sustainability-related-disclosures-in-the-financial-services-sector/>
- Letter of ESMA, January 7, 2021  
[https://www.esma.europa.eu/sites/default/files/library/jc\\_2021\\_02\\_letter\\_to\\_eu\\_commission\\_on\\_priority\\_issues\\_relating\\_to\\_sfdr\\_application.pdf](https://www.esma.europa.eu/sites/default/files/library/jc_2021_02_letter_to_eu_commission_on_priority_issues_relating_to_sfdr_application.pdf)

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Virginie Leroy co-heads the Investment Funds practice of AKD Luxembourg SARL and has significant experience in practicing investment funds business in Luxembourg.

Virginie advises and assists on a daily basis domestic and international clients mainly located in Asia or US in investment management matters covering in particular regulatory and corporate governance aspects throughout the entire investment fund life cycle, including initial structuring, creation, distribution, marketing and management of Luxembourg regulated investment funds such as Specialised Investment Funds (SIFs), Undertakings for Collective Investment in Transferable Securities (UCITS) and non-regulated investment funds such as Reserved Alternative Investment Funds (RAIFs) or Special Limited Partnerships (SCSp). Virginie also assists and advises clients in implementing various investment strategies (hedge fund, real estate or private equity) and helps UK asset managers to be domiciled in Luxembourg due to Brexit.

Virginie has been admitted to Paris Bar in 2001 and is currently a member of the Luxembourg Bar and London Bar as Solicitor of England and Wales.



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