

Asset Management & Investment Funds Update

July 2022



Fund Managers' Sustainability Risk Obligations

Since 10 March 2021, UCITS managers and AIFMs (**Fund Managers**) are required under SFDR to make website and pre-contractual disclosure of their policies for the integration of Sustainability Risks in the investment decision-making process.

Sustainability Risk integration policies are required to set out the processes in place for continuously assessing all relevant Sustainability Risks alongside relevant financial risks (**SFDR Sustainability Risk Policies**). Details of the Sustainability Risk Policy are required to be published on the Fund Manager's website (SFDR Article 3) and in the fund prospectus along with the likely impact of such risks on fund returns, based on the Fund Manager's sustainability risk assessment (SFDR Article 6).

Sustainability risk is the risk of an environmental, social or governance event or condition having a negative material impact on the value of an investment (Sustainability Risks).

Upcoming Sectoral Obligations for Fund Managers

From 1 August 2022, the UCITS and AIFMD regimes require Fund Managers (including self-managed UCITS and AIFs) to assess, measure and manage underlying funds' exposure to Sustainability Risks in accordance with existing relevant governing regime rules. Such UCITS and AIFMD obligations, which were originally intended to come into effect at the same time as the above SFDR measures, aim to ensure that Fund Managers comply with their cross-sectoral SFDR Sustainability Risk obligations (as detailed above) in a manner consistent with relevant governing regime rules for the performance of investment due diligence, risk management, identification and management of conflicts of interest and ensuring adequate levels of resourcing.

However, due to the delayed implementation of the UCITS/AIFMD sectoral measures, Fund Managers must now revisit their approach to compliance with the cross-sectoral SFDR Sustainability Risk rules, in particular the adoption of SFDR Sustainability Risk Policies pre-10 March 2021, and ensure such compliance is in line with their governing regime obligations in advance of the 1 August compliance deadline.

For those Fund Managers which have yet to formally adopt SFDR Sustainability Risk Policies (or otherwise comply with the above-mentioned SFDR Sustainability Risk rules), they should do so promptly and in any event in advance of the 1 August 2022 compliance deadline. This is particularly important in light of last month's Supervisory Briefing from ESMA on the integration of Sustainability Risks and sustainability-related disclosures in which ESMA recommends NCAs take regulatory action to combat greenwashing, including in the event of Fund Managers' failure to integrate Sustainability Risks in line with the UCITS and AIFMD requirements as summarised below. See [here](#) for further details on the ESMA Supervisory Briefing.

New UCITS and AIFMD Sustainability Risk requirements effective 1 August 2022

INVESTMENT DUE DILIGENCE	<ul style="list-style-type: none"> (i) Fund Managers shall take into account Sustainability Risks when undertaking investment due diligence. (ii) Fund Managers that consider investments' principal adverse impacts (PAIs) on sustainability factors under SFDR must take account of such impacts as part of their investment due diligence.
IMPACT	<p>Fund Managers must take account of investments' Sustainability Risks and, where relevant, PAIs on sustainability factors:</p> <ul style="list-style-type: none"> • in the selection and ongoing monitoring of investments • when ensuring adequate knowledge and understanding of the assets in which the funds invest • in written due diligence policies and procedures • <i>in respect of underlying UCITS:</i> when formulating forecasts and performing analyses of investments' contribution to the portfolio composition, liquidity and risk and reward profile of the fund • <i>in respect of underlying UCITS:</i> when verifying (initially and on an ongoing basis) the ability and capacity of any third party which performs risk management activities to perform those activities reliably, professionally and effectively.
SUGGESTED ACTION	
Review SFDR Sustainability Risk Policy to ensure due diligence in respect of Sustainability Risks and, where relevant, the PAIs of investments, is carried out in accordance with existing due diligence rules for Fund Managers.	

RISK MANAGEMENT	<ul style="list-style-type: none"> (i) Fund Managers' risk management policies must include procedures to assess, measure and manage underlying funds' exposure to Sustainability Risks. (ii) Fund Managers' organisational processes and procedures must reflect the integration of Sustainability Risks in the risk management policy.
IMPACT	<p>Fund Managers must establish risk management procedures for the assessment, measurement and management of Sustainability Risks of the underlying funds and ensure existing decision-making procedures, reporting processes and procedures, allocation of functions and responsibilities, internal control mechanisms and record-keeping procedures are applied to the assessment, measurement and management of Sustainability Risks.</p>
SUGGESTED ACTION	
Review SFDR Sustainability Risk Policy to ensure Sustainability Risk assessment, measurement and management procedures comply with existing sectoral rules for risk management, and organisational processes and procedures are applied to the integration of Sustainability Risks.	

CONFLICTS OF INTEREST	<p>Fund Managers' identification of conflicts of interest must include the identification of any conflicts arising from the integration of Sustainability Risks in their processes, systems and internal controls.</p>
IMPACT	<p>Any conflicts of interest arising from the integration of Sustainability Risks across Fund Managers' systems, processes and controls should be identified and managed in line with existing conflicts of interest policies and procedures.</p>
SUGGESTED ACTION	

Review SFDR Sustainability Risk Policy to ensure conflicts of interest arising from the integration of Sustainability Risks in systems, processes and controls are identified and managed in line with existing conflicts of interest rules for Fund Managers.

RESOURCING	Fund Managers shall ensure senior management are responsible for the integration of Sustainability Risks in the investment decision-making and risk management processes and procedures and shall retain the necessary resources and expertise for the effective integration of Sustainability Risks.
IMPACT	Fund Managers should ensure sufficient technical expertise at senior management level, for example through regular training for professional development with respect to sustainability-related matters, to oversee the integration of Sustainability Risks, including (where applicable) the oversight of any delegates' performance of the assessment, measurement and management of Sustainability Risks.

SUGGESTED ACTION

Review SFDR Sustainability Risk Policy to ensure necessary resourcing of Sustainability Risk integration and (where applicable) oversight and monitoring of relevant delegates.

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