Asset Management & Investment Funds Update

December 2022

Central Bank SFDR Review Findings

On 14 November 2022, the day of its SFDR seminar, the Central Bank published findings from a spot-check review of SFDR and Taxonomy disclosures filed ahead of the March 2021 and January 2022 SFDR compliance deadlines.

The findings note that, as of July 2022, the Irish funds sector includes 183 Article 9 funds, 1,276 Article 8 funds and 5,831 Article 6 funds.

As summarised below, the Central Bank's findings highlight both good and bad disclosure practices as well as regulatory expectations for SFDR disclosures which will be of interest to all fund managers but perhaps most acutely for those subject to the next key SFDR compliance deadline of 1 January 2023:

- **SFDR classifications** should not be used as fund labels. Reclassifications under SFDR are expected to be communicated, where appropriate, to investors and 'numerous changes' to funds' SFDR classifications should be avoided.

- **Sustainability risk disclosures** must be fund-specific and kept under review for accuracy (the ongoing review expectation also applies more generally to SFDR-related disclosures). Detailed reasons should be disclosed as to why sustainability risks are not relevant or, where relevant, how such risks are integrated and their likely impact on fund returns. Sustainability risk disclosures were also cited in the Central Bank's findings as an area of future supervisory focus.

- **Taxonomy alignment disclosures** should not include 'negative justifications and/or ambiguity' regarding funds' Taxonomy-aligned investment levels.

- **Article 8 benchmark funds'** managers must have processes in place to monitor relevant index providers and/or delegate investment managers. The Central Bank does not 'consider it appropriate' if neither the fund manager nor the investment manager monitor the composition of the index against the ESG screening criteria on the basis that the index provider is responsible for screening investments in the index or if the fund manager relies on an annual assessment of the ESG strategy but does not carry out ongoing monitoring of an investment manager's ESG approach.

- **Fund names** were generally found to be consistent with fund investment objectives and policies however the Central Bank expects that they be kept under review to ensure they are not misleading.

Areas of future supervisory focus, including as a result of the ESMA CSA on sustainability risks and disclosures planned for 2023, are:

- **Article 8 'Guardrails':** supervisory engagements will focus on funds with a low proportion of E/S aligned investments and reclassifications, including the relevant rationale. Fund managers must carefully consider each fund's SFDR classification "to ensure that it is aligned with both the letter and the intention of the legislative requirements".
- **Marketing materials:** the Central Bank will, where necessary, assess the consistency of disclosures across fund documentation and marketing materials.
- **Fees and costs:** transparent and proportionate cost disclosures must be ensured, and investors should not be subject to undue costs. The Central Bank expects "the fees and costs associated with Article 8 and Article 9 funds should not be disproportionately higher than Article 6 funds (without a legitimate rationale for such higher costs)".
- **Securities lending:** the Central Bank "is interested" in Article 8 and 9 funds engaged in securities lending "in particular, whether these investment funds are in a position to meet their [E/S] characteristics if they have lent out shares and those shares end up taking contradictory positions (such as via the exercising of associated voting rights or because the shares were lent to short sellers which take an opposing view)".
- **Fund service providers:** depositaries' monitoring of ESG-related investment restrictions and categorisation/reporting of breaches such restrictions will be a future supervisory focus.

Next steps

Fund managers should take account of the issues highlighted by the Central Bank as well as the areas of focus to ensure adequate preparation for future supervisory engagements, which are likely as early as next year.