Asset Management & Investment Funds Update

June 2022

ESMA Issues Guidance for Combating Greenwashing

On 31 May 2022, ESMA published guidance for national competent authorities' (**NCAs**) supervision of SFDR compliance by UCITS managers and AIFMs (**Fund Managers**) (the **Guidance**).

The Guidance, which is non-binding and to be applied on a proportionate basis, sets out several key supervisory expectations, including in respect of those SFDR breaches for which regulatory interventions may be necessary to combat greenwashing.

SFDR Breaches & Greenwashing

The Guidance cites the following as examples of cases where regulatory action to combat greenwashing may be appropriate:

1. **Legally required SFDR disclosures have not been made** since the application of the new rules
2. **SFDR disclosures are viewed as severely misleading** in particular where NCAs consistency checks across pre-contractual, website, marketing documents and financial reports highlight a "significant discrepancy" between the fund's investments and its pre-contractual investment commitments
3. **Sustainability risks are not integrated** throughout the organisation following the entry effect from 1 August 2022 of UCITS and AIFMD requirements for the integration of such risks in portfolio and risk management processes and overall governance structures
4. **Financial report disclosures do not match or fulfil pre-contractual characteristics or objectives** as set out in the offering document, fund KIID and/or constitutional document
5. **Funds in scope of Article 9 disclose significant non-sustainable investment holdings** in financial report disclosures

Additional Supervisory Expectations

In addition to the above, ESMA expects NCAs' supervision of SFDR compliance by Fund Managers to include:

- **taking action to ensure portfolio holdings reflect the fund name, objective, strategy, characteristics** for example, if a fund claims to invest in sustainable investments NCAs may directly perform portfolio compliance analysis and engage with Fund Managers for explanations and/or documentation to validate claims and involve the fund depositary in the context of their control function as well as assess reporting of the Fund Manager, internal control functions and external auditors

- **challenging the use of ESG-related terms in fund names** for example, use of the term 'sustainable' or 'sustainability' in the name of the fund should be limited to funds disclosing under SFDR Article 9 or Article 8 where such funds invest in Taxonomy-aligned investments and/or SFDR-defined sustainable investments. Use of the term 'impact' or 'impact investing' or any other impact-related term should only be used in the names of funds investing to positively contribute to social or environmental objectives. ESG-related terms should not be used in the name of index tracking funds applying an exclusion policy that results in a limited number of exclusions or where the fund's holdings are not materially different from a similar non-ESG index

- **reviewing sustainability-related disclosures in fund marketing materials, on websites and in financial reports** for consistency and compliance with applicable SFDR disclosure rules and ensure disclosures do not include boilerplate language, cross-references other than those specifically permitted in the disclosure templates annexed to Level 2, and pre-contractual disclosures indicate under which SFDR article (i.e. Article 8 or 9) disclosures have been made without giving the impression of a 'label' to investors

- **ensuring fund depositaries review ESG investment restrictions** as part of their monitoring for compliance of instructions from the Fund Manager or investment manager and ensure relevant information and data are provided by the Fund Manager to the appointed depositary to enable depositaries perform their functions

- **verifying any product-level PAI consideration is by reference to Level 2 mandatory PAI indicators** in Table 1, Annex 1 of SFDR Level 2. ESMA also considers it reasonable for NCAs to expect funds in scope of Article 9 disclosures to consider PAIs under SFDR Article 7 as, while it is not mandatory to do so, such funds must only make sustainable investments and must therefore take account of PAIs as part of the assessment of investments' compliance with the DNSH principle under the SFDR definition of sustainable investments

- **as part of the ongoing supervision of SFDR compliance,** using "*any further available information (for example, media reports, complaints, whistle-blower notifications etc…) as well as adverse findings reported by internal control functions, external auditors or depositaries*" and carrying out ad-hoc thematic reviews of Fund Managers' compliance with SFDR

- **reviewing sustainability risk disclosures** in pre-contractual documents, sample check website disclosures using surveys or questionnaires relating to the integration of sustainability risks, and ensure Fund Managers implement, periodically review and effectively apply internal policies and procedures relating to investment due diligence, risk management, remuneration, recruitments and human resources (including regular sustainability risk training), organisational structure and decision making, internal reporting and record keeping, conflicts of interest, delegation monitoring, accounting and valuation, costs and fees, NCA reporting and internal control functions and regular controls by senior management.

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