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# Asset Management & Investment Funds Update

**October 2023**

## Key Dates & Deadlines: Q4 2023

The following are key dates and deadlines in Q4 2023 along with possible impacts and action items arising for fund managers.

| Date | Source | Summary | Action/Impact |
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| **Q4 (exact date TBC)** |  | ESMA Guidelines on Fund Names – publication of final report<br>Guidelines on the use of ESG or sustainability-related terms in the name of funds are expected to be finalised and published with an application date of 3 months post-publication and a 6-month transition period for existing fund names.<br>See article on topic in this month's update. | Draft Guidelines set out quantitative thresholds for investment in E/S aligned or sustainable investments for Article 8 and 9 funds which use ESG/sustainability-related terms in the fund name. |
| **Q4 (exact date TBC)** |  | Central Bank ELTIF Consultation - to be published<br>A consultation on a new stand-alone AIF Rulebook chapter for ELTIFs is expected to issue with a view to finalising the national regime ahead of the entry into effect of amendments to the ELTIF regime on 10 January 2024.<br>See here for further details. | This welcome development paves the way for Irish-domiciled ELTIFs to be authorised using the full suite of Irish dedicated fund legal structures, such as the ICAV and Investment Limited Partnership. The AIF Rulebook amendments should remove the principal impediments that fund sponsors have encountered in launching ELTIF products in Ireland. |
| **Q4 (exact date TBC)** |  | Individual Accountability Framework (IAF): Consultation on Business Standards<br>Updated business standards to be published as part of the Central Bank's review and consultation on | Following publication of the IAF Act, Central Bank IAF consultations, and updated F&P procedures, fund managers should progress compliance plans and work programmes taking account of the |

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| | | updates to the Consumer Protection Code.<br>See here for further details. | proposed timeline for implementation of the IAF. |
| **Q4 (exact date TBC)** | | CSRD Scope Revisions – to be finalised<br>The thresholds for CSRD reporting are set to be increased under proposals published by the Commission in September which aim to reduce the number of companies in scope of CSRD.<br>See article on topic in this month's update. | Fund managers should continue to monitor for any impact on existing CSRD scope analysis. Those not in scope of CSRD may be indirectly impacted by a reduced set of available CSRD data. |
| **Q4 (exact date TBC)** | | SFDR: stakeholder workshop<br>The Central Bank has committed to hosting a SFDR workshop on issues identified from its review of Irish funds' SFDR disclosures.<br>See article on topic in this month's update. | The workshop should be a useful opportunity to discuss SFDR issues and regulatory expectations for Level 2 compliance. |
| **3 October** | | Updated MiFID Suitability & Product Governance Guidelines – in effect<br>Updated Guidelines were published in April 2023 taking account of MiFID sustainability-related rules with an effective date of 6 months post publication.<br>See here for further details. | MiFID firms and fund managers with a MiFID top-up licence must ensure compliance with the updated guidelines ahead of the effective date. |
| **3 October** | | ESMA CSA on sustainability – launched<br>During 2024, ESMA will co-ordinate a CSA for MiFID firms including on the collection of sustainability preferences, the categorisation of products with sustainability factors for assessing suitability, incorporating sustainability into the target market assessment.<br>See here for further details. | MiFID firms and fund managers with a MiFID top-up licence should review compliance with MiFID suitability requirements and regulatory expectations for those requirements, ahead of next year's CSA. |
| **5 October** | | EU Green Bond Standard (GBS) – adopted by Parliament<br>EU GBS Regulation, establishing standards for the EuGB label, includes transparency rules and templates for use of proceeds disclosures, a registration and supervision framework for external reviewers of adherence to the standards, minimum investment rules including a minimum 85% allocation to Taxonomy aligned activities. | The EU GBS will establish a voluntary, harmonised standard for green bonds. Once approved by Council, it will be published in the EU Official Journal, enter into force 20 days following publication and start applying 12 months post entry into force. |

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| **10 October** | | Open Hearing on SFDR Consultation<br>Commission hosting hearing on SFDR consultation open until 15 December.<br>See article on topic in this month's update. | Commission expects to adopt SFDR proposals, taking account of consultation feedback, by Q2 2024. |
| **15 November** | | CBI Discussion Paper (DP) on Macroprudential Framework for Investment Funds<br>End of feedback period for DP which sets out potential tools for addressing financial stability risk factors of leverage, liquidity and interconnectedness in the funds sector.<br>See here for further details. | Wide-ranging DP, feedback to which will the Central Bank's consideration of a macroprudential policy for the funds sector as a whole. |
| **28 November** | | ESG Ratings Regulation – Parliament vote<br>Revisions to the Commission's ESG Ratings Regulation proposal have been published by ECON and will be voted on by the Parliament on 28 November.<br>See article on topic in this month's update. | The ESG Ratings Regulation will provide for the authorisation and supervision of EU and non-EU entities which publicly disclose or distribute ESG ratings and is expected to be finalised in H2 2024 and become applicable in 2025. |
| **1 December** | | Operational Resilience Guidelines – deadline<br>The Central Bank's Cross-Industry Operational Resilience Guidelines were published on 1 December 2021 with a two-year transitional period.<br>See here for further details. | The Central Bank expects firms to “actively and promptly” address operational resilience vulnerabilities and be in a position to evidence actions/plans to apply the Guidelines, at the latest, within two years of issuance of the Guidelines (i.e., 1 December 2023). |
| **15 December** | | Commission SFDR consultation – closing date<br>SFDR (Level 1) consultation requests feedback on SFDR compliance issues, alignment with other sustainable finance measures and reform proposals.<br>See article on topic in this month's update. | Commission expects to adopt SFDR proposals, taking account of consultation feedback, by Q2 2024. |
| **15 December** | | ESMA Call for Evidence on T+1 Impacts – response deadline<br>International developments in securities settlement, particularly the US move to T+1 by end-May next year, have prompted ESMA to consider legal/regulatory action to smooth their impact for EU market participants. | The Call for Evidence is an opportunity to engage with ESMA on the extensive challenges arising from a lack of alignment across international settlement cycles. |

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| | | See article on topic in this month's update. | |
| **29 December** | | First scheduled IAF application date<br>The F&P enhancements and individual conduct standards under the Central Bank's IAF are scheduled to apply.<br>See here for further details. | Following publication of the IAF Act, Central Bank IAF consultations, and updated F&P procedures, fund managers should progress compliance plans and work programmes taking account of the proposed timeline for implementation of the IAF. |
| **Pre-year-end** | | CSRD European Sustainability Reporting Standards (ESRS) – to be finalised<br>Initial set of mandatory, sector-agnostic ESRS includes twelve cross-cutting, environmental, social and governance reporting standards and will first apply to NFRD companies for financial year 2024.<br>See here for further details. | Fund managers in scope of CSRD must continue to plan for compliance ahead of the first effective date of 1 January 2024. |

## Central Bank Details Issues with SFDR Level 2 Disclosures

At William Fry's 'Sustainable Finance in Practice for Fund Managers' event last month, the Central Bank's Director of Securities and Markets Supervision, Patricia Dunne, provided specific and detailed commentary on identified shortcomings of Article 8 and 9 funds' SFDR Level 2 disclosures.

The Director's comments on SFDR pre-contractual disclosures (**PCDs**), the first from the Central Bank since Level 2 measures took effect last January, highlight several new and some reoccurring issues and areas of concern, key of which are summarised below. In acknowledgement of the ongoing processes to amend SFDR, both the Level 1 Directive and Level 2 measures, the Director concluded noting that its findings may be considered as part of those processes but did not rule out domestic clarifications to address the issues in a timelier manner. A workshop with key stakeholders will shortly be hosted by the Central Bank to discuss its findings and identify ways to address Central Bank concerns.

### Finding 1

Drawing a distinction between ESG exclusionary screen indices and the environmental/social (**E/S**) characteristics of funds tracking those indices, the Director highlighted the Central Bank's expectation that SFDR disclosure templates (specifically the question on the E/S characteristics of the fund) be completed from the fund's perspective with a positive indication of the E/S characteristics the fund promotes by applying the exclusions embedded in the index methodology.

The Director also spoke to the Central Bank's expected threshold for Article 8 funds. Noting that while the Commission's guidance permits exclusionary strategies in Article 8 funds, the Central Bank does not believe the intention was to water down the Article 8 designation to such an extent that funds with a list of limited investment exclusions should be deemed to be promoting an E/S characteristic absent positive indications of those characteristics. The Central Bank also queried the appropriateness of an Article 8 designation for funds with a low or even zero commitment to E/S aligned investments.

The Central Bank's expectations, many of which have been borne out in regulatory comments on PCDs in new/revised product applications, are likely to be questioned as at least some appear at odds with the Commission's confirmation that Article 8 is neither a label nor does it seek to limit the design of in-scope funds' investment strategies or indeed apply minimum criteria to such funds other than the requirement to promote E/S characteristics.

### Finding 2 (related to finding 1 above)

Focussing again on index tracking funds, the Central Bank expects such funds to assess the E/S characteristics of investments and not rely solely on the index providers' appropriate implementation of ESG exclusionary screens when disclosing the level of E/S aligned investments of the fund.

Such regulatory expectations are similar to those outlined in the Central Bank's pre-Level 2 guidance on SFDR disclosures which noted the Central Bank's concerns as to the level of detail in disclosures of the consistency of designated indices with fund E/S characteristics. These disclosures are being further undermined, in the Central Bank's view, by statements to the effect that neither the fund nor investment manager would monitor the composition of the relevant designated index against the screening criteria applied on the basis that the index provider is responsible for screening investments in the index.

### Finding 3

Addressing a long-standing industry issue when disclosing the split between environmentally and socially sustainable investments, the Director noted the regulatory expectation for such disclosures to be included on a binding basis in PCDs. Furthermore, the Central Bank does not consider the disclosure of an investment range to be meaningful from an investor perspective nor does it consider it adequate to refer in PCDs to such disclosures being available on a website.

A full copy of the Central Bank's speech is available on its website.

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## CSRD: Proposal to Narrow Scope of EU Corporate Sustainability Reporting Rules

Thousands of companies are expected to be brought out of scope of sustainability reporting rules under the Corporate Sustainability Reporting Directive (**CSRD**) and the Taxonomy Regulation following a proposal by the Commission to increase the monetary thresholds triggering such reporting rules.

### Background

Under CSRD and the Taxonomy, large companies, large groups and EU-listed small and medium (other than micro) companies are subject to sustainability reporting along with non-EU companies with significant activities in the EU (see previous briefings here and here for further details). A company/group qualifies as large, medium or small if it meets 2 out of the 3 relevant size criteria set out under the Accounting Directive. The size criteria include both monetary and employee criteria with the monetary criteria set by reference to balance sheet total and net turnover levels.

### Commission proposal

The Commission proposes revising the monetary criteria for all types of companies, which revisions will result in a reduced number of companies subject to sustainability reporting under CSRD and the Taxonomy. The current and proposed monetary criteria are set out in the table below. No change is proposed to the employee criteria which is to remain the same across all classifications.

| | | Balance Sheet | Net Turnover |
|---|---|---|---|
| | | | |
| **Micro companies** | *Current* | 350,000 | 700,000 |
| | *Proposed* | 450,000 | 900,000 |
| **Small (lower end*) companies/ groups** | *Current* | 4,000,000 | 8,000,000 |
| | *Proposed* | 5,000,000 | 10,000,000 |
| **Small (higher end*) companies/groups** | *Current* | 6,000,000 | 12,000,000 |
| | *Proposed* | 7,500,000 | 15,000,000 |
| **Medium/large companies/ groups** | *Current* | 20,000,000 | 40,000,000 |
| | *Proposed* | 25,000,000 | 50,000,000 |

** Member States have the flexibility to define the thresholds for small companies/groups provided such thresholds do not exceed those set out for small (higher end) companies/groups.*

## Next Steps

The Commission expects to adopt proposals in Q4 2023 with a requirement for Member States to apply transposing measures for financial years beginning on or after 1 January 2024 i.e., the first CSRD application date.

# SFDR PAI Reporting: ESAs Publish Good and Poor Practices

In the second annual report on principal adverse impact (**PAI**) disclosures, the ESAs detail good and poor practices for both product (Article 7) and entity-level (Article 4) reporting.

## Good and poor practices

At the end of September, the ESAs published their findings from an April/May 2023 review of PAI disclosures. A summary of the ESAs' findings, including good and poor practices identified, is set out below.

1. *PAI due diligence policy disclosures:* policy disclosures remain extremely limited. The ESAs' cited as poor practice the disclosure of participation in sustainability-related international organisations and initiatives (e.g. Net-Zero Asset Owner Alliance, Climate Action 100+, Principles for Responsible Investments).
    - **Good practice:** DD policy disclosures detailing the strategies adopted for identifying and weighting key PAIs and the organisational policies and procedures assigning responsibility for implementation of those strategies.
2. *Explanation of PAI non-compliance:* non-compliance explanations that rely on the market participant having fewer than 500 employees misinterpret the spirit of Article 4(1)(b). Some non-compliance explanations fail to include an indication of when PAIs will be considered in the future, as required under SFDR.
    - **Poor practice:** explanations that reference unclear procedures and lack of legal clarity in the SFDR PAI consideration rules.
3. *Product-level PAIs:* market participants' display a limited understanding of such disclosures with some confusing SFDR Article 7 with Taxonomy Article 7.
    - **Good practice:** reserving publication of further information on PAI consideration for the first PAI entity statement (fell due on 30 June 2023).
4. *Paris alignment*: voluntary disclosures of alignment with the Paris objectives remain vague and fail to reference indicators used to measure the decarbonisation path of their investments.
    - **Good practice** statements including identification and prioritisation of PAIs, actions taken to mitigate such impacts, description of engagement policy, list of international standards respected, and degree of alignment with the Paris Agreement.
5. *Accessibility of PAI reports*: in line with SFDR accessibility rules, disclosures should not be hidden under ‘required information’ or in the ‘download’ section of websites.
    - **Poor practice**: non-compliance by market participants because they do not have a website.
6. *Different information for professional and retail investors*: disclosures must be the same for professional and retail investors, and must be made easy and straightforward to find, irrespective of the type of investor.
7. *Consideration of PAIs at group level but not on solo basis:* the ESAs criticise the practice of sub-threshold entities opting to explain non-compliance with SFDR PAI consideration requirements while reporting on group-level PAIs.

## ESA Recommendations

*To the Commission:*

- consider replacing the 500-employee threshold for mandatory PAI statements with e.g., a threshold based on the size of the market participants' investments;
- consider making product-level PAI disclosure rules 'comply or explain' regardless of whether entity-level PAIs are considered.

*To NCAs:*

- follow up on non-compliance and consider use of enforcement tools;
- support market participants with publication of supervisory expectations;
- build up NCA expertise.

### ESA Clarifications

- 'Consider' and 'take into account': the requirement to 'consider' PAI means that disclosures should detail how adverse impacts of investments are addressed, e.g., how these are reduced/mitigated. In contrast, the requirement to 'take into account' the PAI for DNSH of sustainable investments is a requirement to take into account the PAI indicators to ensure these do not cause significant harm to the environment or society.
- 'ESG criteria', 'ESG risk' and 'sustainable investment goals': such terms are not related to PAI consideration which should instead focus on 'sustainability impacts', 'sustainability indicators', the 'engagement policies to address the adverse impacts of the investment decisions', and the 'degree of alignment with the objectives of the Paris Agreement' as a good measure of adverse climate impacts.

### Next steps

The above findings have issued to the Commission and are likely to inform both future supervisory actions and the preparation of SFDR Level 1 and Level 2 revisions. As such, they should be factored into fund managers' compliance processes and procedures for any product and/or entity-level PAI reporting. Given the review timeframe, June 2023 entity-level PAI statements were not reviewed for the purposes of the ESAs' report but will be for future iterations of the report.

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## The Government Legislation Programme for the Autumn 2023 session has been published.

The Cabinet has approved 24 bills for priority drafting. Priority legislation includes the Digital Services Bill, the Companies (Amendment) Bill, and the Financial Services and Pensions Ombudsman (Amendment) Bill.

The preparation of a Heads of Bill for the Miscellaneous Provisions (Transparency and Registration of Limited Partnerships and Business Names) Bill is also listed. The Bill is to reform the Limited Partnerships Act 1907 and the Registration of Business Names Act 1963, strengthen Ireland's regulatory framework and respond to concerns raised in relation to the transparency of Limited Partnerships.

See our briefing to view a selection of bills and proposals by industry or sector.

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## SFDR: Overhaul Proposed by the Commission

The fast and challenging pace of EU sustainable finance policy continued last month with the publication of a Commission consultation on revisions to SFDR.

This is despite the regime only being fully effective from 1 January this year and the ongoing process to revise SFDR delegated measures (Level 2).

The consultation, which will run until 15 December 2023, takes the form of a request for feedback on many of the industry's key SFDR compliance issues, including data gaps, legal uncertainty, greenwashing risks and the lack of focus on transition-based investment strategies within the regime.

Feedback is also sought on several, potentially highly impactful, reform proposals. These include the extension of the scope of product-level disclosure rules to encompass all products and the establishment of a sustainable product labelling regime to address policymakers' long-held concerns about the use of Articles 8 and 9 as marketing tools.

The Commission expects to adopt SFDR proposals, taking account of consultation feedback, by Q2 2024.

## Background

SFDR, the sustainability reporting regime for the financial services sector, was the first of a significant and ever-expanding set of EU sustainable finance policy measures. The regime mandates transparency of sustainability risk and impact management practices and sustainable product features to incentivise behavioural change within in-scope entities and to channel investment toward green and socially sustainable investments.

Since first entering into effect in March 2021, SFDR has presented a number of compliance challenges. These range from legal uncertainty, greenwashing and reputational risk due to the limited specificity in many of the key concepts, to data gaps due in part to the incoherence of the EU's sustainable finance policy (which subjected the financial sector to transparency rules before obliging investee companies to make the necessary data available under corresponding EU transparency rules for the real economy).

As a result of these challenges, in tandem with the prominence of the sustainable finance policy on the EU agenda, the Commission is undertaking a 'comprehensive assessment' of the regime with a view to adopting new proposals in Q2 2024.

## SFDR revisions under consideration by the Commission

Proposals tabled for industry feedback include a new EU sustainable product labelling regime, the streamlining of entity-level PAI disclosures both within SFDR and across EU sustainable finance measures, and the application of SFDR product-level disclosures to all products and not just those with sustainability targets or features as is currently the case. A summary of the key proposals is set out below.

### *1. New labelling regime*

Two options for a voluntary sustainable product labelling regime are under consultation. The first option is to establish labels based on products' investment strategies and the second is to build out the existing Articles 8 and 9 with further qualification criteria.

Potential labels under consideration for the first option are:

A. For products investing in targeted, measurable solutions to sustainability issues e.g., investing in renewable energy, social housing or urban regeneration. This resembles the 'sustainable impact' label provided for under the FCA's proposed UK SDR. See our previous briefing for further details of the FCA's proposed UK SDR, final rules for which are expected to be published this year.

B. For products adhering to credible sustainability standards or a specific sustainability-related theme e.g., investing in solid waste and water management companies or those with strong gender diversity levels within management. This resembles the 'sustainable focus' label under the FCA's proposed UK SDR.

C. For products excluding investment in activities with negative environmental or societal impacts.

D. For products focussed on transition that target measurable improvements to the sustainability profile of assets under management e.g., investing in soon-to-be Taxonomy-aligned or transitional Taxonomy-aligned activities, entities with credible targets and/or plans to decarbonise, to improve workers' rights, to reduce environmental impacts. This resembles the 'sustainable improvers' label under the FCA's proposed UK SDR.

The Commission requests feedback on A. - D. and on any other strategy-driven label which might be useful. Questions are also raised on the utility of differentiating between A. and B. above and products with a social and environmental focus, the optimal number of labels, whether the labels should be mutually exclusive, any necessary transition measures, and what the minimum criteria for use of label should be. In the latter's case, the Commission specifically requests feedback on whether minimum criteria should relate to Taxonomy-alignment levels, engagement strategies, exclusions, investment decision-making processes and/or pre-defined, measurable, positive environmental social or governance-related outcomes.

The second option for a labelling regime is to build out the existing Articles 8 and 9 with clarification and the addition of minimum criteria for current concepts of 'environmental/social characteristics', 'sustainable investments', 'contribution to an environmental/social objective', 'do no significant harm' and 'good governance practices'. Whether Articles 8 and 9 should apply a minimum level of Taxonomy-aligned investments is also raised in the consultation.

For both labelling regime options, consultation respondents are asked to opine on the merit of additional disclosures for those products opting into the labelling regime. Tabled for feedback are additional labelled product disclosures relating to the Taxonomy, engagement strategies, exclusions, satisfaction of labels' minimum criteria and marketing materials including naming conventions. In addition, the Commission requests feedback on whether the use of a product label should be subject to third-party verification or if a self-declaration of satisfaction of the label's minimum criteria should be sufficient. In terms of coherence of any labelling regime with other sustainable finance measures, respondents are asked whether the PRIIPs KID should include the label, whether the criteria for any forthcoming ESG benchmark should align with the minimum criteria for product labels, whether passive PAB/CTB trackers should be deemed to satisfy label criteria and whether MiFID sustainability preference rules should take account of the proposed labels.

2. *Streamlining PAI indicators*

The Commission is considering streamlining the PAI indicators currently set out in Annex I of Level 2 and requests feedback in the consultation on which of the indicators respondents consider most and least useful. Streamlining entity-level PAI disclosures across the various EU sustainable finance legislative measures is also under consideration with the consultation requesting feedback on whether SFDR is the correct measure for such disclosure rules given they are also required under the soon-to-be effective Corporate Sustainability Reporting Directive and several sectoral measures.

3. *Broadening the scope of product-level SFDR disclosure rules*

Currently, SFDR requires product-level disclosures for those products with sustainability features or targets. The Commission is considering requiring 'proportionate information on the sustainability profile' of all products or a sub-set of all products based on, for example, AUM or the proportion of retail products under management. The objective of this extension of the scope of product disclosure rules would be to improve investor comparability of products and address the current burden on those products with sustainability features or targets. Based on the consultation questions, the Commission is considering requiring all/a sub-set of products to disclose a limited number of PAI indicators, Taxonomy alignment levels, engagement strategies, exclusions, and/or information about ESG considerations in the investment process.

### Next Steps

Feedback to the SFDR consultation is requested by 15 December 2023 and the Commission expects to adopt proposals, taking account of the feedback received, by Q2 2024.

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## Just using AI? You may still have onerous AI Act obligations

Users of high-risk AI systems will bear a substantial set of obligations to guarantee the safe and lawful use of such technologies. Under the AI Act, a high-risk system includes safety components of defined EU regulatory legislation, such as that relating to machinery; it also includes systems that are used in areas like biometric identification, critical infrastructure management, education, employment, essential services access, law enforcement, migration, and judicial and democratic processes.

See our briefing for an analysis of the multiple obligations for users of high-risk AI systems and how users may be regarded as providers (i.e. the entities with the bulk of the AI Act's regulatory obligations) of a high-risk AI system under the AI Act which is expected to come into force in late 2025 or early 2026.

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## ESMA analyses ESG terms in fund names

On 2 October last, EMSA published an analysis of the use of ESG terms in fund names. Points of note from the analysis paper are set out below.

- The below extract from ESMA's analysis paper details the ESG words used to analyse fund names and ESG disclosures

Table 1
Lists of ESG words and phrases used to analyse investment fund names and documents
Wide variety of ESG terms

| Topic | Names list: # phrases | ESG fund names list: examples | Text list: # phrases | ESG text list: examples |
|---|---|---|---|---|
| E | 451 | water waste, net zero, carbon reduction | 496 | forest, climate change, biodiversity |
| EG | N/A | N/A | 2 | carbon washing |
| ES | 11 | green social, cleaner living | 18 | urbanisation, national disaster |
| ESG | 512 | ESG, better world, global impact | 42 | ESG, SRI, sustainable development |
| G | 4 | governance, selected controversies | 1833 | compliance, audit, oversight |
| S | 221 | equality, empowerment, humanity | 690 | elderly, immigration, malnutrition |
| SG | 37 | gender equality, human capital | 58 | impact washing, gender diversity |
| **Total** | **1,236** | | **3,139** | |

Note: The table displays the breakdown in number of ESG words/phrases per ESG topic used to search benchmark names for ESG language.
Sources: Baier et al. (2020), Amzallag et al. (2022), Mansouri and Momtaz (2022), UN Sustainable Development Goals, Global Impact Investing Network, Morningstar, ESMA.

- "*More and more funds are including ESG-related language in their names, from less than 3 % in 2013 to roughly 14 % in early 2023*"
- "*having an ESG-related term in the fund's name is not a driver of ESG word use in marketing documents.*"
- "*while only 23 % of funds' investment strategies contain at least one ESG word, this percentage increases to 80 % for KIIDs/KIDs and even to 90 % for marketing documents (Chart 6).*"
- "*funds sold to retail investors are associated with more ESG claims in the KIIDs/KIDs compared with funds sold to institutional investors (model 3), but this effect does not exist for the investment strategy or the marketing material (models 2 and 4).*"

### Next Steps

An ESMA webinar is scheduled for 18 October next to outline and discuss the findings of its analysis, which are likely to be used in justifying its upcoming Fund Name Guidelines.

## ESMA 2024 Work Programme

ESMA published its 2024 work programme last month detailing several notable initiatives for the coming year:

- Guidelines on NCAs' enforcement of sustainability reporting under CSRD – to be prepared in 2024.
- Guidelines on periodic information and notification of material changes to be submitted to ESMA, including by benchmark administrators – to be published in 2024.
- Technical advice on the revision of the UCITS Eligible Assets Directive – to issue in 2024.
- Technical standards on marketing documents under SFDR – ESAs may take up their optional empowerment in 2024.
- Peer review on depositary obligations under UCITS and AIFMD.

## ESMA Calls for Evidence of T+1 Impacts

In response to other jurisdictions' imminent (US), considered (UK), or completed (India) shift to T+1, ESMA launched a Call for Evidence on 5 October last with requests for feedback on the impacts, benefits, and costs of a harmonised shortening of the maximum T+2 settlement cycle under the Central Securities Depositories Regulation (**CSDR**).

While ESMA does not currently believe there is a need for legislative or regulatory action to smooth the impact of a move to T+1 abroad, respondents' views are sought on:

- the impact of reducing the settlement cycle to T+1 or T+0 on operations, trading, liquidity formation, or on access to financial markets as well as the impacts from the coexistence of T+2 in the EU with T+1 in the US;
- the costs (one-off and ongoing) and benefits of a shorter than T+2 settlement cycle;

- how and by when a shorter settlement cycle could be achieved; if it is decided that this should be implemented; and
- the impacts on the EU of international developments. In particular, the US and Canada moving to T+1 by end-May 2024, consideration in the UK of T+1/T+0, China's transition to T+0 on Interbank Market government bonds and India's move to T+1 for exchange traded shares. ESMA summarises its initial impact findings as:
  1) EU market participants must carry out all settlement-related processes in US financial instruments overnight.
  2) All settlement-related processes must be carried out within a much shorter time period with many manual processes needing to be automated to settle within the compressed window.
  3) In the case of EU ETFs with US exposure, the liquidity mismatch created by shares settling T+2 but investment in the underlying basket of US securities settling T+1. Such mismatch could be covered by credit lines, overdrafts, or pre-funding but these solutions could have negative consequences including very high costs in a high-interest rate environment particularly for those ETFs with T+3 settlement for creations and redemptions; possible breaches of regulatory investment or cash restrictions (due increased cash holding pre-transaction); increased settlement fails for instruments traded in multiple jurisdictions with, non-aligned settlement cycles; arbitrage and portfolio management as resources might not be available in one jurisdiction for use in another.
  4) Increased time pressure as a result of the FX component of US securities transactions

### Next Steps

The deadline for responding to the Call for Evidence is 15 December 2023.

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## ESG Ratings Regulation: New User and Amended Provider Rules Proposed

Revisions to the proposed ESG Ratings Regulation have been published by the European Parliament's Committee on Economic and Monetary Affairs (**ECON**) ahead of the Parliament's vote on the draft legislation on 28 November next. The revisions, which amend the Commission's proposal published in June this year, include more stringent and prescriptive disclosures for ESG ratings providers, a limitation on issuing aggregated E, S and G scores and requirements for users of multiple ratings to use at least one rating from a small ESG ratings provider (<5% market share in the EU). Notable revisions proposed for consideration and approval by the Parliament are summarised below.

1. ***Users of multiple ratings must engage at least one small provider***

To encourage competition and avoid the negative effects of consolidation across the industry, ECON proposes requiring users of more than one rating to source at least one of the additional ratings from a provider with a no more than 5% market share in the EU. If adopted, this would be the only user-specific requirement under the Regulation.

2. ***More stringent and instructive disclosure rules for providers***

ECON proposes additional disclosures on the types of materiality considered (financial/impact), whether the rating is referring to absolute or relative performance, and the limitations of ratings' methodologies.

3. ***Providers may not issue aggregated E, S and G scores***

Aggregated E, S and G scores have the potential to obscure poor performance on any of these individual metrics and are therefore considered determinantal to the reliability and comparability of ratings. ECON proposes specifically precluding the issuance of aggregated ratings.

4. ***More robust rules for avoidance of conflicts of interest***

The Commission's proposal includes conflicts of interest rules which preclude ESG ratings providers from also providing consulting services, credit ratings, benchmarks, investment activities, audit, or banking, insurance and reinsurance activities. ECON proposes extending such rules including by:

- limiting ESG ratings providers' group entities from providing consulting or audit activities to rated entities; and.
- limiting ESG rating providers' shareholders/members from having an interest in/influence over any other ESG rating provider.

### 5. *ESG ratings' methodologies should use SFDR, CSRD and Taxonomy data*

ECON recommends ESG rating providers 'actively incorporate' standardised data reported under EU sustainable finance legislative measures into their assessments and proposes requiring public disclosure by ESG ratings providers on the use of such data.

### 6. *Users of ESG ratings bear responsibility for such use and internal distribution (including to group entities) is not subject to ESG Ratings Regulation*

While ECON notes that financial institutions are responsible for their use of ESG ratings, including in cases of greenwashing accusations related to their financial products, 'the distribution of ESG information across entities or financial products, which depends on proprietary or established methodologies, including datasets covering emissions and controversies, falls outside the purview of the proposed regulation'. Accordingly, ECON proposes scope clarifications confirming that the ESG Ratings Regulation does not apply to the provision of services to group entities or to disclosures mandated by SFDR or the Taxonomy.

## Next Steps

The ESG Ratings Regulation is expected be finalised and enter into force in H2 2024, with a 6-month transition period resulting in a 2025 application date.

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