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Central Bank of Ireland Speech and Information Note on Sustainable Finance and the Asset Management Industry

November 2022

On 14 November 2022, the Central Bank of Ireland (“**Central Bank**”) hosted a seminar on the Sustainable Finance Disclosures Regulation (“**SFDR**”) for the asset management sector, a further step in the ongoing constructive engagement with the regulator in relation to the implementation of the SFDR and the related EU Taxonomy Regulation. The seminar included a presentation on the data challenges relating to principal adverse impact indicators (“**PAIs**”), performing the do no significant harm (“**DNSH**”) test with respect to sustainable investments and good governance assessments and a panel discussion on key investor protection issues and industry challenges.

“High expectations” of the Funds Sector

In a speech delivered at the seminar, Deputy Governor Derville Rowland made a number of references to the Central Bank’s “high expectations” and high standards for the asset management industry. In her speech, Ms Rowland refers to the Central Bank’s Dear CEO letter of November 2021 setting out the Central Bank’s supervisory expectations with regard to climate, environment and ESG issues. The five key areas of focus highlighted in that letter were governance, risk management framework, scenario analysis, strategy and business model risk and disclosures.

The speech notes that Article 8 and Article 9 SFDR funds remain a small but significant part of Ireland’s funds sector, noting that the proportion of these funds is expected to grow over time given investor demand for investment products which are considered sustainable. Ms Rowland notes that the Central Bank is already seeing this in practice, with current authorisation applications being more likely to be structured as Article 8 or Article 9 products.

> *"Where investments or financial products are described as green or sustainable, this must be meaningful and accurate and based on reliable parameters that are consistently applied both within jurisdictions and across Europe."*
>
> Derville Rowland, Deputy Governor, Central Bank of Ireland, 14 November 2022

In relation to the fast track filing process for changes to fund documentation required as a result of the SFDR Level 2 requirements applying from 1 January 2023, Ms Rowland notes, *“[O]ur tolerance for any disclosures that do not meet the requirements will be low considering the length of time industry has now to comply with these key regulatory changes.”*

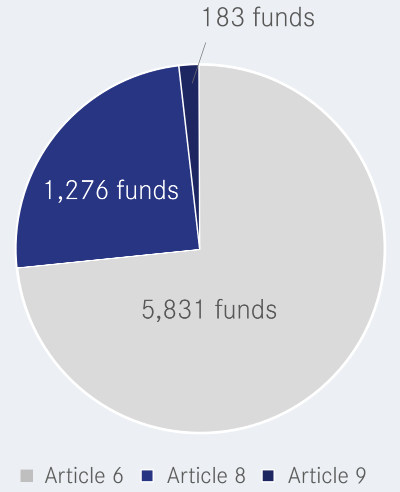
The speech also confirms that work on the Central Bank’s thematic review of funds’ compliance with the SFDR requirements has already commenced, although we understand that this will not now be concluded by year end, as had originally been indicated.

Gatekeeper Review of Disclosures

Ms Rowland also referred to the publication of an information note by the Central Bank on the same date, which includes findings of the gatekeeper review of the investment fund disclosures – including good practices – and Central Bank expectations in relation to the implementation of the next phase of SFDR. The note is designed to inform and assist the funds industry in ensuring that investors and the market have a high degree of trust and confidence in green and sustainable products produced and sold from Ireland.

Having conducted a review of a sample of the submissions received since the application date of SFDR Level 1 on March 2021, the Central Bank has helpfully set out the main disclosure issues encountered and outlined the risks that it has observed in terms of potential greenwashing or areas where there has been a lack of transparency or clarity. The paper also sets out identified good practices and the Central Bank's general expectations.

SFDR Classification



Key Findings of Gatekeeper Review

Nature of Finding	Relevant Requirement	Finding	Expectations
SFDR Classification	Paragraph 28 European Securities and Markets Authority ("**ESMA**") Supervisory Briefing May 2022 *"Without giving the impression of a "label" to investors, an indication as to under which Article of SFDR (and if relevant, the TR) the UCITS/AIF discloses the relevant information should be mentioned in the fund documentation."*	Where an existing investment fund proposes a change in its SFDR classification, the post authorisation submission should include a detailed rationale and justification explaining the basis for the proposed change.	Fund managers should: ▪ ensure that the relevant SFDR classification (either Article 6, 8 or 9) is disclosed in their fund documentation; ▪ consider what any change in classification may mean for existing investors and what communication to investors may be required; ▪ keep classifications under regular review to ensure their ongoing accuracy; ▪ be able to stand over the classification applied to their funds. The Central Bank would not expect numerous changes to a fund's SFDR classification to take place.

Nature of Finding	Relevant Requirement	Finding	Expectations
Generic sustainability risk and / or taxonomy alignment disclosures	Article 6 SFDR, Articles 5 and 6 Taxonomy Regulation	Some of the funds assessed only included generic sustainability risk and / or Taxonomy alignment disclosure on the basis that such disclosure avoids repetition and duplication across all fund documentation and is consistent with other general disclosures.	Disclosures must be specific to the investment fund in question. Fund managers should keep such disclosures under regular review to ensure their accuracy.
Quantification of Taxonomy alignment	Articles 5 and 6 Taxonomy Regulation	Only a small number of funds provided a percentage proportion of investments in environmentally sustainable economic activities. In those cases, detailed information was provided in support of the allocated proportion. A large proportion of assessed funds indicated that they were not in a position to describe the proportion of Taxonomy-aligned investments. Some applicants persists in including negative justifications and / or ambiguity, notwithstanding that the Commission Q&A of May 2022 clarified that these were not permissible.	Disclosures relating to the quantification of Taxonomy-alignment must improve. Fund managers should keep such disclosures under regular review to ensure their accuracy.
Integration of sustainability risks	Article 6(1) SFDR	Generally, funds provided a detailed outline of the reasons why sustainability risks were not relevant, fully addressing these requirements. In some cases, statements were included that sustainability risks are integrated without providing any specific information to outline how this is achieved. Statements that returns may be impacted by investment in certain products and that this would be factored into the decision making process were not supported by specific information on how the impact on returns has been assessed.	Where applicable, funds should provide a detailed outline of the reasons why sustainability risks are not relevant or provide an outline of how such risks are integrated into the investment decision making process. These disclosures must be specific to the investment fund in question. Fund managers should keep such disclosures under regular review to ensure their accuracy.

Nature of Finding	Relevant Requirement	Finding	Expectations
Pre-contractual product disclosures – benchmark indices	Article 8(1)(b) SFDR	There was a lack of detail in terms of how the designated index was consistent with the environmental and / or social characteristics the fund promotes. There were instances where the requirement was undermined by statements to the effect that neither the fund manager nor the investment manager would monitor the composition of the benchmark index against the screening criteria applied on the basis that the index provider is responsible for screening investments in the index. In some cases, it appears that the fund manager does not intend to monitor the delegate investment manager's ESG approach on an ongoing basis but rather will rely on an annual assessment of the application of the ESG strategy.	Fund managers should have processes in place to monitor, on an ongoing basis, the relevant index provider or delegate investment manager.
Naming convention for funds	Paragraph 29, ESMA Supervisory Briefing May 2022 *"Funds' names should not be misleading, as the disclosure of sustainability characteristics should be commensurate with the effective application of those characteristics to the fund ..."*	Naming conventions were consistent with the fund disclosure outlines in its investment objective and strategy.	Fund names must not be misleading. Fund managers should keep their funds' naming conventions under regular review to ensure their continued appropriateness.

The Central Bank will conduct a similar sample review with respect to the filings made in advance of 30 December 2022 deadline to implement SFDR Level 2.

Supervisory Roadmap

The Central Bank has set out in the information note a non-exhaustive list of areas of interest which may form part of a supervisory roadmap into the future, urging market participants to pay particular attention to these matters as they implement the requirements. The Central Bank notes that these areas of interest are in addition to other planned initiatives, such as the ESMA common supervisory action ("**CSA**") on sustainability risks and disclosures, which is planned for 2023.

Adaption of Risk Management Frameworks	Fund managers are required to consider sustainability risks and factors when undertaking investment due diligence and take sustainability risks into account in their organisational procedures, resources, the management of conflicts of interest and risk management policies. The Central Bank refers to its **letter** dated 3 November 2021 setting out its expectations regarding climate and other ESG issues.
Article 8 "Guardrails"	The Central Bank notes that Article 8 SFDR does not prescribe any minimum investment thresholds or any prescribed composition of investments. It has previously indicated that it is supportive of additional work in this area at a European level, including looking at minimum sustainability criteria for Article 8 SFDR products. Notwithstanding the broad nature of Article 8 SFDR funds, the Central Bank's supervisory engagement will focus on funds with a low proportion of their portfolio promoting environmental and / or social characteristics. The Central Bank will examine funds which have changed their classification under the SFDR and will consider further the rational provided at the time of the change. Fund managers need to carefully consider the relevant fund's classification to ensure that it is aligned with both the letter and intention of the legislative requirements.
Marketing Material	The Central Bank will assess the consistency of information disclosed in fund documentation and in marketing material.
Fees and Costs	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. Fund managers should be mindful of the types of third party service providers which such funds utilise and whether / how such services are overseen by the fund / fund manager and what "value add" such services provide to the fund in question.

Securities Lending	The Central Bank is interested in Article 8 or Article 9 funds engaged in securities lending and whether they are in a position to meet their environmental / social characteristics if they have lent out shares and those shares take contradictory positions – such as through the exercise of associated voting rights or because the shares were lent to short sellers which take an opposing view.
Fund Service Providers	The Central Bank will consider the role played by certain service providers, such as depositaries. This could include whether ESG-related investment restrictions are included in the monitoring of the instructions from the fund manager or the investment manager as its delegate. The Central Bank may also consider how a depositary would categorise a breach of an ESG-related investment restriction and the circumstances in which they would report such breaches to the Central Bank or in financial statements.

Comment

The Central Bank has also responded to queries raised by Irish Funds at a meeting that took place on 13 September 2022 to discuss the completion of the SFDR Annexes and the fast track filing procedure. In its responses, the Central Bank noted the importance of following the templates closely, for example with regard to the deletion of non-relevant text and the avoidance of duplication. Any deviations from the templates or the instructions contained within them should be avoided, as any amendments to the templates would require clarification at European level on the approach to be taken.

The publication of the findings from the Central Bank's review and its expectations, together with the supervisory roadmap, is welcome in providing more guidance to fund managers as they seek to implement the detailed and complex requirements. Further recent guidance in the form of the European Supervisory Authorities' ("**ESAs**") Q&A on SFDR Level 2 has also been instructive in this regard. There are a number of challenges and interpretation difficulties remaining, but it is hoped that future publications, such as the Commission's answers to the ESAs' questions submitted in September 2022 (expected to be answered in a phased basis early in the new year) and the findings of the CSA in 2023, will further assist managers in meeting their obligations.

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