

# The current regulatory landscape in the ESG field and what should we expect in 2024

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**L**uxembourg continues to be the leading hub for the establishment of investment funds in Europe. One of the most important current trends driving development in the Luxembourg fund industry is sustainable finance. This trend is not new and in recent years we have all observed a number of novelties and developments in this area. However, we should all expect that such developments will accelerate even more in the future. Yet, this is not without some challenges.

The current regulatory landscape in the sustainable finance and environmental, social and governance (ESG) field is and will continue to be challenging due to the significant amount of regulatory developments. The EU Commission has launched a number of initiatives and amendments which will be crucial for fund managers as the implementation of the ESG regulatory framework in their business and operations proves to be a long-term journey emphasising the importance of being well informed.

The consultations on the sustainable finance disclosure regulation (SFDR) and the draft guidelines on funds' names are definitely on everybody's mind, but there is so much more...

## Anticipated amendment of the SFDR and its Level II RTS and what does it mean in practice?

### Amendment of the SFDR

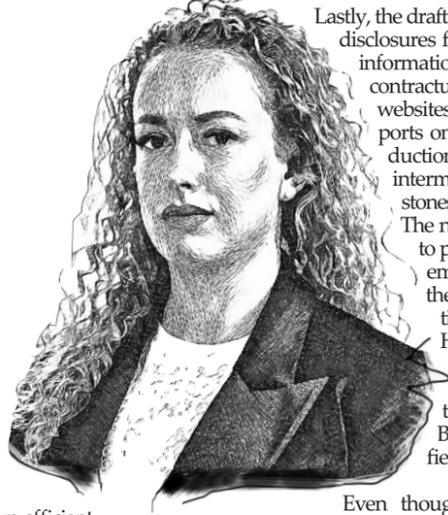
SFDR Level I Regulation started to apply as of 10 March 2021 and its Level II RTS as of 1 January 2023.

From the beginning, it has not been an easy journey for market players to familiarise themselves with this new legal framework. The implementation of the whole set of the required SFDR disclosures either at financial product or entity level was quite challenging. The consultation on SFDR, which was open from 14 September 2023 to 22 December 2023, may be a life-jacket for market players that are still struggling with the SFDR compliance or comprehension. The aim of the consultation is indeed to improve the current legal framework following the feedback received from market players.

The consultation on SFDR disclosed two broad option-strategies. The first one is a product categorisation system to be built on and developing the distinction between Articles 8 and 9 and the existing concepts embedded in them (such as environmental/social characteristics, sustainable investment or do no significant harm). This option would be complemented by additional (minimum) criteria that would more clearly define products falling within the scope of each article. The second option is a product categorisation system following a different approach and focusing on the type of investment strategy (promise of positive contribution to certain sustainability objectives, transition focus, etc.), and hence moving away from the existing concepts. This would imply that concepts such as environmental/social characteristics or sustainable investment as well as the distinction between the current Articles 8 and 9 of SFDR may disappear altogether.

It is clear that depending on the adopted option, the impact would be tremendous. The first option would imply improving the existing legal framework to meet the target of the EU Sustainable Finance Action Plan. The second option, on the other hand, would bring a complete reshaping of the current regulatory framework. For the time being, the concepts are not entirely clear, but there would likely be different sustainability categories and products would be classified depending on their investment strategy. It is unclear whether financial products would need to choose only one category or not and what would be the minimum criteria for a financial product to fall under the one or the other product category.

If the second option were to be adopted, this would imply that work done up until now would have to be reevaluated and the operational processes and models would have to be reassessed. This will end up being quite costly since there would no longer be Article 8 and 9 products, but rather a system based on the investment strategy of the financial product. Market players would obviously need time to digest new requirements, to understand what these new specific criteria would be, the level of disclosures and complexity of measurements. Nevertheless, in the long run, this approach might be easier to understand for



investors and may turn out as more efficient, though this will come at a price.

An AMF (the French *Autorité des Marchés Financiers*) position paper issued a couple of weeks ago gave an interesting vision of a potential outcome for this consultation. The AMF emphasised that the establishment of an EU categorisation system should seek to create wide-ranging categories with criteria that act as entry points. Within such categories, financial market participants would be free to develop more ambitious strategies and practices. However, because there may be multiple sustainable strategies that do not necessarily lend themselves to a simple ranking, there should be no hierarchy between categories.

AMF also stressed that the categorisation system should rely on objective minimum criteria that leave no room for interpretation. On the basis of these principles, AMF proposes four categories: "environmental solutions", "social solutions", "climate transition" and "non-financial filters". Other categories may be introduced over time, for instance "biodiversity transition". Those categories would make the current architecture based on Articles 9 and 8 of SFDR obsolete and replace it altogether. We will have to wait and see if the AMF's position is followed.

Finally, the consultation questions whether the SFDR is the right place to include entity level disclosure obligations. That could imply, that such disclosures could be removed from the SFDR and be replaced by the Corporate Sustainability Reporting Directive (CSRD)'s obligations. As of now, adoption of the revised framework is planned for second quarter of 2024 which is around the corner. So, this topic needs to be closely monitored!

### Amendment of the SFDR RTS

Following a public consultation, the European Supervisory Authorities (ESAs) have developed a proposed Regulatory Technical Standards (RTS) on the content and presentation of disclosures under SFDR, that includes the following changes from the current version of the RTS:

Firstly, several new indicators for principal adverse impacts (PAI) of investment decisions on sustainability factors, focusing on the social adverse impacts, have been added. The ESAs have also made changes to the list of opt-in social indicators and to the other PAI indicators covering environmental adverse impacts. These changes generally purpose to align definitions with the ones in the CSRD, which is a welcomed initiative.

Secondly, the draft RTS include a requirement to disclose the thresholds or criteria for the PAI indicators that the financial product uses to determine that its sustainable investments comply with the "do not significantly harm" (DNSH) principle.

Lastly, the draft RTS incorporate new disclosures for financial products information provided in pre-contractual documents, on websites and in periodic reports on GHG emissions reduction targets, including intermediary targets, milestones and actions pursued.

The new disclosures apply to products having GHG emissions reduction as their investment objective (Article 9(3) SFDR). However, for products that passively track EU Climate Transition or Paris-Aligned Benchmarks a simplified disclosures apply.

Even though welcomed, these changes to the RTS should be fully coordinated with SFDR Level I Regulation review to guarantee legal certainty and to prevent overlapping. For example, the consultation on SFDR Level I Regulation review contemplates making changes to the scope of PAI reporting, so the introduction of additional mandatory PAI may create inconsistencies later on (which would favour moving these PAI from mandatory to optional). Hence another topic that would have to be regularly monitored.

## Latest updates on funds' names using ESG and sustainability-related terms

On 18 November 2022 ESMA launched a consultation on Guidelines on funds' names using ESG or sustainability-related terms. ESMA was concerned that sustainability disclosures may increase the risk of "greenwashing" when funds are named as green or socially sustainable and when there are insufficient sustainability standards. The Guidelines address funds' names by proposing quantitative thresholds criteria for the use of ESG and sustainability-related terminology. The Guidelines also precise that the use of ESG and sustainability-related terminology in fund names should only be used when supported by a material evidence of sustainability characteristics, or objectives that are reflected fairly and consistently in the fund's investment objectives and policy and its strategy as described in the relevant fund documentation. The consultation closed on 20 February 2023 and ESMA received 125 responses, mainly from asset managers and their industry associations, NGOs and consumer representatives.

On 14 December 2023, ESMA issued a public statement in which it explained that since the consultation was launched, the AIFMD and UCITS Directive reviews have progressed considerably and hence ESMA decided to postpone the adoption of the Guidelines to ensure alignment with these reviews. The adopted text of the revised AIFMD and UCITS Directives refers to future ESMA guidelines specifying the circumstances in which the name of an AIF or UCITS would be considered as unfair, unclear or misleading. This public statement of December last year already clarifies a few items, which are worth noting as unlikely to change in the final version of the Guidelines to be adopted:

ESMA no longer considers that the threshold of 50% in sustainable investments for the use of sustainability-related words in funds' names should be retained. ESMA considers it more appropriate that sustainability-related terms in funds' names should be used along the following lines: the fund should (1) apply the 80% minimum proportion of investments used to meet the sustainability characteristics or objectives, (2) apply the Paris-aligned Benchmark (PAB) exclusions, and (3) invest meaningfully in sustainable investments as defined in Article 2(17) of SFDR, reflecting the ex-

pectation investors may have based on the fund's name. These conditions are cumulative, and we cannot help noticing that ESMA has moved away from applying a strict threshold requirement on investment in sustainable investments. Market Players will now have to determine the threshold that would be considered as being "meaningful" and we can sense that this will give room for a subjective assessment.

ESMA is also suggesting the introduction of a new category for which (in addition to the 80% threshold), Climate Transition Benchmark (CTB) exclusions should apply (instead of the Paris-aligned Benchmark (PAB) exclusions containing fossil fuel exclusions). The idea is to avoid penalizing funds with "Transition" terms in their names which strategies are leading to a transition towards a greener economy and attaining the target of the EU Sustainable Finance Action Plan.

## Regulatory screening by the CSSF

Following the entry into force of the EU key regulations in the area of sustainable finance, the CSSF initiated various supervisory actions in order to verify the correct implementation of the various sustainability-related requirements in the investment fund industry, which included on-site inspections as well as off-site thematic review (launched in the second quarter of 2023). Thereafter, in August 2023, the CSSF issued a report to inform the industry of the main observations and expectations in that area – the so-called thematic review observations. This thematic review focused on the organisational arrangements of the fund managers, covering delegation and risk management aspects and including compliance with precontractual, periodic and product website disclosures. In that respect, the CSSF raised a number of points of attention and explained the way it expects market players to operate. The CSSF specifically pointed out that fund managers shall have adequate checks and controls in place to monitor the compliance of all ESG-related restrictions laid down in pre-contractual disclosures. The CSSF also expects that the disclosed asset allocation be aligned and coherent with the environmental/social characteristics promoted by the fund or the sustainable investment objective pursued by the fund.

Moreover, the CSSF reminded that investment fund managers should remain entirely responsible for ensuring compliance with sustainability-related provisions that apply to them, regardless of any delegation of the portfolio management function.

In summary, it is good to note that investment fund managers should take into account the CSSF's observations while assessing their compliance with sustainability-related requirements, and if necessary, take necessary corrective measures to ensure there are no shortcomings to applicable regulatory requirements.

## Conclusion and outlook

There are multiple challenges for investment funds, their managers and initiators on the compliance with ESG related legal requirements. These challenges include uncertainty of interpretation, lack of available data necessary to comply with the disclosure requirements, anticipated revision of the existing legal framework (SFDR, Level II RTS), multiplication of only partially coordinated legislative texts, and various deadlines that have to be complied with. All of these factors are not to be taken lightly. In view of the constant evolution of the sustainability-related regulatory framework, fund managers need to be ready to embrace future changes and adjust swiftly.

One should also not forget about the new rules on corporate sustainability reporting brought forward by the CSRD. The first companies will have to apply the new rules for the first time in the 2024 financial year, for reports published in 2025. So stay tuned and be part of a better and greener future!

# Niveaux records pour les dividendes en 2023

**S**elon le dernier Janus Henderson Global Dividend Index, les dividendes mondiaux ont atteint le chiffre record de 1,66 trillion de dollars en 2023, soit une hausse de 5,0% sur une base sous-jacente.

Cette hausse est principalement due au secteur bancaire, qui a pu verser des dividendes records grâce à la hausse des taux d'intérêt. La croissance des dividendes a été encore plus forte parmi les entreprises néerlandaises de l'indice, qui ont versé 13% de plus qu'un an auparavant.

Un montant record de dividendes a été versé dans 22 pays en 2023. L'Europe continentale a été un moteur important, contribuant aux deux cinquièmes de l'augmentation mondiale. Les paiements de divi-



dendes par les entreprises européennes ont augmenté de 10,4% sur une base sous-jacente pour atteindre un montant record de 300,7 milliards de

dollars. Le Japon a également été un contributeur majeur, bien que la faiblesse du yen ait masqué une partie de la force de 91% des entreprises. Bien que les États-Unis aient été le principal contributeur à la croissance mondiale des dividendes en raison de leur taille, leur taux de croissance sous-jacent de 5,1% était conforme à la moyenne mondiale.

## Prévisions pour 2024

Janus Henderson s'attend à ce que 2024 affiche une croissance sous-jacente similaire à celle de 2023, même si une baisse probable des dividendes spéciaux non récurrents réduira le taux de croissance global. Janus Henderson prévoit des dividendes mondiaux totalisant 1,72 trillion de dollars en 2023, en hausse de 3,9% sur une base nominale, ce qui correspond à un taux de croissance sous-jacent de 5,0%.