

Grey areas among the green: the impact of the EU's sustainability disclosure measures on Channel Islands firms

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The EU is under way with rolling out its package of measures aimed at encouraging deployment of capital in a way that fosters environmental sustainability. In this update we explain what is known (and what remains unknown) about these requirements from a Channel Island funds perspective, and what actions these firms should be taking as a result

Timeline

The EU's Regulation on sustainability related disclosures in the financial services sector (**SFDR**) is part of the EU's package of measures concerning environmental sustainability disclosures and procedures.

- 10 March 2021: the 'Level 1' text of the SFDR came into force, requiring pre-contractual and periodic disclosures at an entity and product level.
- May 2021: the European Commission is expected to endorse **regulatory technical standards (RTS)** concerning the content, methodology and presentation of sustainability-related disclosures. The RTS are expected to come into force on 1 January 2022, to provide more detail on how the SFDR requirements are to be implemented.
- Also from 1 January 2022, a phased implementation of the rules and technical screening criteria under the so-called **Taxonomy Regulation** (which itself came into force on 12 July 2020) will commence. The Taxonomy Regulation will provide a common 'language' for identifying which economic activities are considered environmentally sustainable, supplementing the rules on disclosure set out in the SFDR itself. The Taxonomy Regulation will act as a framework under which further technical criteria may be developed.

Why is this important to Channel Islands firms?

The SFDR and related texts apply to Alternative Investment Fund Managers (**AIFMs**), among other classes of participants in EU financial markets.

This will, on the face of it, include Guernsey or Jersey firms which are non-EU AIFMs within the meaning of the Alternative Investment Fund Managers Directive (**AIFMD**). The exact extent to which SFDR will apply to non-EU AIFMs is one of a number of as-yet-unanswered queries raised by the European Supervisory Authorities (**ESAs**) with the European Commission. It is anticipated that further guidance will be issued in due course, including as to whether the rules apply to sub-threshold AIFMs.

However, the current expectation is – and firms are generally proceeding on the basis that – the SFDR will apply alongside other AIFMD disclosure requirements where non-EU managers are actively marketing funds within the European Economic Area (ie excluding where interests are acquired by European investors following reverse solicitation).

The SFDR will also (indirectly) catch Channel Islands firms which are delegates of EU AIFMs, such as providing portfolio management and/or investment advice to EU firms that themselves are subject to the

regulations. Such firms will look to their Channel Islands delegates to ensure compliance with the SFDR requirements.

What are the relevant requirements of the SFDR?

Entity-level requirements

While currently unclear, it is anticipated that the RTS and/or further guidance from the European Commission will clarify that the entity-level requirements apply to non-EU AIFMs which are marketing funds within the EEA.

All such managers should therefore take steps to ensure sustainability risks are integrated within their investment decision-making process and remuneration policies.

In addition, initially all managers must address the so-called 'comply or explain' requirement, either:

- implementing and disclosing a policy for due diligence on principal adverse impacts of its investments on environmental and social criteria, or
- explaining why they do not consider the principal adverse impacts to apply.

From 30 June 2021, the exact entity-level requirements will diverge depending on the number of a firm's employees. Channel Islands firms may themselves have relatively few employees but, if a subsidiary of a larger group, it is anticipated that further guidance from the EU Commission may clarify that all the group's employees, whether inside or outside the EU, should be assessed against this threshold.

Managers over the 500 employee threshold must, from 30 June 2021, disclose principal adverse impacts of investments on environmental and social criteria, on their websites and in documentation issued to investors. Managers falling under the threshold will still benefit from the option to 'comply or explain'.

Product-level requirements

The exact requirements will depend on the focus of the fund.

For any fund marketed within the EEA, irrespective of its strategy or focus, certain basic disclosures are now required in addition to the disclosures required under Article 23 of the AIFMD.

In addition, where funds promote environmental or social characteristics (**Article 8 funds**) or have sustainable investment as their objective (**Article 9 funds**), the SFDR requires additional disclosures on how those characteristics or objectives are met.

It is these disclosure requirements, in particular, that will be expanded on by the RTS. For the time being, managers should look to comply with the principles set out in the SFDR, and be ready to adopt the more granular requirements once the RTS are adopted.

What if funds are no longer being marketed?

Pending further confirmation from the European Commission, non-EU AIFMs which are no longer marketing the funds under AIFMD national private placement regimes will not need to separately provide the required investor disclosures. However, there will be certain periodic reporting requirements to the extent the fund has European investors.

What should Channel Islands firms be doing now?

Firms should be mindful both of the high-level disclosure requirements already in force and of the more granular detail that will be required as the EU's package of sustainable finance regulations comes into force over the next 12-24 months.

In the first instance, firms should identify whether they are caught either as a delegate of an EU AIFM or as a non-EU AIFM actively marketing under AIFMD national private placement regimes and decide how to approach the manager-level disclosures outlined above. Fund products should also be assessed to identify whether they fit the definition of Article 8 or Article 9 funds.

In each case appropriate policies should be implemented and disclosures prepared for inclusion on websites and/or investor-facing documentation, as required.

Does the SFDR apply within the United Kingdom?

Post-Brexit, the SFDR is not part of UK law. Rather, the UK government has announced its intention to introduce a mandatory disclosure regime and its own green taxonomy, with these expected to be rolled out from 2023 onwards.

As such, it is not necessary for the SFDR requirements above to be complied with where funds are marketed to investors in the United Kingdom, except where the funds will also be marketed into the EEA.

However, in the lead up to implementation of the UK regime, other managers may still decide to adopt at least some elements of the SFDR as the basis for their own disclosures and due diligence in order to signal to the market their intentions in this area, particularly those managers with EU offices where the SFDR has already been incorporated into their business model.

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