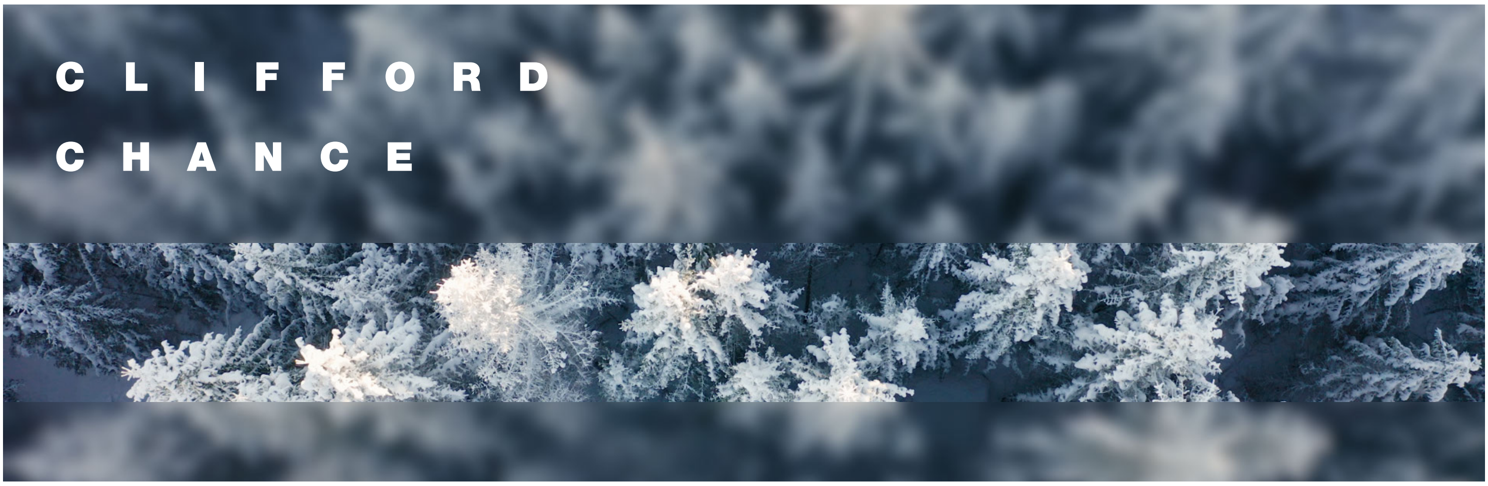


# ESG: WHAT'S A PRIVATE FUND MANAGER TO DO?

## What are the key recent developments?

ESG is without doubt one of the key themes for the investment management industry for 2020 and beyond. Regulators across the globe are each developing their own agendas at their own pace, leaving something of a regulatory labyrinth for the global private fund manager to navigate. This snapshot briefing focuses on:

***EU developments:*** As part of its Sustainable Finance Action Plan, the EU has developed the **Sustainable Finance Disclosure Regulation** ("**SFDR**"), which imposes specific ESG-related disclosure requirements, and the **Taxonomy Regulation**, which acts as a 'dictionary' for determining environmentally sustainable economic activities.

***US developments:*** A new rule from the Department of Labor ("**DoL**"), which clarifies and limits the use of "non-pecuniary" considerations when ERISA fiduciaries make investment decisions.

## What is the timing?

The SFDR will apply (in phases) from **10 March 2021**, and the Taxonomy Regulation (in phases) from **1 January 2022**.

The US DoL rule was published at the end of **October 2020**. It is effective on **12 January 2021** and applies to investments made and investment courses of action taken after that date.

## How are these updates relevant for private fund managers?

All EU AIFMs and any non-EU AIFMs that bring themselves within the scope of AIFMD (e.g. by marketing to EU investors) will need to comply (in varying degrees) with both the SFDR and the Taxonomy Regulation. This includes sub-threshold AIFMs; there is no size-based test.

The US DoL rule will be (indirectly) relevant to any fund manager who plans to admit ERISA money into its funds, e.g. from US private pension plan investors.

## We outsource to a third party AIFM - are these developments still relevant?

Broadly, yes. In relation to the EU rules, ultimate responsibility for compliance lies with the AIFM but the AIFM is likely to 'push down' the compliance burden to its delegates and will most likely want the ability to scrutinise the relevant fund documents in order to ensure that it is meeting its own compliance obligations.

## What does this mean in practice - how will my documents change?

SFDR compliance involves making disclosures on the integration of sustainability risks in investment decisions, and the principal adverse impacts of investment decisions on sustainability factors. The disclosure covers both manager level and fund level, and is required to be included on websites, in pre-contractual materials (including PPMs) and in periodic reporting documents over a fund's life. There are additional disclosure obligations for so called 'Article 9' and 'Article 8' funds, i.e. those which, respectively, have sustainable investment as their objective or seek to promote environmental or social characteristics. The Taxonomy Regulation requires managers to include statements about the alignment (or lack thereof) of their funds with the Taxonomy Regulation sustainability criteria. The extent (if any) to which funds present themselves as having an ESG focus will also need to be carefully considered in light of the target investor base; if US private pension plans are a component, managers will wish to consider how an ESG focus affects a product's consideration by those investors. We believe Article 8 and Article 9 funds can be suitable for ERISA investors even under the new DoL rule. One will need to consider how a fund's disclosures will be read with an ERISA lens. A determination that any particular fund is suitable will be made by the ERISA investors and will be fact-specific.

## What about funds which have already had their final closing?

Given the lack of guidance surrounding the SFDR, this is currently a grey area. However, it is our view that it does not make sense, nor add value, for fund managers to update the PPMs of funds that have held their final close and are no longer marketing and that the rules should be interpreted in that framework. The periodic reporting requirements, on the other hand, are likely to apply to those older funds, absent any future guidance to the contrary.

## Will this impact commercial terms?

We do not anticipate material commercial changes, albeit things are still at a relatively early stage. ESG reporting is of course nothing new. We do see ESG-related diligence queries and disclosure requests increasing, both in number and in scope/granularity.

## What about Brexit?

In the UK, the SFDR will not become part of EU retained law post-Brexit, and only the 'high level' environmental objectives contained within the Taxonomy Regulation will continue. However, in November 2020 the UK Government and regulators made a number of coordinated announcements about the UK's commitment to the ESG agenda, including the development of a UK-specific version of the EU's Taxonomy Regulation. You can find more detail on these announcements in our briefing: **The UK, sustainable finance and climate regulation: the next steps**.

## How can Clifford Chance help?

We are on hand to help sponsors navigate the fast-changing landscape of ESG frameworks at both international and national level. We have practical experience within our Private Funds Group when it comes to navigating these developments and can help you during and after your fundraising period. More generally, our wider global ESG Board aims to ensure that our clients benefit from our collective experience by drawing together our cross-disciplinary and cross-jurisdiction expertise.

You can find out more information about our ESG offering on our **website**.

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