Society of Actuaries in Ireland

Sustainable Finance Disclosure Regulations (SFDR) – implications for investors

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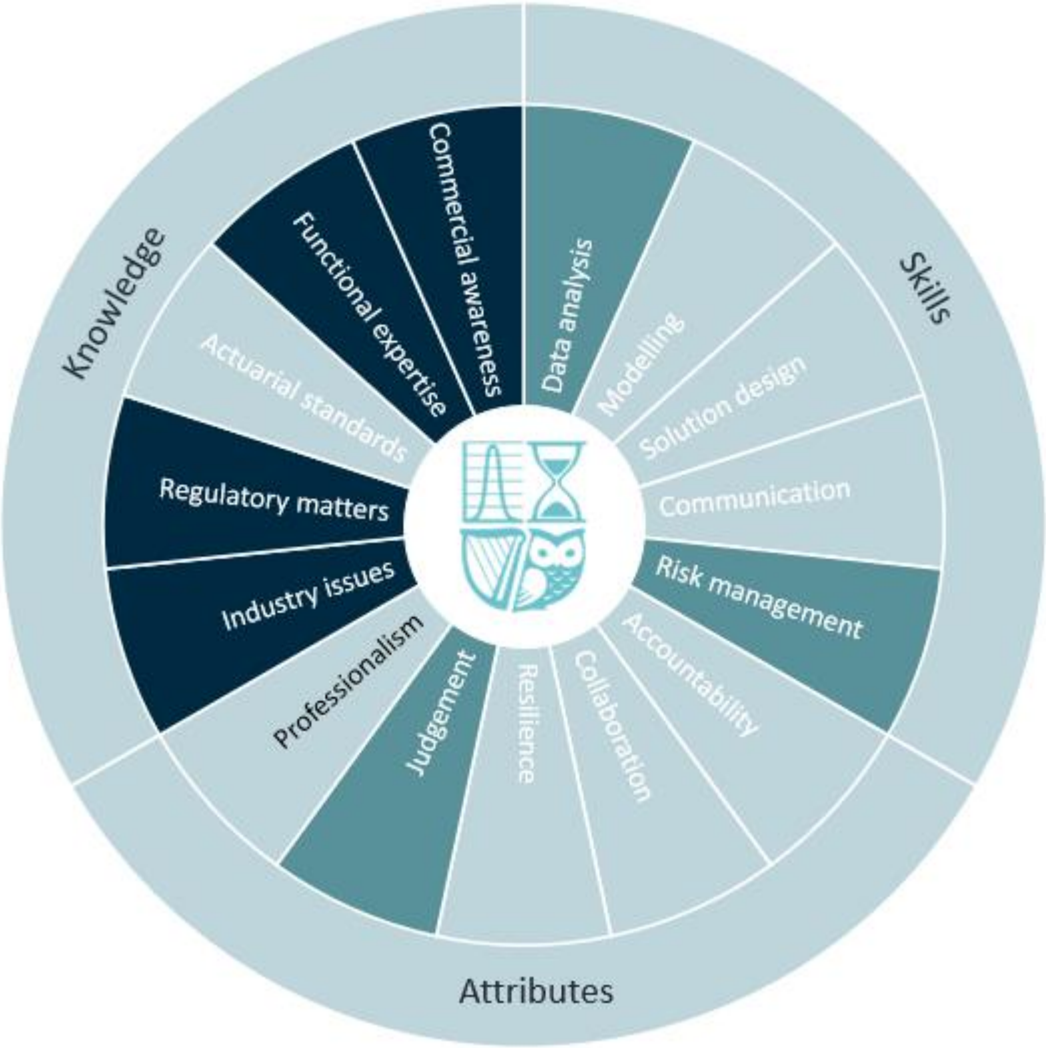
Competency Framework Wheel



SFDR – the sustainability disclosures regulation

A Pension Investor's perspective

Society of Actuaries in Ireland
24 September 2021

Peter Fahy
Partner | Head of Pensions

Contents

- What is SFDR and where does it fit into the bigger picture?
- What is the specific impact of SFDR on pension schemes?
- Next steps

What is SFDR?

SFDR is part of a bigger picture

- The EU has committed to becoming the world's first climate neutral continent by 2050
- As part of this the EC has devised a Sustainable Action Plan, to incentivize and where necessary compel financial market participants ("**FMPs**") to make private capital available for green projects
- To do this, the EU has either enacted or is progressing an overarching regulatory framework

The Regulatory Framework

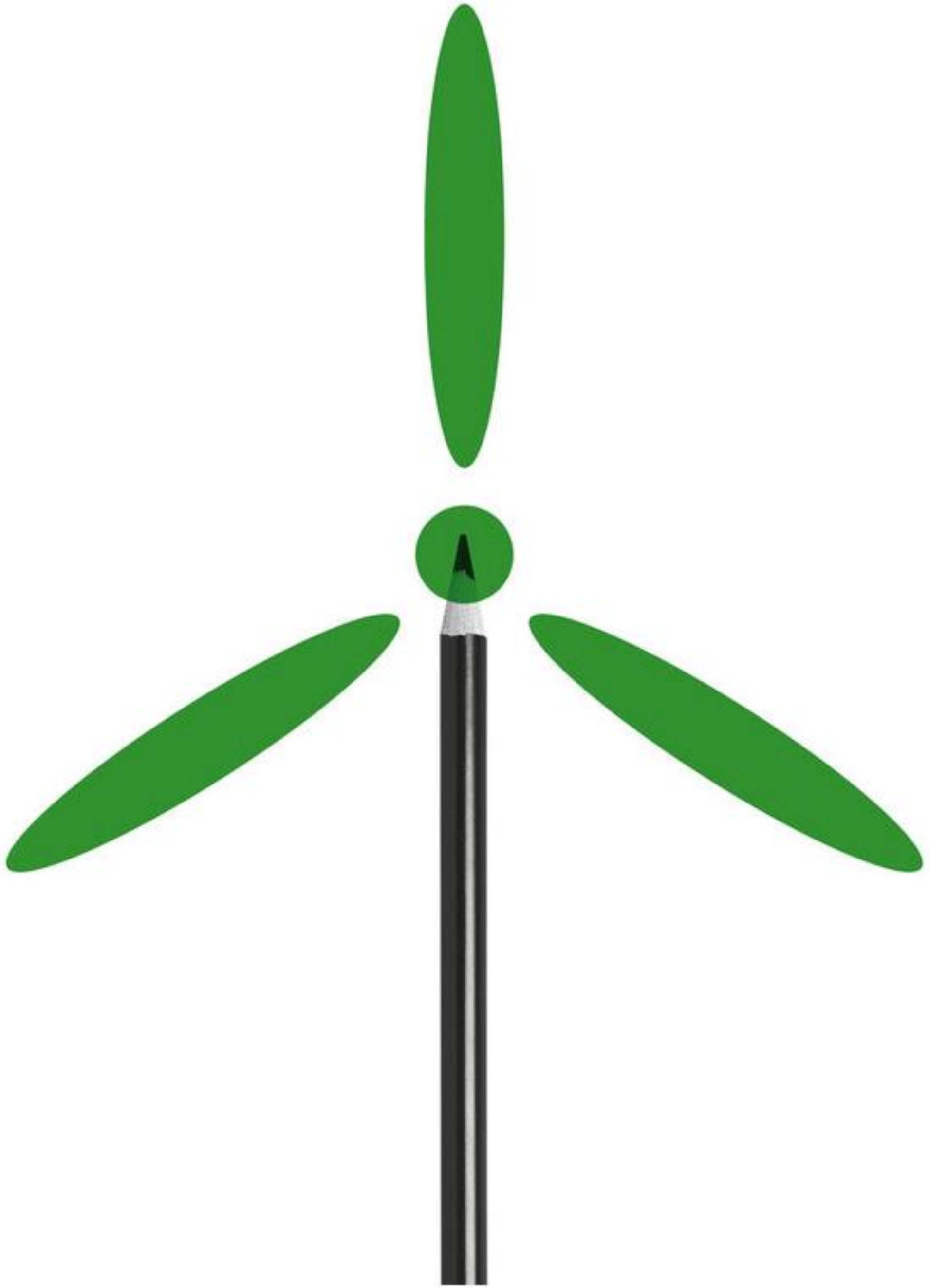
SFDR is part of a bigger picture

These action points have progressed and have now become regulations or advanced legislative proposals:

Taxonomy Regulation	A unified classification system for sustainable activities
SFDR	Consistent disclosure requirements in relation to sustainability
Benchmarks Regulation	Standardised sustainability benchmarks for green products
MiFID and IDD	Indicating sustainability considerations in financial advice
UCITS and AIFMD	Integrating sustainability risks and factors into UCITS and AIFMD
Corporate non-Financial Disclosure	Strengthening ESG data reporting and accounting rule-making
Green Bonds	A common green bond standard to increase comparability and transparency
EU Ecolabel	Common EU Ecolabel for sustainable products, including financial products
Corporate Governance	Fostering sustainable corporate governance and collecting evidence of undue short term pressure from capital markets
CRR / Solvency II	Incorporating sustainability into prudential requirements
Credit Ratings	Integrating sustainability in ratings and market research

So what is SFDR itself?

"SFDR" is Regulation (EU) 2019/2088
on sustainability related disclosures in the financial services sector



How does it apply to pension schemes?

It applies to a range of FMPs and financial products – including pension schemes

Financial Market Participants

Insurance undertakings which make available insurance based investment products (IBIPs)
Investment firms which provide portfolio management
IORPs
Manufacturers of pension products
AIFMs
PEPP providers
Managers of qualifying venture capital funds
Managers of qualifying social entrepreneurship funds
UCITS management companies
Credit institutions which provide portfolio management

Financial Product

A segregated portfolio
An alternative investment fund (AIF)
An IBIP
A pension product
A pension scheme
A UCITS
A PEPP

Impact on pension schemes – not all is clear

Article 2(7) of SFDR defines an "**IORP**" as

"an institution for occupational retirement provision authorised or registered in accordance with Article 9 of Directive (EU) 2016/2341 [the IORP II Directive] except

- *an institution in respect of which a Member State has chosen to apply Article 5 of that Directive or*
- *an institution that operates pension schemes which together have less than 15 members in total"*.

An IORP is an institution, irrespective of its legal form, operating on a funded basis, established separately from any sponsoring undertaking or trade for the purpose of providing retirement benefits in the context of an occupational activity on the basis of an agreement or a contract agreed: (a) individually or collectively between the employer(s) and the employee(s) or their respective representatives...

The Irish state has applied an Article 5 derogation only to one-member schemes, so all pension schemes with more than 15 members are subject to SFDR

In Ireland, a pension trust does not have a separate legal personality from its trustees; so the Irish State can apply the Directive to the trustees rather than the "IORP"; Irish law has never been consistent as to whether the trustees or the scheme are the IORP

Under **Article 2(1)**, the definition of a "**financial product**" includes a pension product, or a pension scheme. Pension scheme is defined as in the IORP II Directive:

"'pension scheme' means a contract, an agreement, a trust deed or rules stipulating which retirement benefits are granted and under which conditions."

- So is an Irish pension scheme a "pension scheme" [financial product] under SFDR, or an IORP?
- Are the individual fund choices under a DC scheme, or different sections of a scheme, a "pension scheme" under SFDR?

What are the key obligations applicable to IORPs/pension schemes under SFDR?

Disclosure is required

- On a publicly available website.
  This is in line with existing EU obligations under SRD II
- To members and prospective members ("**made available**")
- In periodic reporting (**Article 8, 9**)

Three broad heads of disclosure:

- Sustainability risk
- Adverse Impacts
- Product specific disclosures

Sustainability risks

Monitoring the potential impact of external ESG risks on the value of the scheme's investments	
Article 2(22)	A sustainability risk is any environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the [scheme's] investment.
Article 3	IORPs shall publish information on their **websites** about their policies on the integration of sustainability risks in their investment decision-making processes.
Article 5	IORPs shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks, and publish this on their website. These are the policies required under sectoral legislation, including the IORP II Directive, which as implemented under Irish law provides: *(1) The trustees of a scheme or trust RAC shall establish and apply a sound remuneration policy…. in respect of (a) the trustees of the scheme or trust RAC, (b) persons who carry out key functions, (c) other categories of staff employed by the trustees of the scheme or trust RAC whose professional activities have a material impact on the risk profile of the scheme or trust RAC, and (d) a service provider referred to in section 64AM to whom a key function or other activity referred to in that section is outsourced unless such service provider is covered by the Directives specified in subsection (4)(e)*[in essence, a regulated financial institution or fund] Chapter 1.8 of the draft PA Code of Practice for trustees provides that "*There must be a written remuneration policy for trustees (where relevant), KFHs, **any outsourced service providers** and any other personnel employed by the trustees to carry out professional activities."*
Article 6	In **member and prospective member disclosures**, IORPs shall include descriptions of the manner in which sustainability risks are integrated into their investment decisions, and the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.

Adverse Impacts

Monitoring the Trustee’s impact on the wider world	
Article 2(24)	Sustainability factors are defined as environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.
Article 4	IORPs must publish, and maintain, on their websites, information relating to the sustainability factor impact of their investment decisions
Article 4(1)(a)	Where the IORP considers the principal adverse impacts of [its] investment decisions on sustainability factors, it must publish a statement on [its] due diligence policies with respect to those impacts.
Article 4(2)	Outlines the minimum required information, including the IORP’s policies on identification and prioritisation of impacts, descriptions of the principal adverse impacts and any proposed actions in relation thereto, summaries of SRD II engagement policies, where applicable, and reference to the IORP’s adherence to responsible business conduct codes, recognized due diligence and reporting standards and where relevant degree of IORP’s alignment with the Paris Agreement.
Article 4(1)(b)	If an IORP does not consider the adverse impacts of [its] investment decisions on sustainability factors, it should publish a statement that it does not consider such impacts, providing clear reasons for this, including whether and when the IORP might intend to consider these impacts.

Adverse Impacts *Continued*

Article 4(3)	FMPs exceeding average of 500 employees will be obligated to make a 4(1)(a) statement. By contrast, FMPs such as Irish IORPs, with less than 500 employees, can choose not to consider such impacts, and publish an Article 4(1)(b) statement instead.
Article 7	Where IORPs apply 4(1)(a), they should include how their product (pension scheme) considers such impacts.

The **Article 4(1)(a)** disclosure obligation applies at IORP level from 10 March 2021, and at pension scheme level from 30 December 2022

Product Specific Disclosures

Article 9

- Regulates any pension scheme with sustainable investment as its investment objective.
- Irish pension schemes should not be in scope for Article 9, as long as sustainable investment is not the primary objective of the scheme.

Article 8

- This may be in scope for some Irish pension schemes.
- It will apply to pension schemes promoting social or environmental characteristics, among other characteristics.
- This will be much harder to define, and it is still unclear what qualifies as 'promoting' a characteristic.
- This characteristic needs only be one aspect of the pension scheme. Therefore, a pension scheme with an ESG focus as part of an investment strategy towards satisfying its retirement savings purpose, could fall within Article 8.

Additional Article 8/9 requirements

- Such financial products (ie “pension schemes”) are subject to product specific regulation – more detailed disclosures and evidence of due diligence to justify the scheme’s status as an **Article 8 or 9** scheme.

  eg for **Article 8**, how the “characteristics” are met

- Regulatory technical standards will detail these requirements more extensively.

Implementation Dates

The Regulation applies from **10 March 2021**

Product specific and **Article 8 and 9** elements apply from various dates in 2022/early 2023

What is the role of the ESAs?

ESAs

Under the Regulation, the European Banking Authority (**EBA**), European Insurance and Occupational Pensions Authority (**EIOPA**) and European Securities and Markets Authority (**ESMA**) collectively are the European Supervisory Authorities (**ESAs**).

The ESAs are obligated to draft **regulatory technical standards**, (**RTSs**) to specify the content and presentation of SFDR information.

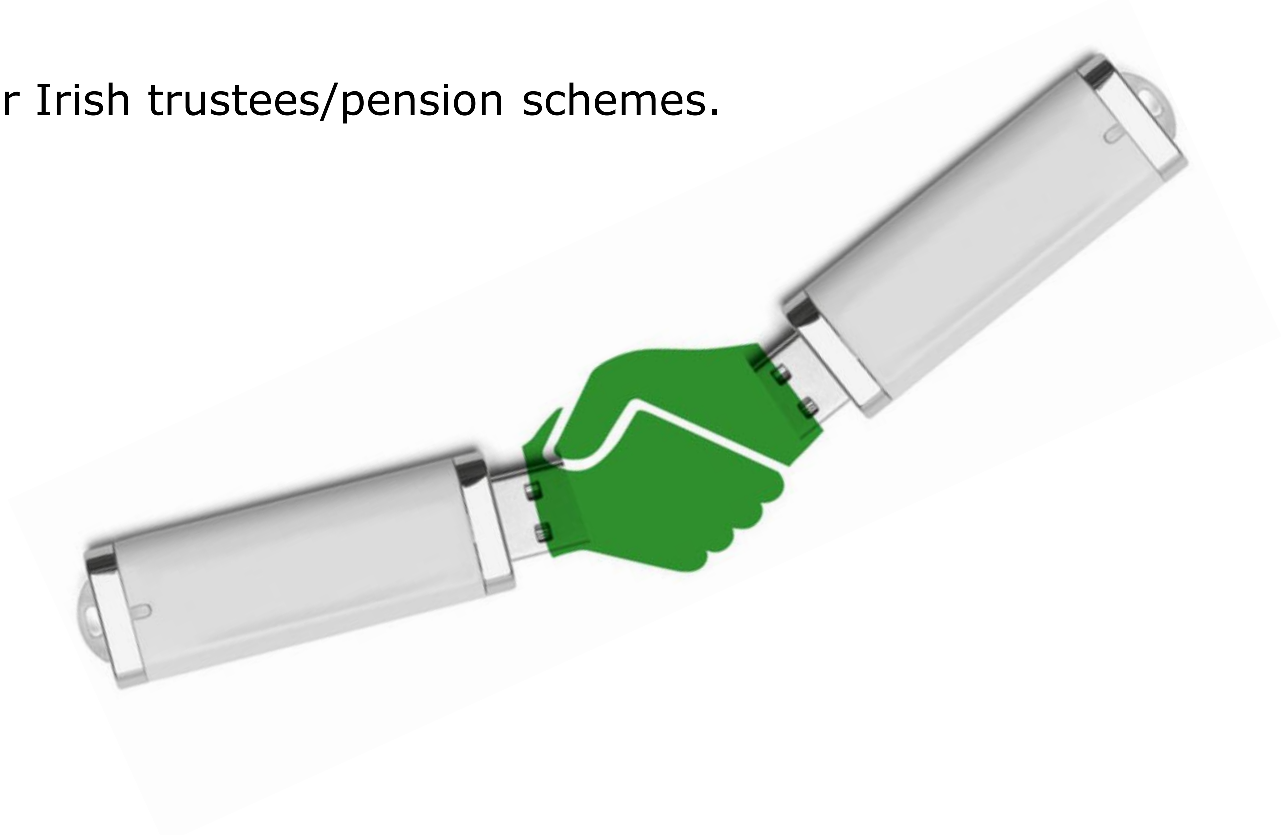
Final RTSs won’t be adopted until July 2022

Who regulates compliance with SFDR?

The Commission has stated that application of SFDR is not conditional on the adoption of the final RTSs – draft RTSs should be referred to pending adoption of final RTSs

Under **Article 14**, Member States must ensure that the 'competent authorities', designated in accordance with the relevant sectoral legislation monitor the compliance of FMPs with SFDR requirements. The competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under this Regulation.

The Pensions Authority is the competent authority for Irish trustees/pension schemes.



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SFDR implementation – perspectives from a fund manager

Society of Actuaries in Ireland

Christine Brentani, Technical Manager, Risk and Compliance, ESG/Sustainability Project

24 September 2021

Agenda

Introduction

SFDR Level 1 Implementation at abdrn including steps taken and challenges

SFDR Level 2 and Taxonomy Regulation – next steps

Conclusion

abrdn

We invest to help our clients create more

Focused on fundamental research

>30

Worldwide operating locations

€532bn

In assets managed for our clients

- More opportunity. More potential. More impact. We offer investment expertise across all key asset classes, regions and markets so that our clients can capture investment potential wherever it arise
- By combining market and economic insight with technology and diverse perspectives, we look for optimal ways to help investors navigate the future and reach their financial goals
- And by putting environmental, social and governance (ESG) considerations at the heart of our process, we seek to find the most sustainable investment opportunities globally. By ensuring the assets we invest in are ready for and resilient to a world in transition, we act as guardians of our clients' assets

Source: abrdn, 30 June 2021

Across broad, deep and diverse investment capabilities

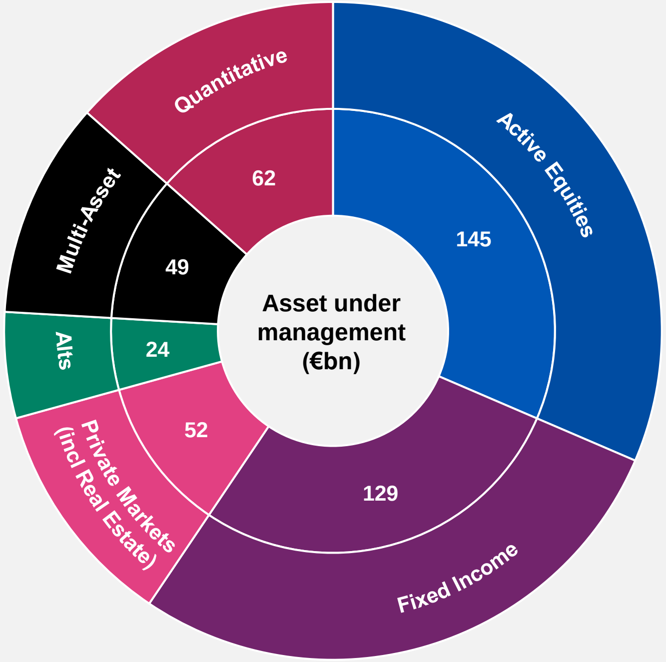
A broad range of asset class capabilities

Globally connected to deliver better investment results and innovation

>1,000*
Investment professionals

25*
Countries investment managers are in

€532bn
Assets under management



- **Independent** and **active** asset manager, AuM >€532bn
- Offering a **comprehensive range** of developed and emerging market equities, fixed income, multi-asset, real estate, quantitative, private markets and alternative solutions
- **High quality research** and fundamental investment understanding underpin sustainable outperformance
- Long-established track record of making ESG considerations core to our investment approach
- **ESG fully embedded** in all our investment processes to generate the **best long-term outcomes for our clients**

Figures may appear not to add due to rounding. An exchange rate of £1:€1.1649 as at 30 June 2021 has been used throughout unless stated otherwise
Source: Aberdeen Standard Investments, 30 June 2021 (* 31 December 2020). AUM breakdown does not include cash/liquidity assets of circa €55bn

SFDR Level 1 – Implementation (1)

How the SFDR rules apply to abrdn

- **abrdn is a financial market participant (FMP) in the following ways:**
  - As a UCITS Management company
  - As an alternative fund manager (AIFM)
  - As an investment firm which provides portfolio management

- **In-scope products:**
  - A UCITS
  - An alternative investment fund (AIF)
  - A portfolio managed in accordance with MIFID II requirements

- **Rules apply in the EU only**
- **Some of our products are wrapped by other FMPs into their insurance-based products. These FMPs will need to make their own product disclosures to their clients**

Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (SFDR)

SFDR Level 1 – Implementation (2)

Product categorisation - shades of green

Article 6 Products	Article 8 Products	Article 9 Products
Sustainability risks are integrated into investment decisions	Product promotes social or environmental characteristics provided the companies in which the investments are made follow good governance practices	Product has sustainable investment as its objective

Source: abrdn, 30 June 2021

SFDR Level 1 – Implementation (3)

Steps taken at abrdn

1. Product categorisation – Article 6, 8 or 9

2. Updated pre-contractual disclosures, i.e., fund prospectuses

3. Updated Article 8 and 9 product website disclosures

4. Updated entity-level website disclosures

  a. How sustainability risks are integrated into the decision-making process

  b. How principal adverse sustainability impacts and indicators are taken into account

  c. How remuneration policies are consistent with the integration of sustainability risks

5. Passed on information to clients who wrap our products

SFDR Level 1 – Implementation (4)

Challenges

- Lack of clear definitions as to what classifies as an Article 8 product - the legislation casts a wide net; FMPs want to avoid greenwashing
- Labelling products explicitly as Article 8, 9 versus just describing the characteristics – will retail clients understand what Article 6, 8, 9 means?
- Dealing with extra requirements from jurisdictions that are gold-plating the EU rules, i.e., French AMF Doctrine

SFDR Level 2 and Taxonomy Regulation – next steps

What is left to do

- **Draft Level 2 rules supplementing SFDR Level 1 require detailed pre-contractual, website, periodic reporting and entity-level principal adverse impact disclosures → we are preparing for these**

- **Taxonomy Regulation imposes requirements to calculate taxonomy alignment of investments in economic activities which qualify as environmentally sustainable, i.e., climate change mitigation, climate change adaptation → we are working with data vendors to obtain the required data**

- **Challenges:**
- **Data availability for required calculations**
- **Final Level 2 regulation has not yet been published**

The legislators have delayed implementation of the Level 2 requirements to 01 July 2022

Conclusion

- Work is being undertaken to ensure new SFDR and Taxonomy rules are implemented on time and that clients have the information they require

- We are in the process of refreshing and updating existing SFDR disclosures and preparing for the first periodic reports

- We continue to communicate with clients on their requirements

- We are working with trade associations to ensure that our views, along with the client perspectives, are taken into account as legislators finalise the rules

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GB-200921-157267-1

Investor Perspective

Robert Meaney, Mercer

Sustainable Finance Disclosure Regulation (SFDR)
Initial Actions – Regulation

- Considerations from an institutional investor perspective – mainly pension schemes, but also insurers, charities, endowments/foundations etc
- Lack of guidance locally – focus has generally been on a principles-based / comply or explain approach
  - Some investors have looked for their own legal advice in this area
- Regulatory requirements – initial
  - ESG / Sustainability Risks Policy
  - Principal Adverse Impacts Statement – comply or explain
  - Remuneration Policy
  - Pre-Contractual Disclosures
  - Public disclosure
  - Confirmation of classification (?)
- Disclosure requirements for decision making

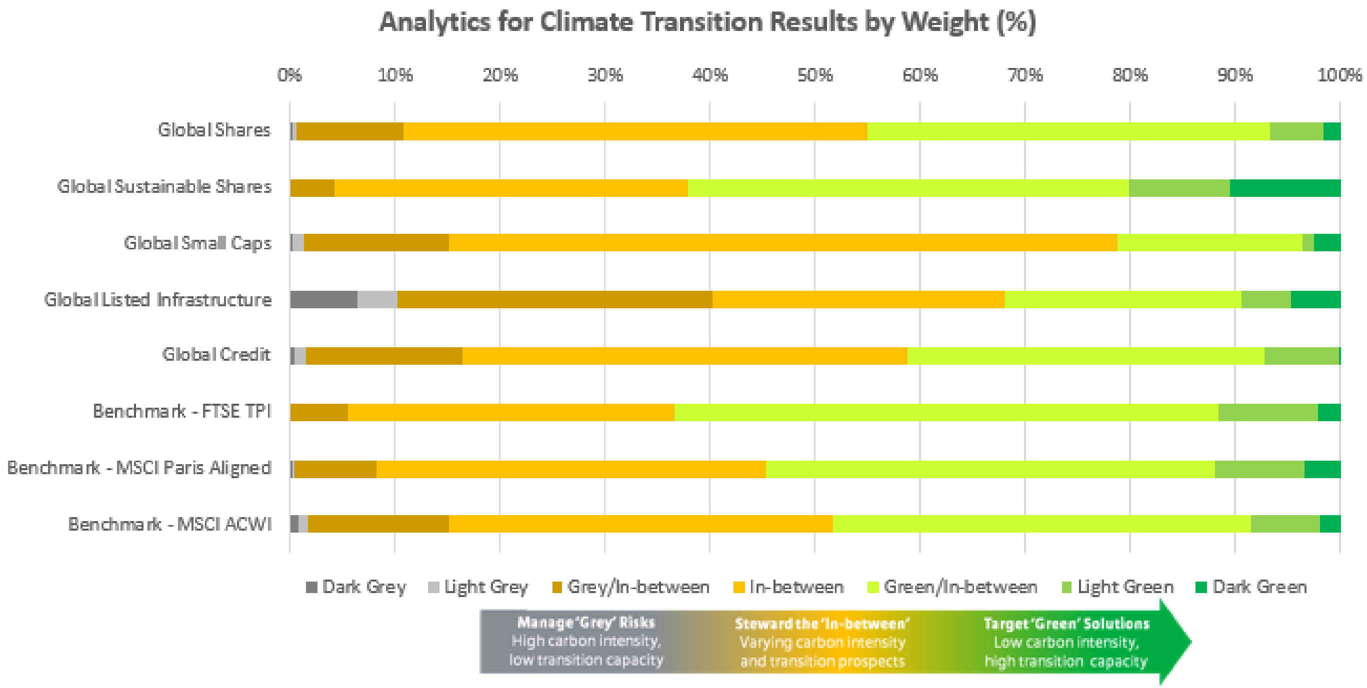
Sustainable Finance Disclosure Regulation (SFDR)
Investment Actions

- Sustainability / ESG has definitely been pushed up the agenda
  - Driven by regulation, stakeholders – personal views, members, sponsors etc
- Investment Strategy / Portfolio Actions
  - Adviser engagement
  - Manager engagement / challenge
  - Alternative Fund Options – Article 8 or 9 offerings
  - Private Markets
  - Net Zero Pathway
  - Climate risk modelling
  - Impact investment / social considerations

Transition to a Low-Carbon Economy
Investors are targeting a <2ºC Scenario

Increasing investor focus to move forward from scenario analysis to target a <2ºC scenario as a priority, because:

1. Risks are increasingly shorter term
2. Opportunities in the next decade
3. Transition scenario more likely than not
4. In investors' interests over the long term



Source: Mercer, with underlying metrics from MSCI ESG Research and ISS

Increasingly being considered by investors, particularly those with medium to long-term time horizon

MERCER

Q&A

Please click on the ‘Raise Hand’ icon

to ask a question

and

<u>wait to be unmuted</u>

or

Use the Q&A function