KPMG

# Asset Management Reporting & Regulatory Update

September 2024

# Agenda

## 18 Sept 2024

| | |
|---|---|
| **Introduction** – Conor Moroney | |
| **Financial Reporting Update** – Conor Moroney | 20 minutes |
| **Regulatory Update** – Déirdre Finn | 15 minutes |
| **SFDR 2.0 Update** – Sarah Moran | 20 minutes |

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# Financial Reporting Update

-

Conor Moroney, Director, Financial Services Audit

# Contents




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# FRC

## Revisions & publications

Conor Moroney, Director, Financial Services Audit

# 1. FRC revises FRS 102

**December 2022**

FRC published Financial Reporting Exposure Draft (FRED) 82 proposing a number of amendments to FRS 102, and other FRSs.

**April 2023**

FRED 82 was open for public comment until 30th April 2023

**March 2024**

On 27th March 2024, the FRC issued amendments to FRS 102 The Financial Reporting Standard applicable in UK and ROI

**January 2026**

The amendments to FRS 102 will be effective for accounting periods beginning on or after 1 January 2026, with early adoption permitted

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# FRC revises FRS 102

## Leases

**Key changes:**

- Based on IFRS 16 Leases
- On balance sheet accounting for all* leases – right of use (RoU) asset & lease liability
- Exemptions available*

**Key simplifications from IFRS 16:**

- More discount rate (DR) options
- Reduced modification triggers requiring a revised DR
- Simpler approach to recognizing gains/losses for sale and leaseback transactions

**Transition:**

***Lessee***

- Apply retrospectively
- No restatement of comparatives
- Cumulative effect of initially applying the standard is recorded as an adjustment to opening retained earnings

***Lessor***

- No transition adjustment – account for leases applying revised FRS 102 from the date of initial application

** Exemptions available for short term & low value leases*

## Key Amendments

***Other amendments also introduced including, revisions to business combinations, fair value measurement, uncertain tax positions, supplier finance arrangement disclosures and a revised Section 2 aligned with the IASB's Conceptual Framework***

## Revenue

**Key changes:**

- Based on IFRS 15 Revenue from Contracts with Customers
- Apply 5-step revenue recognition model
- Focus on control, not transfer of risk & reward
- Consider impact on contracts with bundles of goods/services, variable consideration, warranties, customer options, or significant financing components.

**Key simplifications from IFRS 15:**

- Accounting policy choice for capitalisation of costs to obtain a contract.
- May apply the five-step model to portfolio of similar contracts.
- Simplifications for allocating discounts.
- Disclosures are aligned to IFRS for SMEs.

**Transition:**

- Apply retrospectively
- Option to either:
  1. Restate comparatives (FRS 102 10.12)
  2. Not restate comparatives, record cumulative effect of initially applying the standard as an adjustment to opening retained earnings.

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# Revised FRS 102 - Other Amendments based on IFRS developments

## Conceptual framework

### Updates to Section 2 Concepts and Pervasive Principles

A revised Section 2, updated to reflect the IASB's Conceptual Framework for Financial Reporting, issued in 2018.

## Fair Value

### Updates to Section 2A Fair Value Measurement

- A new Section 2A of FRS 102, replacing the Appendix to Section 2.
- Definition of fair value revised based on IFRS 13 definition (effective 2013).
- More comprehensive guidance on fair value measurement.

## Small Entity disclosure

### Small Entity disclosure requirements

**Section 1 A – UK Entities**

- No change in requirement to give a true and fair view or in legally required minimum disclosures
- No longer any 'encouraged' disclosures
- Additional disclosures now specifically identified as required

**Section 1 A – Ireland Entities – No change**

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# Section 2A Fair Value Measurement of FRS 102

Fair Value Measurement Guidance (aligning with IFRS 13):

## 1. Market Participant Assumptions:

- Focus on assumptions market participants use in pricing.
- Additional guidance on determining market participant assumptions.

## 2. Fair Value Hierarchy:

- Level 1: Quoted prices in active markets for identical assets/liabilities.
- Level 2: Observable inputs other than quoted prices.
- Level 3: Unobservable inputs (internal data or management assumptions).
- Clarification on the distinction between levels and when to rely on observable vs. unobservable inputs.

## 3. Improved Disclosure Requirements:

- Detailed disclosures on fair value measurements, especially for Level 3 inputs.
- Description of valuation techniques, sensitivity analysis, and changes in valuation approach

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# Revised FRS 102– Other Incremental Improvements

## Section 3

### Financial statement presentation

- Positive statement re. GC basis application and consideration of future.
- Guidance re. the role of materiality & aggregation of information.

## Section 11/12

### Basic and other FI

- Removal of IAS 39 option (unless already applied)

## Section 19

### Business Combination and Goodwill

- Identifying the acquirer
- Consideration vs remuneration
- Additional Disclosure requirements

## Section 26

### Share based payments

- Share based payment with cash alternative

## Section 29

### Income Taxes

- Uncertain Tax treatments (IFRIC 23)

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# FRC revises UK Corporate Governance Code

## UK Corporate Governance Code 2024

The UK Corporate Governance Code applies to all companies with a premium listing in the UK; other companies may choose to apply it voluntarily

On 22nd January 2024, the FRC published a revised version of the UK Corporate Governance Code (2024 Code)

On 29th January 2024, the FRC published guidance to support users of the code.

Provides advice, further detail and examples of good practice and will stimulate boards' thinking on how they can carry out their role in governing the company effectively.

Boards flexibility to "comply or explain" remains the foundation of the 2024 Code.

Compliance can mean either complying with the Code's provisions or providing a "cogent and justified" explanation for why a provision is not suitable

The 2024 Code will apply to financial years beginning on or after 1 January 2025*

**Except for provision 29, relating to the requirement for a board declaration on the effectiveness of risk management and internal controls, which will apply from 1 January 2026*

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# 2024 Code - Key changes

## 01

### Audit, risk & internal control

- **Principle O** expanded to clarify board responsibility for maintaining effectiveness of the risk management & internal control framework.
- **Provisions 25 & 26** updated to reflect FRC's Minimum Standard on Audit Committees & the External Audit
- **Provision 29** introduces new reporting obligations for boards in their annual report. Under provision 29, boards are now required to report on the effectiveness of a company's material internal controls.

## 02

### Board leadership & company purpose

- **Principle C** now requires that governance reporting focuses on board decisions & outcomes in the context of strategy & objective
- **Provision 2** expands the board's role to ensure that the desired company culture has been embedded within their organisation.

## 03

### Composition, success & evaluation

- **Provision 23** amended to acknowledge that companies may have further initiatives in place alongside their diversity and inclusion policy.
- **Principle J** amended to promote diversity, inclusion & equal opportunity, without referencing specific groups

## 04

### Remuneration

- **Provision 37** amended to specify the inclusion of malus & clawback provisions in directors' contracts and/or other agreements
- New **Provision 38** requires companies to describe their malus & clawback provisions in the annual report
- **Provision 40** has been removed

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# FRC Thematic Review


***FRC Thematic Review of reporting by the UK's largest private companies, published 31 January 2024***

- **Considered:**
    1. Strategic report
    2. Presentation of primary statements including cashflow statement and supporting notes
    3. Revenue
    4. **Judgements & estimates**
    5. Provisions & contingencies
    6. **Financial instruments**
- **Quality of reporting was mixed, particularly for complex or judgemental matters**
- **Better practice examples demonstrated clear, concise & consistent reporting**
- **Good quality reporting does not necessarily require greater volume**
- **Issues identified could have been avoided with sufficient critical review & scrutiny**

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# Reporting by the UK's largest private companies: key observations

**01**

The **best strategic report** disclosures focused on the elements of development, performance and position that are **key for an understanding of the company**, explained in a **clear, concise & understandable** manner that was **consistent** with the disclosures in the financial statements.

**02**

To enable users to fully understand a business, disclosures should **explain the nature of its operations** and how (where relevant) it **fits into** a wider **group structure**.

**03**

Accounting policies for complex transactions/ balances were often **boilerplate**. **Entity-specific policies** are particularly critical for revenue, better examples explained the nature of each significant revenue stream, the timing of recognition and how the value of revenue was determined.

**04**

Better examples of judgement/ estimate disclosures included **detail of the specific judgement involved** and **clearly explained** the **rationale for the conclusion**. The significance of estimation uncertainty was much more apparent when sensitives were quantified.

**05**

For some **material provisions**, **the level of detail** provided on **the nature of the obligation and associated uncertainty was insufficient**. Users benefit from clear disclosures of this information to allow them to fully understand the risks affecting the company.

**06**

**Disclosure of financial instrument risks** was generally **boilerplate**, describing the nature of the risks without explaining why they are relevant. Better examples explained the specific nature of the risk and quantified the exposure and sensitivity to potential future changes.

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# IFRS 18

## Presentation and disclosure in Financial Statements

Conor Moroney, Director, Financial Services Audit

# IFRS 18 - Presentation and disclosure in Financial Statements

**"IFRS 18 Presentation and disclosure in Financial Statements" will replace "IAS 1 Presentation of Financial Statements"**

## What's the issue?

*Investors' calls for more relevant, transparent and comparable information*

## What's the impact?

- *IFRS 18 will replace IAS 1*
- *More structured income statement*
- *Disclosed and* ***audited*** *Management Performance Measures* ***(MPMs)****
- *Greater disaggregation of information*

## What's next?

- *Effective from 1 January 2027 and applies retrospectively*
- *Early adoption is permitted*
- *Comparatives are required in first year of application*

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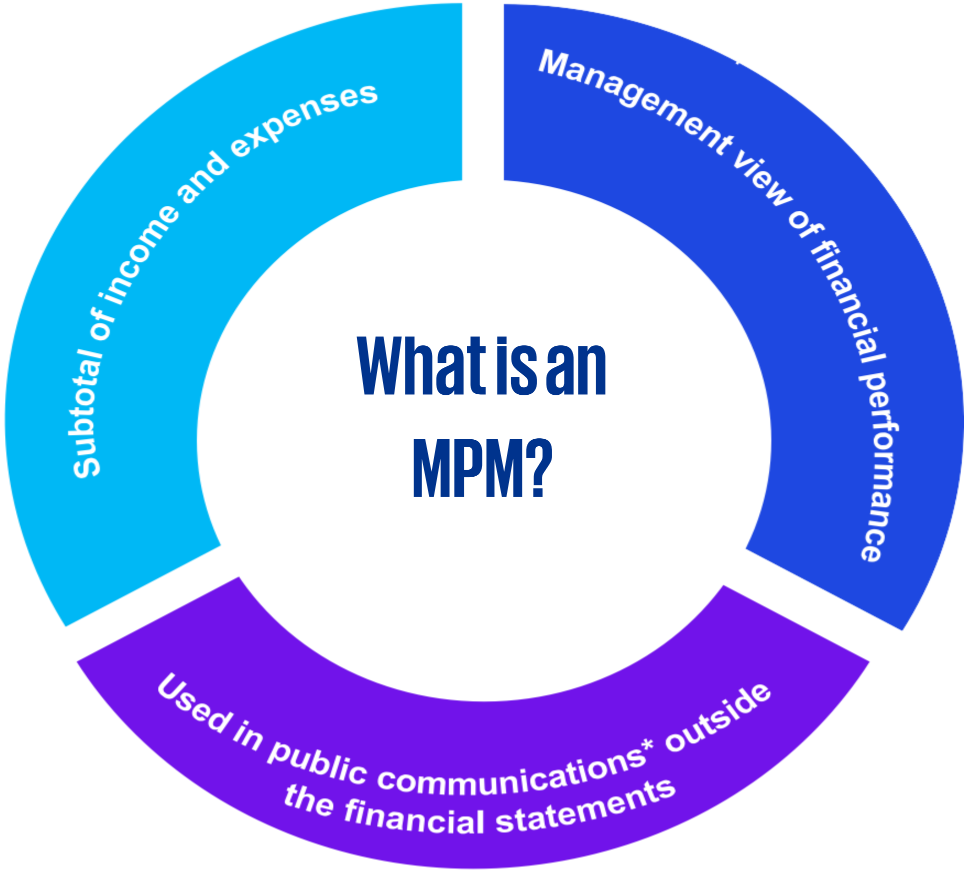
# Which 'non-GAAP' measures are now reported in the financial statements?




The **definition** of **Management Performance Measures (MPMs)** is **narrow**.

**MPMs** are a sub-set of non-GAAP measures and must be reported separately in a **single** note.

MPMs **exclude** the following:

- Non-financial performance measures – e.g. customer satisfaction statistics.
- Financial performance measures that are not subtotals of income and expenses – e.g. free cash flow.
- Totals/subtotals specified in IFRS® Accounting Standards – e.g. gross profit.

MPMs will now be reported in the financial statements **and subject to audit**. As a result, companies may decide to revisit the purpose and relevance of existing 'non-GAAP' measures communicated outside of the financial statements.

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# What are the new disclosures for MPMs?

In a **single** note in the financial statements, a company:

- states that the MPM provides management's view of the company's financial performance
- explains why the MPM provides useful information and how it is calculated;
- reconciles the MPM to a total/subtotal specified in IFRS Accounting Standards, including the tax and non-controlling interest effects for each reconciling item; and
- **explains any changes – e.g. changes to calculations and any new MPMs.**

## Notes to the financial statements

| | 20X7 | Tax effect | Effect on NCI |
|---|---|---|---|
| **Adjusted operating profit (MPM)** | **X** | | |
| Restructuring costs | (X) | (X)[a] | (X) |
| **Operating profit** | **X** | | |

[a] The tax effect of restructuring costs in [*Country S*] is calculated based on the statutory tax rate applicable in [*Country S*] at the end of 20X7, which was X percent.

The same requirements apply for both public and private entities

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# What will the income statement look like?

**1**

**Two newly required subtotals** on the face of the income statement

| Income statement<br>Companies without specified main business activities | | |
|---|---|---|
| Operating | Revenue | X |
| | Operating expenses (analysed by nature, function or both as appropriate) | (X) |
| | **Operating profit** | **X** |
| Investing | Share of profit or loss of equity-accounted investees | X |
| | Income from other investments | X |
| | Interest income from cash and cash equivalents | X |
| | **Profit or loss before financing and income tax*** | **X** |
| Financing | Interest expense on borrowings and lease liabilities | (X) |
| | Interest expense on pension liabilities | (X) |
| | **Profit before tax** | **X** |
| | Income tax | (X) |
| | **Profit for the year** | **X** |

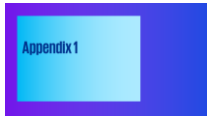
* Companies providing financing to customers as a main business activity (e.g. banks) typically do not present this subtotal.

**2**

Income and expenses classified into three categories, depending on a company's main business activities

**3**

Results of equity-accounted investees no longer presented as part of operating profit (now always in the investing category).




Appendix 1



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# Will companies change how they group information in the financial statements?

## Potentially, yes!

Companies now have enhanced guidance on grouping – i.e. aggregating and disaggregating – information in the financial statements.

This includes:

- **newly defined 'roles'** for the primary financial statements and for the notes;
- **shared characteristics** of items as a basis for aggregation and disaggregation – e.g. nature, function, size, geographical location and regulatory environment; and
- **single dissimilar characteristic**, which can result in disaggregating items, if material.

**New disclosures apply to discourage companies from labelling items as 'other' and aggregating items into large single amounts.**

**Determining how to group information remains a judgement area**

More **aggregated** information

### Role of the primary financial statements

Provide a '**useful structured summary**' of the company's assets, liabilities, equity, income, expenses and cash flows

More **disaggregated** information

### Role of the notes

Provide additional **material** information

**Materiality** continues to apply when presenting and disclosing information in the financial statements. However, for the primary financial statements, companies will also need to consider if the statements provide a 'useful structured summary'.

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# Other changes

## Cash flow statement

- **Operating profit is the starting point** for the indirect method.

- The **option** for classifying interest and dividend cash flows as **operating activities** has been **eliminated**.

**Cash flows (general model)***

| Financing | Investing |
| --- | --- |
| ▪ Dividends paid | ▪ Dividends received |
| ▪ Interest paid | ▪ Interest received |

*Classifying interest and dividends will differ for companies with specified main business activities.

## Balance sheet

- **Goodwill** is presented as a new line item on the face of the balance sheet.

| | |
| --- | --- |
| Property, plant and equipment | |
| **Goodwill** | **X** |
| Intangible assets | |
| **Total non-current assets** | **X** |


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# Key takeaways....

## More structured income statement

- New subtotals including ‘operating profit’
- Income and expenses classified into three categories – operating, investing, financing
- Main business activities drive the classification of income and expenses

## Disclosed and audited MPMs

- MPMs* are now disclosed in the financial statements <u>and subject to audit</u>
- MPMs capture some but not all ‘non-GAAP’ measures
- New disclosures may involve additional effort

* Management performance measures

## Greater disaggregation of information

- New disclosures for items labelled as ‘other’
- Enhanced guidance on how to group information within the financial statements
- Remains a judgement area


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# Appendix 1

# IFRS 18 - What are the new categories of income and expenses?

All companies classify income and expenses into three new categories.

**Operating** – income/expenses arising from a company's main business activities and anything not investing or financing.

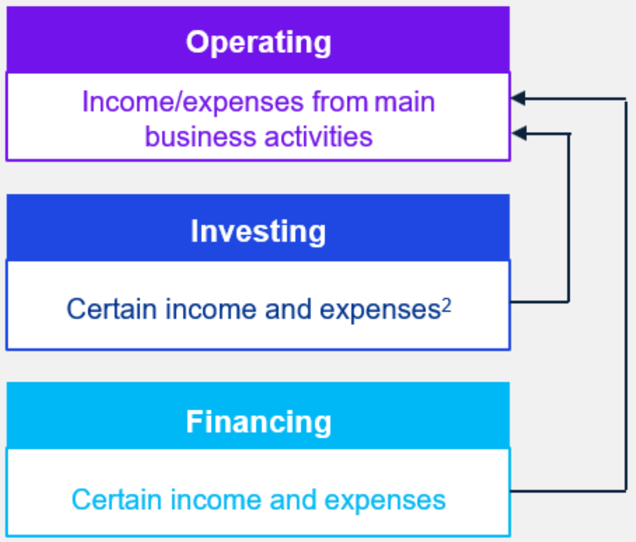
**Investing** – income/expenses from:

- investments in associates, joint ventures and unconsolidated subsidiaries;
- cash and cash equivalents; and
- assets that generate a return individually and largely independently (e.g. rental income from investment properties).

**Financing** – comprising:

- income/expenses from liabilities related to raising finance only (e.g. interest expense on borrowings); and
- interest income/expense and effects of changes in interest rates from other liabilities (e.g. interest expense on lease liabilities).

Companies with **specified main business activities**[1] classify additional items of income and expense in the **operating** category that would otherwise be classified in **investing** or **financing**.




[1] This term is defined in IFRS 18 as investing in assets (e.g. real estate companies, insurers) or providing financing to customers (e.g. banks).

[2] Share of profit/loss of equity-accounted investees is always classified in investing.

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# IFRS 18 - How does the nature of your business activities impact the categories?

The classification of income and expenses varies depending on a company's main business activities.

Companies with multiple main business activities that include specified main business activities may find it onerous to classify income and expenses in the income statement.

| | Manufacturer A | Manufacturer B | Bank | Real estate |
|---|---|---|---|---|
| **Main business activities** | Manufacturing and sales of goods | Manufacturing and sales of goods and providing finance to customers | Providing finance to customers | Investing in assets |
| **Interest expenses on borrowings** | Financing | Operating* and choice between operating and financing** | Operating* and choice between operating and financing** | Financing |
| **Gains/losses on investment property** | Investing | Investing | Investing | Operating |

* Includes all interest expenses from borrowings that relate to providing financing to customers.

** An accounting policy choice applies to interest expense from borrowings that do not relate to providing financing to customers.


Face of SOCI

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# IAASA's Observations Document YE 2023

# IAASA: the bigger picture impacting entities

**Macro economic impacts:** Inflationary pressures, interest rate increases, elevated energy prices, and concerns over consumer sentiment – a challenge for many issuers.

Issuers must provide **greater transparency** about the impact of interest rate risks and liquidity risks on their financial position, performance and cash flows.

the **going concern**, may need to consider:
(a) a greater number of factors than in the past, &
(b) reflect the impact of those factors evolving more quickly.

**Re-financing**:
Inflation & interest rates may prompt issuers to seek additional financing or amend terms of existing facilities leading to modification of financial instruments.
**Other financial risks** Macro-economic environment may require changes in the methods and assumptions used in the preparation of the **sensitivity analysis**, which should be disclosed if significant.

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# IAASA's key observations

## Fair-value measurement and disclosures

Ensure that changes in interest rates and/or investor demand are factored into the fair value.

Are the key assumptions disclosed? , Are significant changes explained? Has climate been factored into FV where material?

## IAS 36 *Impairment of Assets*

Consider the background of both macro-economic uncertainties.

Do impairment assumptions remain reasonable and supportable [IAS 36.33(a) refers]?

Consider is the market capitalisation an impairment indicator?

## Alternative performance measures (APMs)

Instances of APMs non-compliance recurring include: check labelling, APM's are defined, adjusted APMs are defined & explained, and link the APM and & the relevant IFRS measures.

## Climate risks in VIU calculations

Climate risks may be an impairment indicator.

VIU calculations & key assumptions must be updated to reflect climate risks.

Is future expenditure related to climate risk targets included in VIU calculations?

ESMA's Guidelines on APMs can be found on the ESMA website.

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# Other topics

**The 2023 Annual Observations document can be found on IAASA's website.**

## 01

**Expected credit losses (ECL) and significant increase in credit risk (SICR)**

**Forward-looking information (FLI) &**

**Post model adjustments (PMAs)**

## 02

**IFRS 8 Operating Segments**

IAASA has continued to examine issuers' disclosures of their operating segments and, in particular, ensure they are reporting the segments that correspond to their internal management reports.

## 03

**European single electronic format (ESEF)**

ESMA has recently published an updated ESEF Reporting Manual applicable to the 2023 financial year.

## 04

**Going concern.**

Increased vulnerability of some issuers in the current macro-economic environment may raise questions about their to continue as going concerns.

## 05

**Covenants**

The effects of inflation and interest rates may impact an entity's ability to meet the covenant requirements included in facility agreements.

## 06

**Amendments to IAS 1**

*Presentation of Financial Statements* and IFRS Practice Statement 2: *Disclosure of Accounting Policies*

The amendments require issuers to disclose their material accounting policy information rather than their significant accounting policies

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# KPMG's Accounting Advisory Team

Our specialised accounting advisory team has significant experience in advising asset management clients on complex accounting issues arising from business transactions, business decisions and from new or revised accounting standards. Typically these complexities are driven by:

- The establishment of new fund structures & consideration of consolidation requirements
- Fund re-domiciliation's and re-organisations
- The establishment of securitisation vehicles
- IFRS 9 classification and measurement considerations
- Structured finance transactions
- Fund manager remuneration schemes
- Revenue recognition requirements for management fees and performance based fees


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# Regulatory Update

Déirdre Finn, *Director, Risk and Regulatory Consulting*

# Central Bank of Ireland Risk Themes

**Risk Theme A** — **Drivers: Macroeconomic and geopolitical environment**

1. **Risk Area 1**: Inflation and interest rate risks
2. **Risk Area 2**: Asset valuation and market risk
3. **Risk Area 3**: Liquidity and leverage risks
4. **Risk Area 4**: Credit and counterparty risks

**Risk Theme B** — **Drivers: How regulated entities are responding to today's changing world**

5. **Risk Area 5**: Consumer and investor detriment risks
6. **Risk Area 6**: Operational risks and resilience
7. **Risk Area 7**: Risk management practices and risk transfer
8. **Risk Area 8**: Data deficiencies and modelling risks

**Risk Theme C** — **Drivers: Longer term structural forces at play**

9. **Risk Area 9**: Climate and other environmental-related risks
10. **Risk Area 10**: Financial crime risks
11. **Risk Area 11**: Strategic risks

***Note****: Risks are not ranked or of equal importance*

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# Key CBI Supervisory Priorities 2024/25

Ireland is one of the **largest hubs for investment funds globally** and is also **host to the largest Exchange Traded Fund (ETF) and Money Market Fund (MMF) sectors in Europe**. Given this footprint and the remit that that Central Bank of Ireland holds over the supervision of the Funds sector, this **sector will continue to be a priority focus**. In its most recent Regulatory Supervisory Outlook, the Central Bank identified the following key priorities for the sector:

1. Risk-based scrutiny and approval of prospectus applications, fund applications, fund service provider applications and new trading venues
2. Completion of the ESMA Common Supervisory Action on Sustainable Finance Disclosure Regulation (SFDR)
3. Participation in ESMA's Depositary Peer Review
4. Conclusion of thematic reviews on pre-trade controls frameworks and feeding into ESMA's corresponding Common Supervisory Action
5. Implementation and operationalisation of EU Green Bond authorisations and post-authorisation filings for issuers
6. Sectoral/thematic assessments, including the completion of the ESMA Common Supervisory Action on the SFDR
7. Further development of an understanding of the use of AI and related governance processes from a conduct perspective, in particular for trading activities and corresponding opportunities and/or potential negative impacts on market integrity
8. Continuing to enhance the capacity to identify and pursue instances of market abuse

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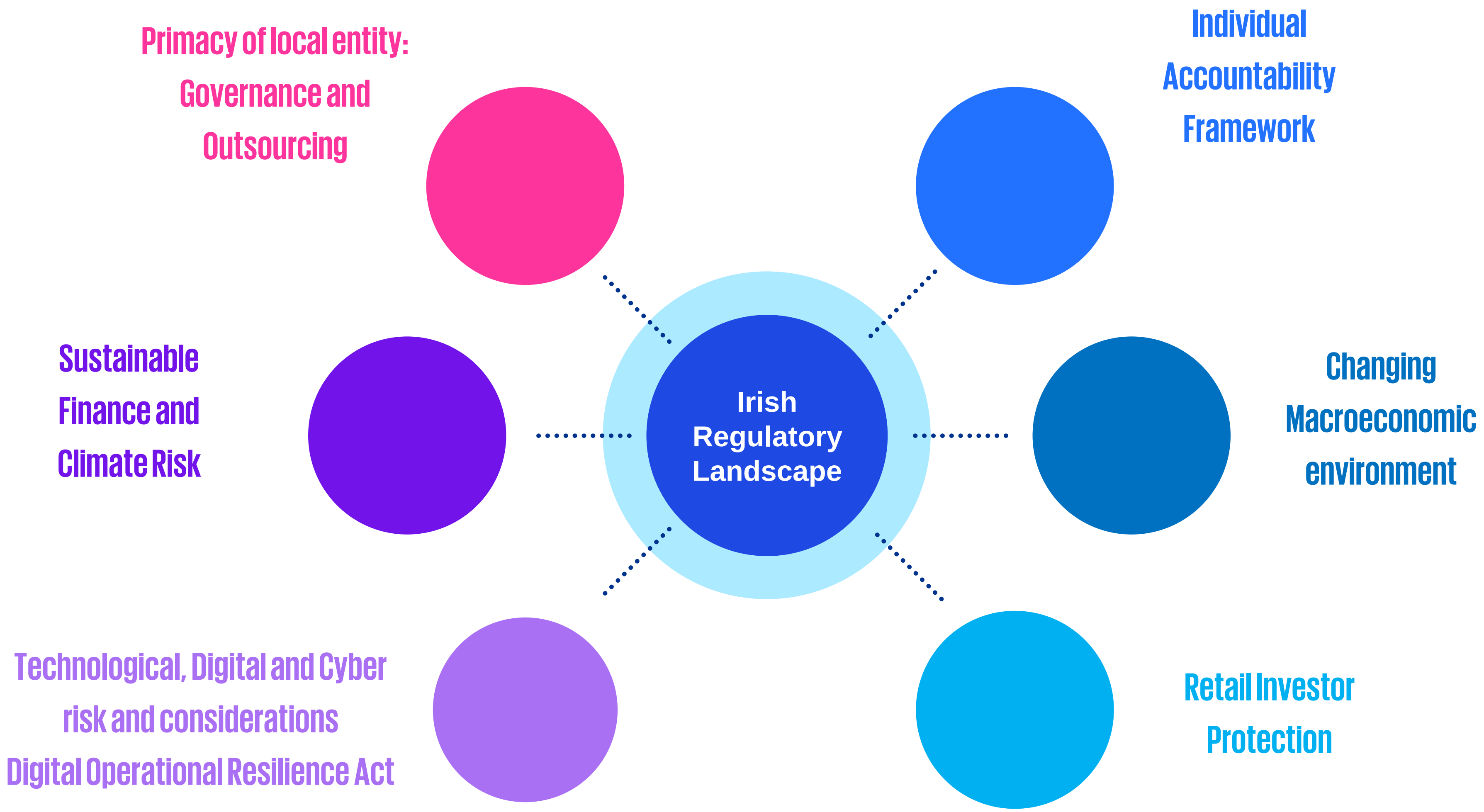
# Topical Regulatory Issues

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# Senior Executive Accountability Regime

The Senior Executive Accountability Regime (SEAR) will come into affect on the 1 July 2024 for individuals who hold a Pre-Approval Controlled Function (PCF) role at in-scope firms and on the 1 July 2025 for Independent Non-Executive Directors (INEDs) and Non-Executive Directors (NEDs). The introduction of SEAR forms part of the wider Central Bank of Ireland Individual Accountability Framework (IAF) and places obligations on firms to set out clearly where responsibility and decision-making lies for the business and to clearly document what those responsibilities entail.


## Allocated Responsibilities

- **Prescribed Responsibilities** – defined by the CBI, **must be allocated to a PCF**. CBI does not intend being overly prescriptive in terms of allocation
- **Inherent Responsibilities –** inherent to a particular role e.g. CEO, CRO, etc.
- **Other Responsibilities** – any other material activities or risks not captured by prescribed responsibilities

## Management Responsibility Map

- One document to be prepared summarising overall governance arrangements (including outsourcing)
- Should demonstrate that there are no gaps in responsibilities across firm
- Document must be kept up to date, retained for 10 years and be available to the CBI on request

## Statements of Responsibility

- Firms will need to clearly set out the responsibilities of each individual in a PCF role in their Statement of Responsibilities
- Draft Statement of Responsibilities is set out in the CBI's Constitution Paper
- Statement must be kept up to date, retained for 10 years and be available to the CBI on request

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# DORA Overview

DORA creates a regulatory framework for digital operational resilience under which firms must ensure that they can withstand, respond to and recover from all types of ICT-related disruptions and threats. The requirements will be homogenous across all EU member states.

## Objectives:

### A broader EU Digital Finance Package:

- Digital finance strategy
- Proposal on markets in crypto-assets (MiCA)
- Proposal on distributed ledger technology (DLT)

### Fostering technological development

- Encouraging innovation
- Supporting competition

### Ensuring financial stability and consumer protection

- Resilience of financial infrastructure and institutions
- Minimising harm to consumers

## Scope:

### Harmonisation of rules

- Streamlining and upgrading existing financial legislation
- Plugging gaps in the framework

### Strengthening oversight

- Coherence and consistency
- Raising awareness of ICT risk

### Extending the regulatory perimeter

- Capturing a wider range of financial entities
- Bringing third parties in scope

## Approach:

### A European approach

- 27 Member States
- European Commission, Council and Parliament
- European Supervisory Authorities & National Competent Authorities

### Clear priorities

- ICT Governance & Risk Management
- ICT-related Incident Management & Reporting
- Digital Operational Resilience Testing
- Information Sharing
- ICT Third-Party Risk Management

### Prescriptive requirements

- Overarching rules and detailed technical standards

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# The Timeline

**611**
Subsection included in the DORA across 47 Articles

**27**
Member states impacted by DORA

**1** **First time**
Exercise, there is no blueprint.


### Start
- ✓ DORA gap analysis / determination of the situation
- ✓ Definition of responsibilities
- ✓ Identification of other dependent projects

**Consultation phase** – 19/6/2023 (Batch 1) / 12/8/2023 (Batch 2)
- ✓ Consideration of new insights from consultations
- ✓ Involvement of all relevant entities
- ✓ Implementation planning

**Station 1 – 17 January 2024**
- ✓ Publication final draft RTS / ITS (Batch 1)
- ✓ Final review involving relevant entities

**Station 2 – 17 June 2024**
- ✓ Publication final draft RTS / ITS (Batch 2)
- ✓ Final review involving relevant entities

**Sprint - Final implementation phase**
- ✓ Implementation support
- ✓ Possible start of preparation for first DORA supervisory examinations (OSI)

**17 January 2025**
Goal
**DORA compliance**

**Outlook**
- ✓ OSI-preparation


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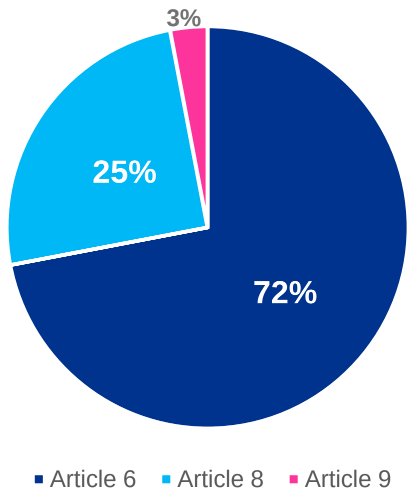
# SFDR 2.0 Update

Sarah Moran, *Director, Sustainable Futures*

# Market Snapshot – Lux & Ireland focus




Based on Maples Group’s analysis of over 26,000 funds across Luxembourg and Ireland it was found that **over 28% of funds are sustainability focused** (i.e. are categorised as either Article 8 or Article 9)

**20% YoY**

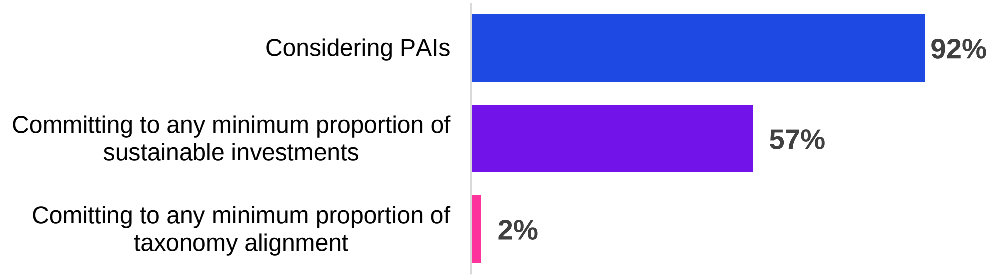
Increase in the number of Article 8 and 9 Funds

**51%** of new funds in 2023 were Article 8 or Article 9. At this growth rate we expect that **Article 8 and 9 funds will likely represent more than half** of the European fund universe in the near future.

## ETF sector has embraced SFDR

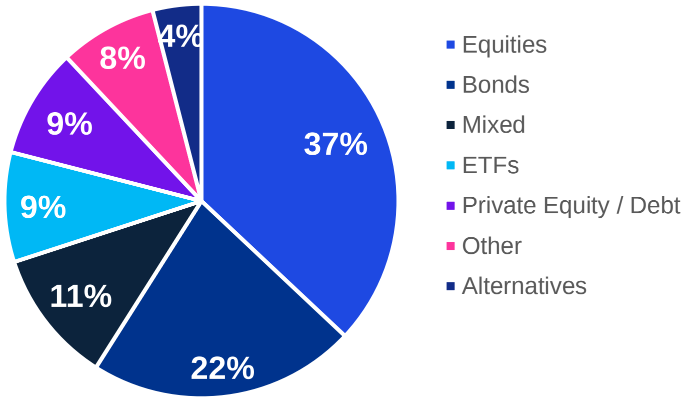
32% of ETFs in the sample **are categorised as Article 8 funds** which is above the average for the broader fund sector.

## Article 8 Funds & MiFID Sustainability Preferences

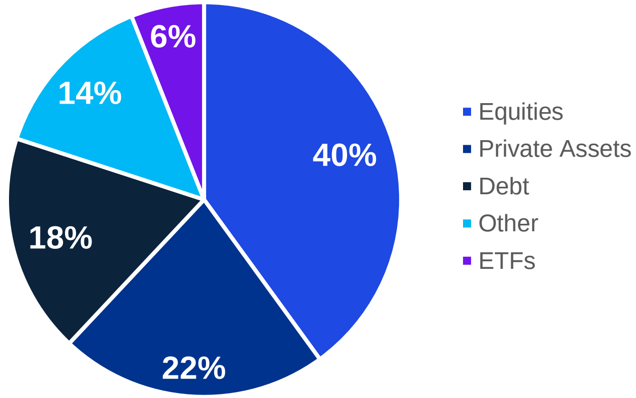



- 92% of the sample are choosing to satisfy the consideration of PAIs at fund level to meet the MiFID sustainability preferences
- Commitment to holding Taxonomy aligned investments remains significantly low at 2%. Although CSRD may increase this in the longer term.
- Ascertaining whether an investment is Taxonomy-Aligned is still quite challenging for managers due to the lack of available, reliable and / or verifiable data

## Asset Allocation in Article 8 Funds




## Asset Allocation in Article 9 Funds





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**Source:** SFDR Impact Analysis 2nd Edition (maples.com)

# The evolution of SFDR...

2021 L1

- SFDR regulations EUR-Lex - 02019R2088-20200712 - EN - EUR-Lex (europa.eu)
- Joint Consultation on Taxonomy-related sustainability disclosures (europa.eu)

- Dear CEO Letter Nov 2021
- Sustainable Finance Disclosure Regulation : Process clarifications for UCITS and AIFs precontractual documentation updates applicable 10 March 2021
- Process clarifications for UCITS and AIFs precontractual documentation updates in relation to the Taxonomy Regulation1 and Level 2 measures in relation to the Sustainable Finance Disclosure Regulation Nov 2021

2022

- SFDR RTS Delegated regulation - 2022/1288 - EN - EUR-Lex (europa.eu)
- Updated Joint ESA Supervisory Statement on the application of the SFDR Mar 2022
- ESMA supervisory briefing addressed to EU NCAs to promote common supervisory practices on the SFDR May 2022
- ESAs clarifications on the SFDR RTS. June 2022
- European Commission Q&A on 25 May 2022
- ESAs Call for Evidence on greenwashing (europa.eu)
- Consultation on Guidelines on funds' names using ESG or sustainability-related terms (europa.eu)
- Call For Evidence on market characteristics for ESG Rating Providers in the EU (europa.eu)

- Process clarifications for UCITS and AIFs precontractual documentation updates in relation to the Level 2 measures in relation to the Sustainable Finance Disclosure Regulation Oct 2022
- Sustainable finance and the asset management sector: Disclosures, investment processes & risk management Nov 2022

2023 L2

- EU Commission targeted consultation on the implementation of the SFDR)
- Joint consultation on the review of SFDR Delegated Regulation (europa.eu)
- Review of the SFDR disclosures – public event on the ESA's consultation (europa.eu)
- Commission Notice - EU Taxonomy and links to SFDR July 2023
- ESMA and NCAs to assess disclosures and sustainability risks in the investment fund sector (europa.eu)
- ESMA34-1592494965-554 Public statement on Guidelines on funds' names (europa.eu)
- JC 2023 18 - Consolidated JC SFDR Q&As (europa.eu)
- JC 2023 55 - Final Report SFDR Delegated Regulation amending RTS (europa.eu)

- Process clarifications for UCITS and AIFs pre-contractual documentation updates in relation to the Commission Delegated Regulation (EU) 2023/363 Feb 2023
- Sustainable Finance in Practice for Fund Managers - Remarks by Patricia Dunne, Director of Securities and Markets Supervision (centralbank.ie)
- "An evolving supervisory approach in the funds sector" - Remarks by Patricia Dunne, Director of Securities and Markets Supervision at the Irish Funds Asset Manager Forum (centralbank.ie)

2024

- JC 2023 18 - Consolidated JC SFDR Q&As (europa.eu) Jan 2024
- Fact Book | EFAMA
- ESMA34-472-440 Final Report on the Guidelines on funds names (europa.eu)
- EFAMA response to ESMA Consultation on fund names using ESG terms | EFAMA
- ESA Final Report on Draft Regulatory Technical Standards (RTS) on the Review of PAI and Financial Product Disclosures in the SFDR Delegated Regulation
- JC 2024 06 Joint ESAs Opinion on the assessment of the SFDR (europa.eu)
- ESMA36-287652198-2699 Final Report on Greenwashing (europa.eu)

- CBI Regulatory & Supervisory Outlook

SFDR 2.0


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# Common critiques of SFDR

## Definition of "sustainability"

Definitions of **sustainability** between SFDR and EUT (EC & ESAs)

No uniform methodology for "Sustainable Investments" (PSF)

EU T should become the sole, common reference point for sustainability (ESMA)

## Article 8 "promoting sustainability"

Article 8's limitations (all but one vs or only one) (PSF)

Article 8 is too broad (ESAs)

Minimum disclosures for all financial products required (ESMA)

## Data requirements

Access to data is needed for continuous monitoring – to make sure commitments are met (PSF)

Information not sufficiently clear to retail investors (ESAs)

Consumer and industry testing should be carried out before Implementation (ESMA)

## Categorisation

"Embrace" categorisation (ESAs)

Introduction of product categorisation for sustainability and transition required (ESMA)

## Transition investments

Legislate for transition (ESA)

Transition categories (PSF)

Definition of transition investments should be incorporated (ESMA)

**Watch out for the EUT Capex KPI**

## The EC's original "Ask"

Extend the list and refine the content of "PAIs* to include more S topics

Transparency by financial products around decarbonisation targets, including intermediary targets and milestones, where relevant, and actions

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# A new era emerging for SFDR...

## Joint ESAs opinion on assessment of SFDR

- Product **classification** incl. "sustainability' and 'transition'
- Consumer **testing**
- Revisit concepts of "**Sustainable**"
- Extend scope to more products

Joint ESAs Opinion

## EFAMA Factbook

**"Less of a puzzle, more of a plan"**

- A more **user-friendly** disclosure regime
- **Categorisation** system for financial products (products contributing positively, "transitioning" products, products adhering to specific sustainability themes/credible sustainability standards

Fact Book | EFAMA

## ESMA's final report in naming guidelines

- 80% **threshold** – proportion of env / social / sustainable investments)
- **Exclude** investments referred to in PAB/CTB screens
- For sustainability-related terms, commit to invest **meaningfully** in sustainable investments

ESMA | Naming Guidelines

## ESMA's final report in Greenwashing

- NCAs and ESMA have been implementing a **risk-based approach** to supervision – building sustainability-related capacities and expertise through training programs

ESMA | Greenwashing

## ESMA's opinion on Sustainable Finance Framework

- Extending the EU T and standardising definitions of **'sustainable'**.
- **Baseline MDRs** for all financial products.
- A product **categorisation** system for investors to understand the sustainability features of products.

ESMA | Sustainable Finance Framework


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# CBI's evolving supervisory focus

## 2022

### Gatekeeper review points

- SFDR (re)classification
- Generic sustainability risk and/or taxonomy alignment disclosures
- Quantification of taxonomy alignment
- Integration of sustainability risks
- Pre-contractual product disclosures – Benchmark Indices
- Naming convention for funds

Sustainable finance and the asset management sector: Disclosures, investment processes & risk management Nov 2022

## 2022

### Supervisory roadmap

- Adaption of Risk Management Frameworks
- Article 8 'Guardrails' – minimum sustainability criteria
- Consistent marketing material
- Fees & Costs – transparent & proportionate
- Securities Lending – avoiding contradictory positions
- Fund Service Providers e.g. depositories

Sustainable finance and the asset management sector: Disclosures, investment processes & risk management Nov 2022

## 2023

### Comments by Patricia Dunne

- Article 8 funds - exclusions
- Article 8/9 funds – minimum portion
- Index tracking funds - screening

**Areas of supervisory focus**

- Adaption of Risk Management Frameworks – investment DD & procedures
- Securities Lending – avoiding contradictory positions
- Machine Learning incl NLP

- Sustainable Finance in Practice for Fund Managers - Remarks by Patricia Dunne, Director of Securities and Markets Supervision (centralbank.ie)
- "An evolving supervisory approach in the funds sector" - Remarks by Patricia Dunne, Director of Securities and Markets Supervision at the Irish Funds Asset Manager Forum (centralbank.ie)

## 2024

### CBI Regulatory & Supervisory Outlook

- Article 9 - Green bleaching
- Poor ESG data quality
- ESMA CSA on SFDR – Phase 2 concludes Sept 24
- Sectoral/thematic assessments

CBI Regulatory & Supervisory Outlook

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# ESMA's naming guidelines

## Guidelines on funds' names Timeline

**2022**
124 responses asset managers and their industry associations, NGOs and consumer representatives

**18 November 2022**
Launch- Consultation Paper Guidelines on funds' names using ESG or sustainability-related terms

**20 February 2023**
Closing- Consultation Paper on Guidelines

**14 December 2023**
Update - Statement on Guidelines

**26 March 2024**
Publication in the EU Official Journal
AIFMD &UCITS

**14 May 2024**
Publications – Guidelines

**21 August 2024**
Publication Translations

**21 November 2024**
Applications date- Guidelines apply to all newly created funds

**21 May 2025**
End of transition period for funds existing prior to application date

### Problem
•The name of a fund is usually the first attribute investors see – the name can have a significant impact on their investment decisions
•Competitive market pressures create incentives for asset managers to include terminology in their funds' names designed to attract investor assets

### Response
Funds using **transition-**, **social-** and **governance-related** terms; **environmental-** or **impact-related** terms; and **sustainability-related** terms
•80% threshold – proportion of investments used to meet environmental or social characteristic or sustainable investment objectives)
•Exclude investments in companies referred to in the CDR (PAB & CTB screens)
•For sustainability-related terms, commit to invest meaningfully in sustainable investments (per the SFDR definition)

### Challenges with timing
•ETFs/index funds follow a quarterly rebalance cycle (February, May, August, November) index product changes should ideally be implemented at the same time (e.g. Feb or May)
•Feb problem – depends on NCA approval processes, external dependencies, client feedback
•May problem – misses the deadline

SMA publishes translations of its Guidelines on funds' names (europa.eu)

•The Guidelines will start applying **three months** after the publication, i.e. on 21 November 2024
•The transitional period for funds existing before the application date will be **six months** after that date, i.e. 21 May 2025. Any new funds created on or after the application date should apply these Guidelines immediately.

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# ESMA's naming guidelines - summary

Summary of the Categories of Terms and Related Restrictions[1]

| Restricted sustainability-related terms in fund names | Min. 80% of investments meet sustainability characteristics or objectives | Exclusions | Invest "meaningfully" in sustainable investments as per SFDR | Additional requirements |
|---|---|---|---|---|
| Environmental | Yes | EU PAB | No | N/A |
| Sustainability | Yes | EU PAB | Yes, but no prescribed minimum | N/A |
| Impact | Yes | EU PAB | No | Positive & measurable S or E impact alongside a financial return |
| Social | Yes | EU CTB | No | N/A |
| Governance | Yes | EU CTB | No | N/A |
| Transition | Yes | EU CTB | No | Clear and measurable path to S or E transition |

CTB and PAB exclusions[1]

| Exclusions | Climate Transition Benchmark (CTB) | Paris-Aligned Benchmark (PAB) |
|---|---|---|
| Baseline exclusions | • Any activities related to controversial weapons<br>• Cultivation and production of tobacco<br>• Violators of the UNGC principles or OECD Guidelines | • Any activities related to controversial weapons<br>• Cultivation and production of tobacco<br>• Violators of the UNGC principles or OECD Guidelines |
| Activity exclusions | • No | • Coal & lignite (revenues >1%)<br>• Oil fuels (revenues >10%)<br>• Gaseous fuels (revenues >50%)<br>• Electricity producers (revenues >50% from electricity emitting more than 100g CO2 e/kWh) |

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Note 1: ESMA's Guidelines on ESG Fund Names | Morningstar

# ESMA Final Report on Greenwashing – core considerations

| Dimensions | Detailed parameters used to analyse greenwashing under each dimension | | |
|---|---|---|---|
| Roles | Trigger | Spreader | Receiver |
| Sustainability topics (and sub- topics) about which a claim is communicated | **Governance and resources**<br>• **Board and senior management role**<br>• (governance related elements of entity- level ESG policies)<br>• **ESG resources and expertise** (incl. ESG dedicated staff) | **ESG Strategy**<br>• **ESG Strategy, objectives, characteristics** (integrations of sustainability in strategy, ESG characteristics, sustainable objectives, taking into account clients' sustainable preferences.<br>• **Sustainable management policies**<br>• **ESG credentials** (qualifications, labels, certificates): adherence to (voluntary) reporting frameworks (e.g. UNPRI; TCFD), labels, ratings, awards, certifications<br>• **Engagement with stakeholder** (proxy voting and active engagement) | **Sustainability metrics and targets Receiver**<br>• **ESG performance to data:** ESG results, metrics for real-world impact<br>• **Pledges about future ESG targets** (incl. net zero targets), transition plans |
| Qualities through which the claim is misleading investors or consumers | **Misleading through provisions of information's**<br>• Empty claims (exaggerations and /or failure to deliver on claims)<br>• Inconsistency<br>• Irrelevance<br>• Outright lie (false)<br>• Suggestive use of ESG-related terminology | **Misleading through omission of information**<br>• Selective disclosure/ cherry-picking<br>• Omission or lack of discoloured<br>• Vagueness or ambiguity or lack of clarity<br>• Lack of fair and meaningful comparisons, thresholds and /or underlying assumptions<br>• No proof (unsubstituted)<br>• Outdated information | |
| Channels through which the claims are communicated | Regulatory information (e.g. Prospectus, Financial statements, Mandatory sustainability disclosure, Issuers' Press releases etc.)<br>Ratings (inc. ESG ratings) and Benchmarks & Labels<br>Intermediary/advice information | Marketing materials (including website social media, presentations to investors)<br>Product information (including internal classifications)<br>Voluntary reporting, falling outside previous categories | |

**Best Practice Building Blocks**

1 Disclosure obligation

2 Product labels and standards

3 Marketing restriction

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# Direction of travel – SFDR 2.0

**Best Practice Building Blocks**

1. Disclosure obligation
2. Product labels and standards
3. Marketing restriction

## SFDR 1.0

- Entity-level Disclosure
- Non-Labelled Products
- Qualifying criteria
- Consumer-facing Disclosure
- Pre-contractual Disclosure
- Ongoing Disclosure

## SFDR 2.0

- Entity-level Disclosure
- Non-Labelled Products
- Product Labelling Regime
  - Categorisations
- Naming restrictions
- Qualifying criteria
- Consumer-facing Disclosure
- Pre-contractual Disclosure
- Restricted terms
- Ongoing Disclosure
- Greenwashing Recommendations

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# Case study: robust sustainable investment frameworks to help mitigate greenwashing risks for sustainable finance claims across markets

**Best Practice Building Blocks**

1 Disclosure obligation

2 Product labels and standards

3 Marketing restriction

## 2. Product labels and standards

- Robust and credible fund objectives, criteria, thresholds, KPIs
- Exclusion aligned to market expectations and embedded into investment process
- Alignment between firm-level and fund-level targets
- Governance to ensure data accuracy and completeness, and consistent application

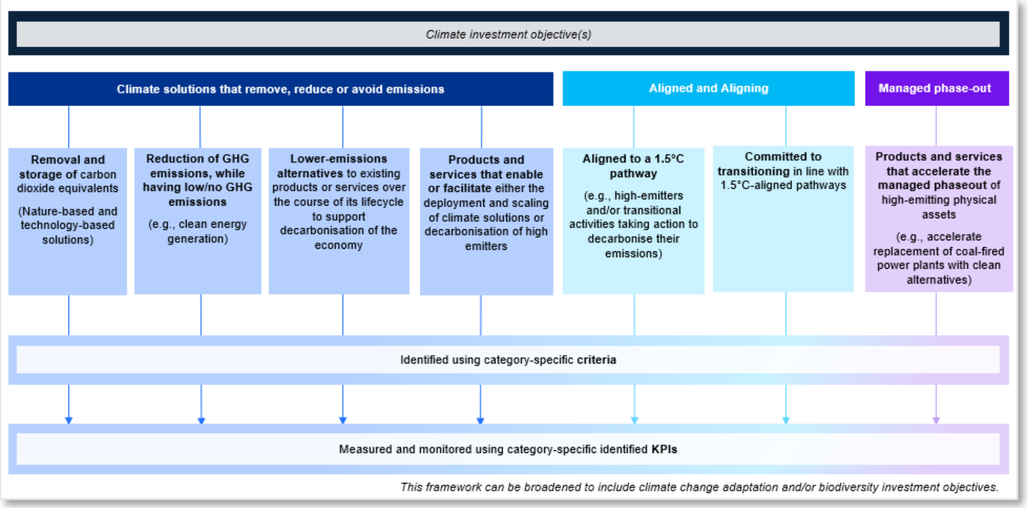
## 1. Disclosure obligation

- The annual report is complete and critically compared with the pre-contractual agreements
- Review of Article 10 reports for completeness and comparison with best practices for website disclosures

## 3. Marketing restriction

- Pre-contractual agreements are complete and accurate
- Compliance with fund name requirements and anti-greenwashing rules

## Example sustainable investment framework

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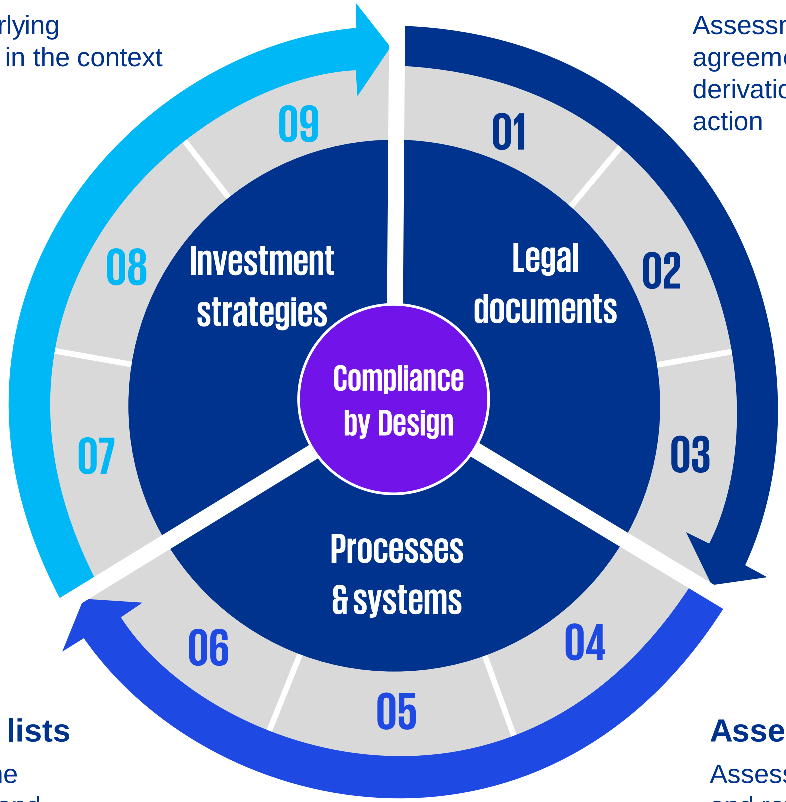
# Holistic assessment of sustainability-related aspects of products

**ESG strategies**
Appraisal of the underlying investment strategies in the context of ESG

**Sales brochures**
Assessment of the pre-contractual agreements for completeness and derivation of recommendations for action

**Scoring / Ratings**
Critical evaluation of the approach to determining ESG ratings, including a comparison with best practices

**Annual reports**
The annual report is checked for completeness and critically compared with the pre-contractual agreements




**Sustainability quotas**
Review of the processes and calculation methods for all sustainability quotas

**Article 10 Reports**
Review of Article 10 reports for completeness and comparison with best practices

**Positive/negative lists**
Process analysis for the application of positive and negative lists

**Asset Controlling**
Assessment of asset controlling and review processes

**Exclusions**
Review of processes and IT architecture to take exclusion lists into account

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# Clearly derived recommendations with a final seal of quality

## Module 1
### Legal documents

- The **sales prospectuses**, **annual reports** and **Article 10 reports are checked** for **completeness** using an audit guide
- In addition, attention is paid to **editorial and stylistic issues to** ensure optimum **comprehension by readers** and end customers
- During the audit process, **clear recommendations for action** are **documented**, which can be derived with the help of our experience in the area of reporting

## Module 2
### Processes and systems

- All processes relating to **exclusions**, **positive and negative lists** and the **asset control** are **reviewed** for **effectiveness and efficiency**
- Particular attention is paid to the **degree of automation** and **scalability in** order to **ensure efficient and error-free processes** even with an increasing number of sustainable products
- Through our experience in process modeling and IT architecture, **final improvement proposals** are consolidated and provided

## Module 3
### Investment strategies

- The investment strategy, sustainability ratios and ESG ratings are **examined in** this package to ensure that **they make sense and are correct**
- Furthermore, a critical comparison is made between the investment strategy and the **fund name,** taking **ESMA requirements** into account. In addition, **KPI calculation methodologies** are compared with the regulatory standards
- Due to the inclusion of the entire **sustainability strategy when** considering the investment strategy, this module represents the **highest degree of personalization**

## KPMG assurance of all three approaches

- Following a successful **assessment of all audit items in the three modules,** KPMG issues a quality seal for the audited product
- By opting for all modules, the auditor receives a holistic view of the entire value chain, which means that conformity with regulatory requirements can be fully ensured and **end-to-end recommendations** can be made

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# Thank you



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