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CSSF Thematic Review on the implementation of sustainability-related provisions in the investment fund industry

The CSSF published a report of its Thematic Review on the implementation of sustainability-related provisions in the investment fund industry.

On 3 August 2023, the Commission de Surveillance du Secteur Financier (CSSF), Luxembourg's financial regulator, published a report of its Thematic Review on the implementation of sustainability-related provisions in the investment fund industry (CSSF Thematic Review).

1. Background

After the entry into force of key sustainable finance regulations, such as the SFDR and TR, and the revision of the AIFMD and UCITS Directive frameworks, all imposing new disclosure obligations on financial market participants, the CSSF has recently reviewed how successfully these sustainability-related provisions have been implemented by the investment fund industry in Luxembourg.

The objective of the report is to inform the industry of the CSSF's main observations and to prompt corrective actions, targeting five areas in particular:

1. Organisational arrangements of investment fund managers (IFMs), including the integration of sustainability risks by IFMs
2. Compliance of precontractual disclosures, including product website disclosures
3. Compliance of periodic disclosures and their consistency with precontractual disclosures
4. Fund documentation and marketing communications
5. Portolio analysis

2. Key considerations

1. Organisational arrangements of IFMs

With regard to **delegation to third parties**, the CSSF highlights that IFMs remain entirely responsible for ensuring compliance with sustainability-related provisions that apply to them, regardless of the potential delegation of any function to third parties.

This concerns, in particular, the publication of all the information that is required to be available on the IFM's website or on another website (subject to sufficient cross-references to the relevant other website being made on the IFM's website), pursuant to Article 10 SFDR.

If the IFM chooses to delegate any function to a third party, this must be done subject to a written initial due diligence process, during which the IFM must ensure the consideration of any sustainability-related provisions. The IFM must ensure on an ongoing basis that the KPIs provided by the third party are sufficiently clear to allow an independent review of the model used by the third party to select investments. These KPIs should also be determined at appropriate intervals, taking into account when the fund's net asset value is calculated.

With regard to **risk management frameworks**, the CSSF recommends that an IFM's risk management processes factor in all sustainability risks that could potentially affect the value of an investment negatively and materially (see Article 2(22) SFDR). This involves stating the sustainability risks in a fund's profile, conducting scenario analyses and implementing stress tests. While the CSSF highlights that appropriate checks and controls are needed to ensure the compliance of ESG-related restrictions set out in precontractual disclosures, it also underlines that the inclusion of sustainability risks into the risk management processes should not stop there. IFMs should take a holistic view when integrating the sustainability risks alongside the other risks to which IFMs are or might be exposed with the funds being managed.

Regarding investment compliance, the CSSF highlights that IFMs must have adequate checks and controls in place to monitor compliance with all of the ESG-related restrictions set out in the precontractual disclosures.

2. Compliance of precontractual disclosures, including product website disclosures

Following their review of **precontractual disclosures**, the CSSF states that fund names, the environmental/social characteristics and the sustainable objectives must be detailed in a manner that is accessible, clear and not misleading. This also means that precontractual disclosures must include enough details about these objectives and characteristics to permit potential investors to make an informed investment decision. In addition, the CSSF expects IFMs to use **fund names** that are aligned with the relevant fund's investment objective and policy and that follow the relevant principles-based guidance on fund names in the Supervisory Briefing, regardless of whether they are making disclosures under Article 6, 8 or 9 SFDR.

While the SFDR does not clearly define the key parameters to be used to assess sustainable investments, the CSSF expects IFMs to clearly set out their assumptions and methodology when **assessing sustainable investments**. Outlining their methodology either as part of the precontractual disclosures or as part of their product website disclosures under Article 10 SFDR will ensure greater transparency and comparability across funds. This also applies to providing sufficiently detailed and relevant information on the consideration of principal adverse impacts (PAI) that relate to the individual fund in question, including references to the procedures put in place to mitigate those impacts.

Similarly, the CSSF reiterates to IFMs the importance of easily accessible sustainability-related **disclosures on the product's website**. This accessibility requirement includes the publication of a ''summary'' section, which should include the information referred to in Article 24 and Article 37 SFDR RTS. It also includes publishing information related to "data sources and processing", "limitations to methodologies and data" and potential "engagement policies".

3. Compliance of periodic disclosures and their consistency with precontractual disclosures

Several observations regarding the content of **periodic disclosures** were made. Firstly, the CSSF highlights that the annual report must contain a prominent statement underlining that any information on the extent to which the environmental/social characteristics and sustainable objectives were achieved can be found in the annex of the report. This annex must include *inter alia* details on:

- the sustainability indicators used to assess to what extent the environmental/social characteristics or sustainable objectives have been achieved,
- the limitations for these indicators defined in precontractual disclosures, and

- the quantitative assessment of the indicators.

The CSSF also expects IFMs to provide clear and detailed information on the PAIs analysed for each financial product. In doing so, IFMs must also take into account the qualitative and/or quantitative information included in the precontractual disclosures. A generic reference to a general global policy is clearly insufficient. Similar transparency is expected in relation to any actions (including shareholder engagements) taken to meet the environmental/social characteristics or sustainable objectives of the investments held during the reference period. Related provisions set out in precontractual disclosures must be taken into account and a generic reference to a global policy is, once again, insufficient.

The CSSF reminds IFMs that they are obligated to ensure ongoing compliance with the binding commitments set out in the precontractual disclosures. In addition, IFMs must provide sufficiently clear information (e.g. proportion of investments meeting environmental/social characteristics) to allow investors to verify whether these figures are consistent with those set out in the precontractual disclosures.

4. Fund documentation and marketing communications

The CSSF restates that marketing communications **must be consistent** with any information disclosed under SFDR, as well as any of the fund's legal or regulatory documents. This consistency requirement extends, for example, to the fund's name or the way in which any information related to the individual funds is presented. The marketing communications must provide information that is specific to individual funds and does not contradict or diminish the importance of any information published in the precontractual disclosures.

In the spirit of providing information that is clear, accessible and not misleading, IFMs must ensure that when highlighting product-level sustainability credentials, they also indicate the body that has granted the credentials, the date on which they were granted and details on the specific fund to which they were granted. An example of good practice includes providing a hyperlink, allowing investors to easily find the fund-specific sustainability-related information.

5. Portfolio analysis

The CSSF expects IFMs to ensure the ongoing compliance of their portfolio holdings with, for example, potential exclusion clauses in the precontractual disclosures, as well as compliance with the fund's environmental/social characteristics or sustainable objectives.

3. Next steps

The CSSF is expected to continue to strengthen its supervision of IFMs in Luxembourg on sustainability-related aspects, notably in the context of the Common Supervisory Action (**see CSA**) announced by the ESMA in July 2023.

In the meantime, the CSSF is currently gathering detailed information on precontractual product disclosures for Luxembourg-based financial products as part of its data collection exercise, which was launched in March 2023 and is to be completed by 31 October 2023 (**see here**). A similar exercise has already been announced with an initial deadline of 31 January 2024 for the collection of equivalent information in periodic disclosures (**see here**).

Read the full CSSF Thematic Review here_

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