<u>Warning Notice No. 1/25 of February 11, 2025</u>

Complying with sustainability-related obligations in the asset management

1. Introduction

The aim of this warning is to provide players of the asset management industry with some guidance that may help them be compliant with the sustainability-related obligations, also in the vein of ESMA's initiatives intended to fulfil the European supervisory convergence.

The recently introduced legislative changes are part of a broader package of EU initiatives aimed at steering markets and capital towards an inclusive and sustainable growth, and which has already exerted a significant impact on financial intermediaries and asset managers' behaviour, both from an operational perspective and in terms of complying with transparency requirements.

Moreover, the EU legal framework on sustainable finance is already evolving, with the launch of a comprehensive assessment process of Regulation (UE) 2019/2088 (SFDR or disclosure Regulation), with the review of Delegated Regulation (EU) 2022/1288, supplementing the SFDR, and with the initiatives of streamlining sustainability reporting as announced by the President of the European Commission in November 2024, confirmed thereafter on January 29, 2025 (C*ommunication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions*).

In such a context, Consob actions will be oriented to promoting a uniform application of sustainability-related rules across European countries, supporting the revision process, and contributing to the overall simplification of the existing legal framework.

2. Consob's supervisory actions

Consob monitors the approaches adopted by management companies for implementing EU sustainability-related requirements, both in terms of operational management and transparency at the entity level and at the product level with a specific focus on ESG features of CIS (collective investment schemes), and on consistency between the investment policy outlined in the offering documents *ex ante* and the actual investment strategy carried out by funds' managers *ex post*.

In that respect, Consob's supervision is performed on an ongoing basis according to the adopted risk-based approach, covering the area of sustainability-related disclosure (both on regulatory documents and on marketing material), and developing other *ad hoc* supervisory initiatives. For instance, as part of the Common Supervisory Action, under the coordination of ESMA. The supervisory activity is complemented by the support of the main national asset management industry associations.

The supervisory experience gave the opportunity of identifying key elements of the sustainability-related regulation resulting in a list of good and poor practices reported in *Annex I*; such practices may help fund managers comply with industry regulation and operationalise ESG rules into suitable conduct.

This Warning Notice shall be read in conjunction with Consob's *Warning Notice* no. 1/24 of 25 July 2024. Indeed, the latter focuses on sustainability-related obligations in the provision of investment services and on sustainability-related disclosure at the entity level[1]. This Warning Notice stresses out some key elements of the sustainability regulation such as **the inclusion of ESG factors in the CIS' investment decision-making process**, and **appropriate financial product's disclosure**[2].

Given the complexity and the evolutionary aspects of the sustainability-related regulation in the financial sector, it deserves pointing out that the principles and practices hereby discussed do not cover all issues worthy of attention, as further issues may arise from forthcoming steps of supervisory activity.

3. A reminder of the key elements of the applicable legal framework

3.1 Sustainability-related disclosure under the SFDR: products' transparency provisions

As far as financial products are concerned, SFDR transparency provisions are specifically designed to match the different features of financial products, distinguishing between: financial products falling within the provisions of Art. 6 (SFDR), a generic category of financial products that neither promote ESG characteristics nor have sustainable investment objectives; financial products falling within the provisions of Art. 8 (SFDR) that promote environmental or social characteristics, or a combination of those characteristics; financial products falling within the provisions of Art. 9 (SFDR) that pursue one or more sustainable investment objectives.

Level 2 indicates detailed disclosure to be provided with for Art. 8 and Art. 9 products, distinguishing between pre-contractual, periodic and website disclosure. In particular, for pre-contractual disclosure and periodic disclosure, it is required to be provided through special templates to be attached to the prospectus/offering document or annual financial statement. Additionally, the Taxonomy Regulation -Regulation (EU) 2020/852- integrates the product disclosure requirements envisaged by the Disclosure Regulation (i.e. SFDR).

The **pre-contractual disclosure** templates for products falling within the scope of Art. 8 and Art. 9 SFDR (Annex II and Annex III of EU Delegated Regulation 2022/1288), shall include, *inter alia*, information concerning:

- the identification of sustainable objectives and environmental and/or social features, as well as indicators to gauge the degree of accomplishment;

[1] Recommendations in Warning Notice no. 1/24 of 25 July 2024 (https://www.consob.it/web/consob-and-its-activities/-/warning-notice-no.-1/24-of-25-july-2024) focusing on disclosure at entity level apply also to asset managers.

[2] Sustainability-related disclosure applies both to the activity of collective asset management and to the service of portfolio management. The recommendations outlined in this Warning Notice on products' sustainability disclosure apply to all financial intermediaries -even different from asset managers- providing the service of portfolio management.

- in case of sustainable investments (products falling within the scope of Art. 9 SFDR and products falling within the scope of Art. 8 SFDR with a portion of sustainable investments), information regarding the principle of "do not significant harm" (DNSH) in relation to the environmental and social objectives, specifying:

  - how adverse impact indicators on sustainability factors (so-called principal adverse impact indicators or PAI) are taken into account, distinguishing between mandatory indicators (those reported in Table 1 of Annex 1 of EU Delegated Regulation 2022/1288), and optional indicators (the ones reported in Tables 2 and 3 of the abovementioned Annex that are relevant in light of the product's features);

  - details regarding the way sustainable investments are aligned with OECD Guidelines for multinational enterprises (Due Diligence Guidance for Responsible Business Conduct) and with the United Nations Human Right Principles (so-called minimum safeguard);

  - binding elements of the investment policy and the policy for assessing sound and good governance.

In that respect, <u>with the aim of providing with clear, accurate, and comprehensive information to investors, intermediaries are invited to consider the following points</u>:

- clear and exact identification of <u>promoted sustainable characteristics and/or sustainable objectives pursued</u>; in this regard, for instance, intermediaries should avoid generic expressions such as "this product pursues environmental/social objectives";
- identification of <u>one or more indicators suitable for assessing each and every</u> promoted sustainable characteristic and/or sustainable objective pursued;
- illustration (also in brief) of the <u>assessment approach</u> adopted for checking the DNSH principle and the safeguard clauses. In particular, with regard to the DNSH principle, a clear indication that such principle is gauged though <u>all mandatory indicators</u> (those reported in Table 1 of Annex 1 of EU Delegated Regulation 2022/1288), eventually reporting optional indicators (those reported in Tables 2 and 3 of Annex 1 of EU Delegated Regulation 2022/1288) that are applicable and suitable due to the actual ESG features of the financial product;
- information regarding both the investment strategy and the checks on sound and good governance[3], which should be adequately explained, for instance, with (a brief) reference to the *negative screening* process, the positive selection criteria (positive screening factors), the management objectives in terms of ESG risk or ESG rating, both at the issuer and at the portfolio levels;

[3] With regard to good governance, it is worth considering the clarifications published by both the European Commission and the ESAs. In that respect, it has been specified that the verification of the principle of good governance does not cover specific asset classes, such as: **a)** government bonds ("Therefore, a financial product referred to in Article 8, paragraphs 1, 2 and 2a, of Regulation (EU) 2019/2088 investing only in government bonds does not need to apply the requirements related to good governance practices [...]" EC Q&As of 17 May 2022); (**b)** real assets ("By extension from Q&A V.6, real assets like cars or real estate held in SPVs or holding companies do not require a good governance practice check, only investee companies do." ESAs Q&A no. V.27 - JC 2023 18).

- in terms of good governance check, a clear statement that such check is extended to all assets in the portfolio (not only on the portion of assets that promote environmental/social characteristics and on asset that are regarded as sustainable investments)[4];
- as far as financial products falling within the scope of Art. 9 SFDR are concerned, it shall be specified that the index eventually designated as benchmark is based on "sustainable" methodology and criteria in such a way to ensure consistency between the product's features and the reference benchmark.

The templates on **periodic information**, (Annex IV and Annex V of EU Delegated Regulation 2022/1288) are intended to provide investors with information on the results achieved in terms of ESG goals and sustainability profiles *ex ante* declared on the offering documentation. Specifically, it shall include information on:

- the extent to which the sustainable characteristics promoted by the product have been met or the sustainable investment objectives have been achieved, with specific reference to the sustainability indicators metrics;
- in relation to sustainable investments (if any), how the principal adverse impacts on sustainability factors have been taken into account within the DNSH check;
- the share of sustainable investments with an environmental objective aligned with the EU Taxonomy; the share of sustainable investments with an environmental objective which is not aligned with the EU Taxonomy; the share of socially sustainable investments.

In that respect, intermediaries are invited to consider the following points:

- the e*x post* value of each indicator identified *ex ante* with the aim of gauging the degree of accomplishment of each promoted characteristic/pursued objective;
- in relation to the DNSH principle, information regarding whether, or not, the qualitative/quantitative criteria underlying the adverse impact indicators' have been satisfied.

3.2 Considering ESG factors within the CIS investment decision-making process

The amendments to the delegated acts of AIFMD and UCITS require, among other things, that:

- sustainability risk shall be integrated – under the responsibility of senior management - into the management of funds (both UCITS and Alternative Investment Funds -AIFs-);
- the mapping of conflict of interests shall include types of conflicts arising from the integration of sustainability risks into companies' procedures/processes;
- asset management companies are expected to count on resources with due skills for integrating sustainability risks;

[4] In this regard, it is worth considering the clarification provided by the ESAs according to which "Where a financial product referred to in Article 8, paragraphs 1, 2 and 2a, of Regulation (EU) 2019/2088 pursues investment in companies, the companies must follow good governance practices. Failing that, the financial product is in breach of Article 8 of Regulation (EU) 2019/2088" (ESAs Q&A n. V.5 – JC 2023 18).

- the risk management process shall consider the CIS exposure to the sustainability risk.

Information regarding the firm's policies on the integration of sustainability risks within the investment decision-making process shall be released on the web page of the management company (art. 3 SFDR).

So far, in broad terms, the examination of ESG policies has revealed that ESG/sustainable investments selection is based on

- exclusion criteria (negative screening);
- positive selection criteria (positive screening);
- defining goals in terms of ESG score/rating at the overall portfolio level and/or at the single asset/issuer level.

In that respect, with the aim of encouraging asset managers to adopt sound and effective sustainable approaches, intermediaries are invited to consider the following points:

- effective monitoring of ruled out investments/issuers (exclusion criteria), determination of the frequency for periodic review of such criteria as the list of eligible target investments is expected to be periodically updated in order to reflect the actual issuers' operational conditions;
- defining screening criteria (thresholds, metrics, and indicators) that allow an effective selection of eligible target investments and business initiatives that turn out to fit ESG/sustainability parameters, either at the time of the investment or in evolutionary terms. In particular, such criteria are expected to underpin choices (target investments and business initiatives) resulting from a sound assessment of each of the three pillars (E-S-G) relevant in the view of the characteristics promoted/objectives pursued. The selection process is expected to ensure that each and every eligible target investment complies with the good governance requirement;
- if the assessment of single pillar (and of the parameters underlying them), deemed to be relevant on the basis of the product's specific ESG features, is complemented by the use of synthetic indicator (i.e. score/rating/portfolio's ESG risk, or, if applicable, the benchmark) computed according to an internal methodology, such methodology should be objective and such to ensure consistency in the assessment of the fund and of the benchmark, and to allow following (*ex post*) checks and monitoring;
- ensuring compliance with selection criteria defined *ex ante* on the basis of updated and reliable information; the definition of objective criteria for the treatment of issuers for which information is not available, or it is just partially available;
- definition of an overall independent, transparent, and fair process. In this respect, it is essential to ensure functional and organizational independence to the three major phases in which the process is structured: *a*. definition of both the ESG goals and criteria and of the binding elements to achieve sustainable targets, environmental and social features; *b*. implementing investment choices; *c*. monitoring the aforementioned targets and binding elements; the execution of the overall process shall be traceable in such a way that, in case, it will be possible to be proved it *ex post*.

4. Concluding remarks

In light of recent concerns regarding sustainability in the financial sector, and following the guidance provided within this Warning Notice, Consob will continue to keep the focus of its supervisory activity on the implementation of the provisions on sustainable finance by asset managers. Such an activity will be carried out taking into due consideration the evolutionary elements of the relevant regulation on the subject with particular respect to the coordination at the European level.

THE CHAIRMAN
Paolo Savona

ANNEX

Examples of good (+) and poor (-) practices

Pre-contractual product disclosure: clarity and fairness		
Area of interest for disclosure	**Practices**	**Good practices (+) Poor practices (-)**
Promoted characteristics / pursued objectives	Identification of promoted features/objectives pursued through generic expressions (e.g., the product promotes environmental features; the product pursues social objectives)	-
	Disclosure regarding target values of the ESG rating or ESG risk of the portfolio (which may instead be represented in the description of the investment strategy) rather than mentioning promoted characteristics/objectives pursued	-
	Identification of an excessive number of characteristics and objectives (which do not serve to guide *ex ante* the product's investments selection, but rather to enable *ex post* the justification of such investments in the light of - at least- one of these characteristics or objectives)	-

	Specific identification of the promoted characteristics/objectives pursued on the basis of officially accepted classifications (e.g., sub-objectives identified for the UN -United Nations-SDGs or, for the environmental part, the classification of objectives under Art. 9 of the Taxonomy Regulation and, for the social part, the classification in the final report on social taxonomy as reported on the *Platform on sustainable finance*, published in February 2022)	+
Indicators to gauge the degree of accomplishment of characteristics/objectives	Exclusive identification of a synthetic indicator of portfolio performance regarding all the characteristics and objectives pursued	-
	Identification of one or more specific indicators for each objective and/or characteristic	+
	Displaying a table with a clear association between the indicator employed and the objective pursued and/or characteristic promoted	+
DNSH	Generic statement that PAI (principal adverse impact indicators) and good governance are assessed on the basis of internal models, without providing further details about these models	-
	Use of generic expressions such as 'we have considered the main indicators'	-
	Precising exactly that the DNSH verification implies the verification of all mandatory PAIs and, where relevant, specification of additional optional PAIs deemed relevant in view of the characteristics promoted/objectives pursued	+
	Summary illustration of the assessment approach adopted by the manager, e.g. by specifying to the type of qualitative and/or quantitative thresholds set internally	+

<table>
<tr><td>Binding elements of the strategy</td><td>Summary illustration of negative screening, positive selection criteria as well as management goals accounting for e.g. ESG risk or ESG portfolio rating</td><td>+</td></tr>
<tr><td colspan="3">Periodic product disclosure: clarity and accuracy</td></tr>
<tr><td>Area of interest for disclosure</td><td>Practices</td><td>Good practices (+)
Poor practices (-)</td></tr>
<tr><td rowspan="2">Extent to which characteristics/objectives are met</td><td>Displaying a table including ex post values computed on the basis of ex ante identified indicators - for each specific sustainable characteristics/goal</td><td>+</td></tr>
<tr><td>In the case of disclosure of the synthetic indicator (ESG score/risk/rating) on the ESG performance of both the the product and the benchmark, where both indicators are calculated by the management company, such condition has to be clarified also highlighting that the methodology underlying the calculation is the same for both the fund and the benchmark and that it is based on objective criteria</td><td>+</td></tr>
<tr><td>DNSH</td><td>Clear and effective reporting on whether or not the outcome complies with the qualitative/quantitative criteria underlying the assessment of adverse impact indicators (PAIs)</td><td>+</td></tr>
<tr><td colspan="3">ESG factors inclusion in the decision-making process:
sound and effective process</td></tr>
<tr><td>Area of interest for process</td><td>Practices</td><td>Good practices (+)
Poor practices (-)</td></tr>
<tr><td rowspan="2">Exclusion Lists</td><td>Imposing binding constraints related to the exclusion lists within the front office procedure</td><td>+</td></tr>
<tr><td>Periodic revision of exclusion lists, at least once a year</td><td>+</td></tr>
</table>

	Setting the exclusion lists depending upon the specific sustainability features of the CIS	+
Investments' monitoring and screening criteria	Screening criteria exclusively designed on the basis of the sustainability goal of overall portfolio rather than setting criteria related to single issuers (e.g. in terms of ESG score/rating/risk of the portfolio)	-
	Setting ESG tolerance thresholds on each of the three pillars (E-S-G) for each single issuer	+
	Setting screening criteria depending upon the specific sustainability features of the CIS	+
Use of ESG information	Use of ESG information obtained by one sole info-provider without further checks/comparison	-
	Use of information concerning the issuer's ESG profile in terms of its overall assessment, without detailed the assessment of both individual pillars and the parameters underlying them	-
	In case ESG information on issuers is not available, or it is just partially available, applying investment filters or setting limitations (depending on whether the absence of information is partial or total, also depending upon whether the lack of information is relevant for examining key elements of the ESG assessment)	+