

Placement Agent and Investor Relations Professionals Dinner

13 November 2024

Strategic Planners
Deal Closers
Reputation Protectors
Award Winners
Precedent Setters
Legal Innovators
Trusted Advisors
Forward Thinkers
Boundary Breakers
Problem Solvers
Community Leaders
Progress Makers

Current View on the Market and Key Trends in Fund Terms

Current Views on the Market

Continued high interest rates and inflation and lack of M&A activity and liquidity is still impacting investor behaviour

While we are starting to see the wheels turn, fundraising remains challenged and slow especially for European GPs

Challenge is to create momentum for a decent first close (ideally +50% of target)

A re-up rate of +70% is a good result

GPs must have real confidence as to which of their existing LPs will back them

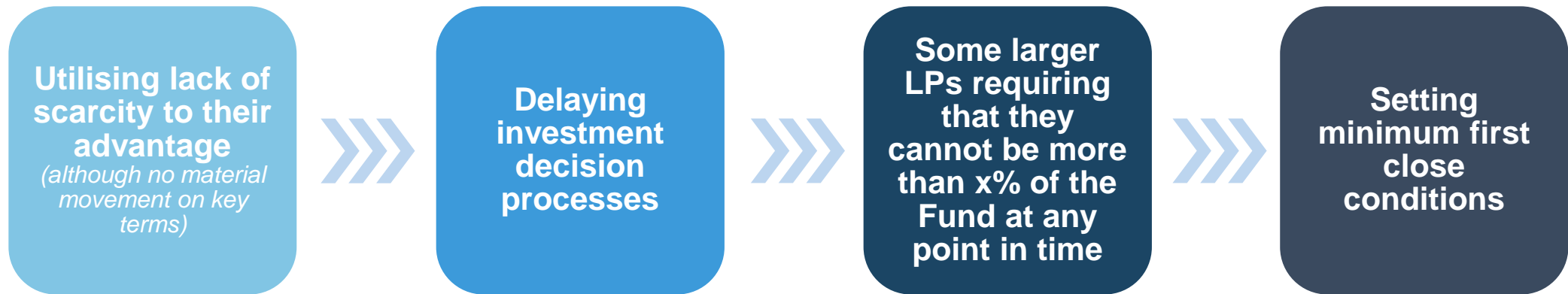
Most investors only have room for a handful of new GP relationships

European GPs need a compelling narrative

Many of our clients are achieving their targets or hard-caps but most are taking 12 to 18 months

Optimism that there will be a return to 'normality' in 2025 and 2026

Investor Behaviour



Wealth Channels

- Increasing trend to target a broader base of high net-worth individual investors via private wealth channels.
- Range of structuring options:
 - **HNWI Feeders:** Private wealth feeder managed by third party private bank or manager. Most common approach for mid-market fund sponsors.
 - **Other options:** Authorised fund vehicles including UCI Part II, ELTIF, LTAF. Suitable to facilitate marketing to retail investors but there are stringent diversification, concentration and other requirements that apply. Less common in the mid-market.
- Private wealth managers and distributors may require an EU passported fund structure be put in place.
- Access existing European HNWI networks.
- Increased role of intermediary platforms (e.g. S64 and iCapital) to facilitate capital raising from private wealth channels.

Fundraising Strategies in the Current Environment



Communication

- Start communicating to existing and target LPs about fundraising plans early, especially with core LP relationships
- Carefully consider what communication is about target
- Any terms changes to be clearly set out and rationale communicated to LPs
- Refine “the story” around predecessor fund, lessons learnt and liquidity plans and strategy



Incentives

- Management fee discounts still common
- Utilise offering of co-investment either by setting up co-investment vehicles and/or offering preferential co-investment rights



Liquidity

- Create liquidity for LPs:
 - NAV
 - LP tender processes
 - GP continuation funds
 - Stapled primary commitments from secondary market



Process

- Ensure fundraising straddles 2 calendar years
- Rolling closings
- Flexible timeline responding to investors' processes
- Design documents to de-risk capital without holding a formal first closing – allows GPs to communicate a sizeable first closing to potential investors and the market
- Build momentum around a core group of investors

Key Trends in Fund Terms

- **Management fee / offsets / portfolio service charges**

- headline 2% rate remain unchanged – tipping point at fund size of c.€3.5bn where there is pressure for lower management fee
- early close/large investor discounts
- 100% offset of portfolio fees remains the norm BUT increasingly funds are carving out certain fees from the offset (e.g. for operating partners, capital markets services, admin services etc).

- **Borrowing**

- ILPA guidance published on NAV facilities (July 2024) (<https://www.proskauer.com/alert/ilpa-guidance-on-nav-facilities>)
- expect increased investor focus on borrowing limitations

- **Recycling**

- GPs looking to broaden ability to recycle, so that all proceeds can be recycled during the investment period (subject to overall cap on investments) – one of many liquidity tools available to GPs

- **Term extensions**

- increasingly seeing relaxation of extension provisions in GP's favour

Key Trends in Fund Terms

- **Jurisdiction**

- Luxembourg remains the principal jurisdiction when targeting significant European capital, though receiving more queries about Ireland as an alternative
- Channel Islands remains a viable alternative for speed/cost reasons where marketing under NPPR is a workable alternative

- **Investment limitations and conflict transactions**

- fund-to-fund / continuation vehicle / fund alongside fund transactions more prevalent

- **Fundraise periods**

- not yet borne out in the data, but a number of GPs are looking to extend fundraises to 18 months/relax the extension provisions

- **GP commitment**

- minimum required in the LPA remains relatively consistent with prior years, though larger GPs are building in more flexibility to increase commitment over investment period above figure in LPA

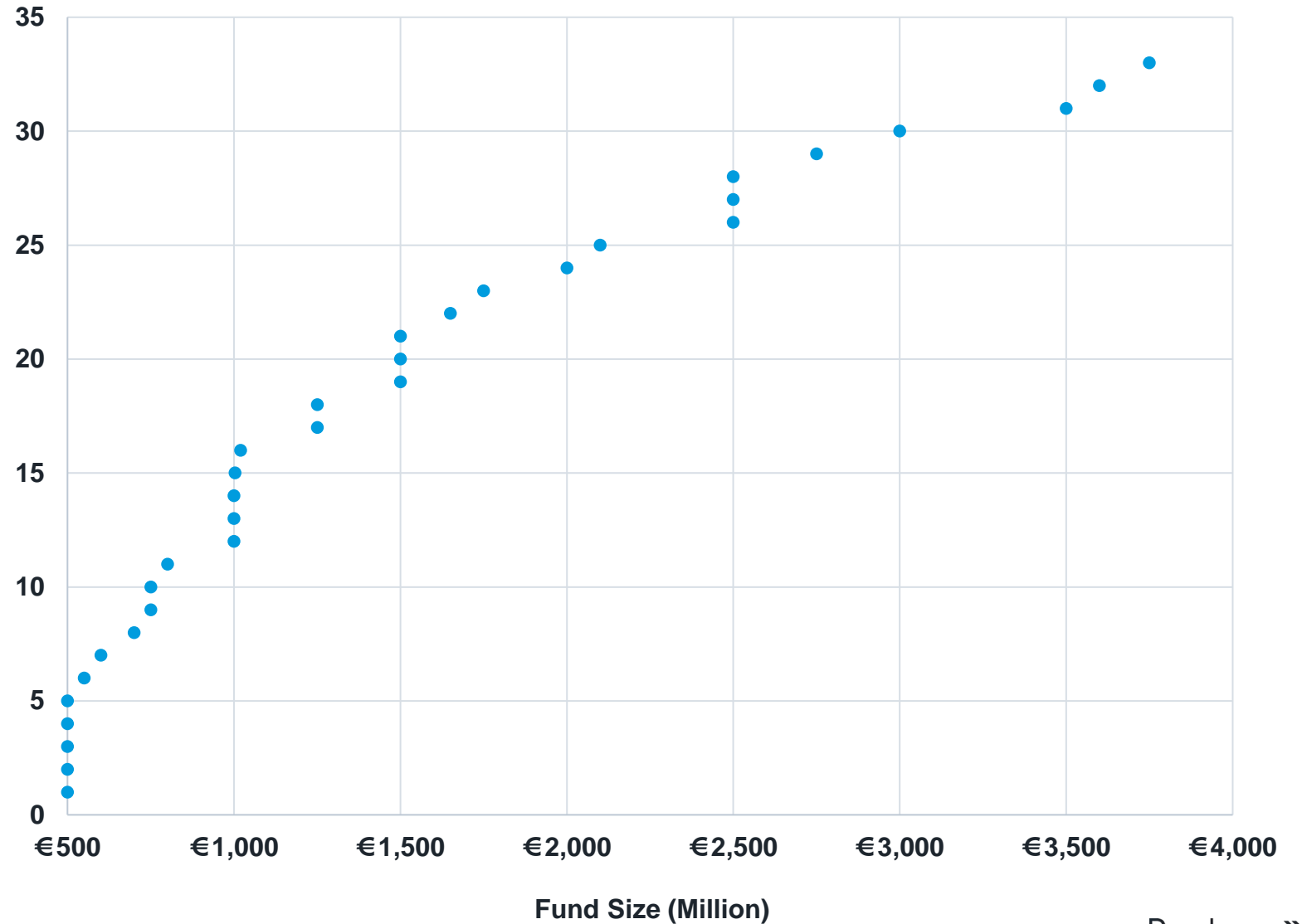
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Q&A

APPENDIX 1 - Fund Terms Data

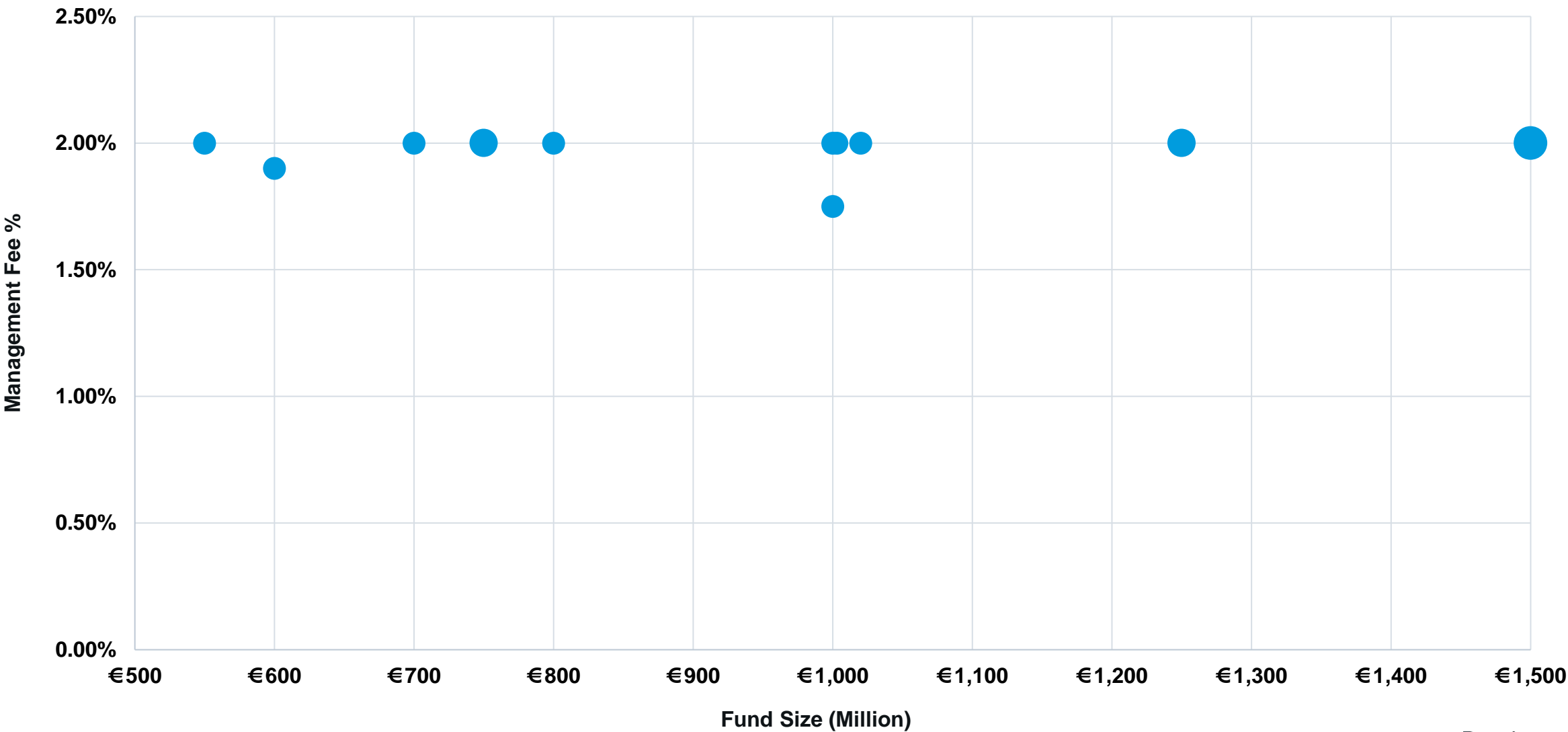
Data Methodology

- 33 European Buyout Funds
- 2022-2023 Vintages
- Fund Sizes €500M – €3.75B



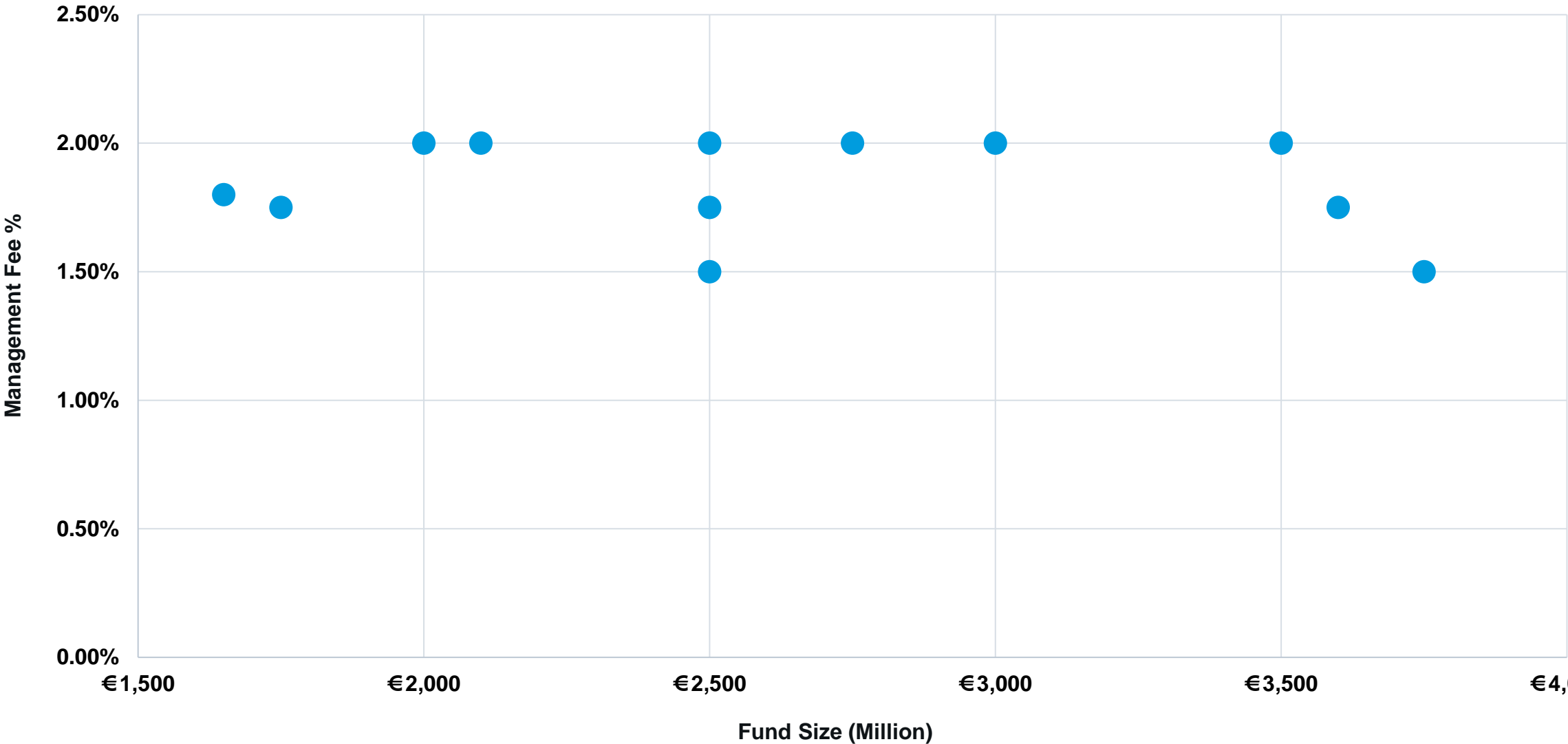
Annual Management Fee Rate – Investment Period (% of Base)

>€500M-€1.5B



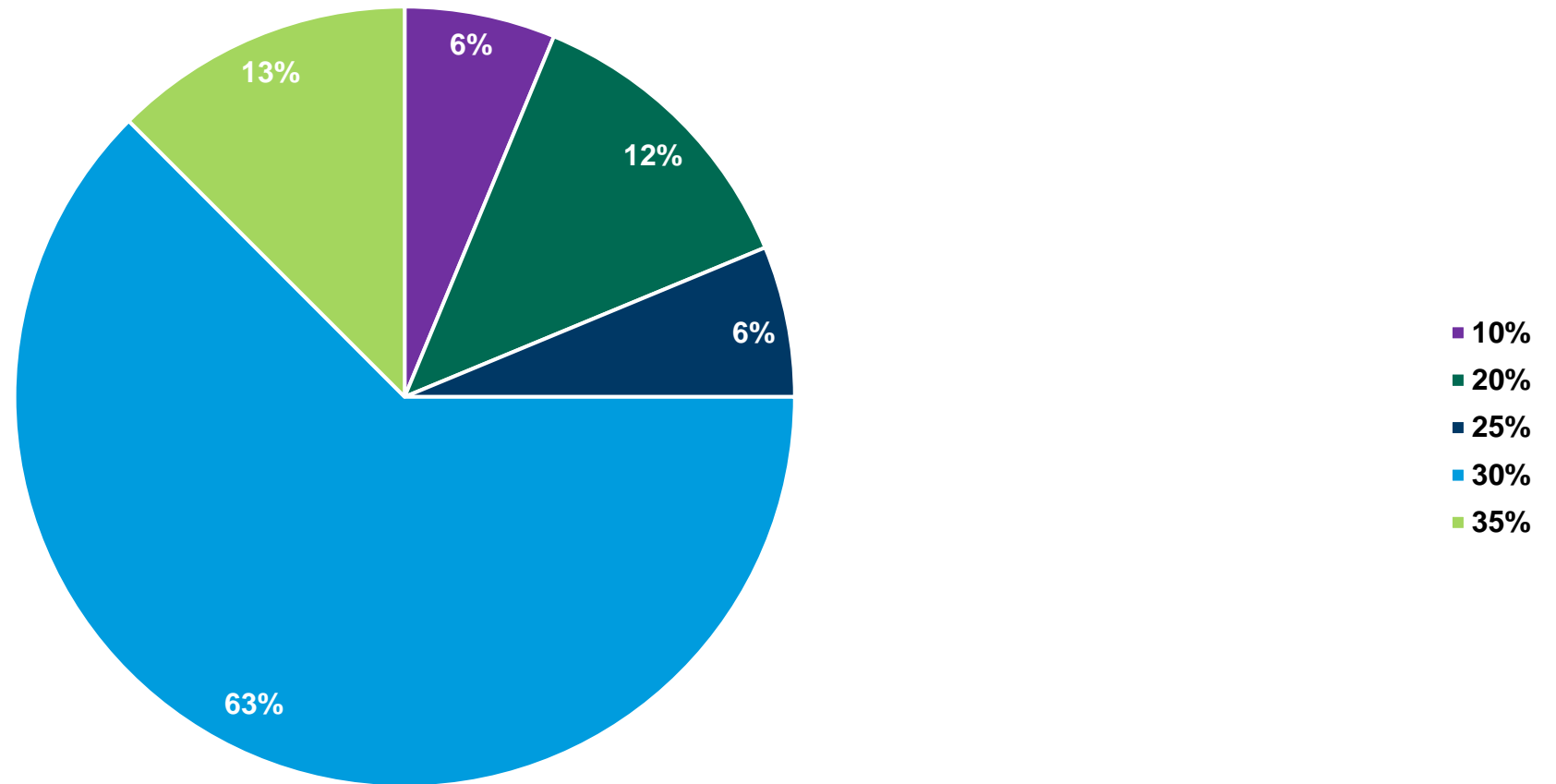
Annual Management Fee Rate – Investment Period (% of Base)

>€1.5B-€3.75B



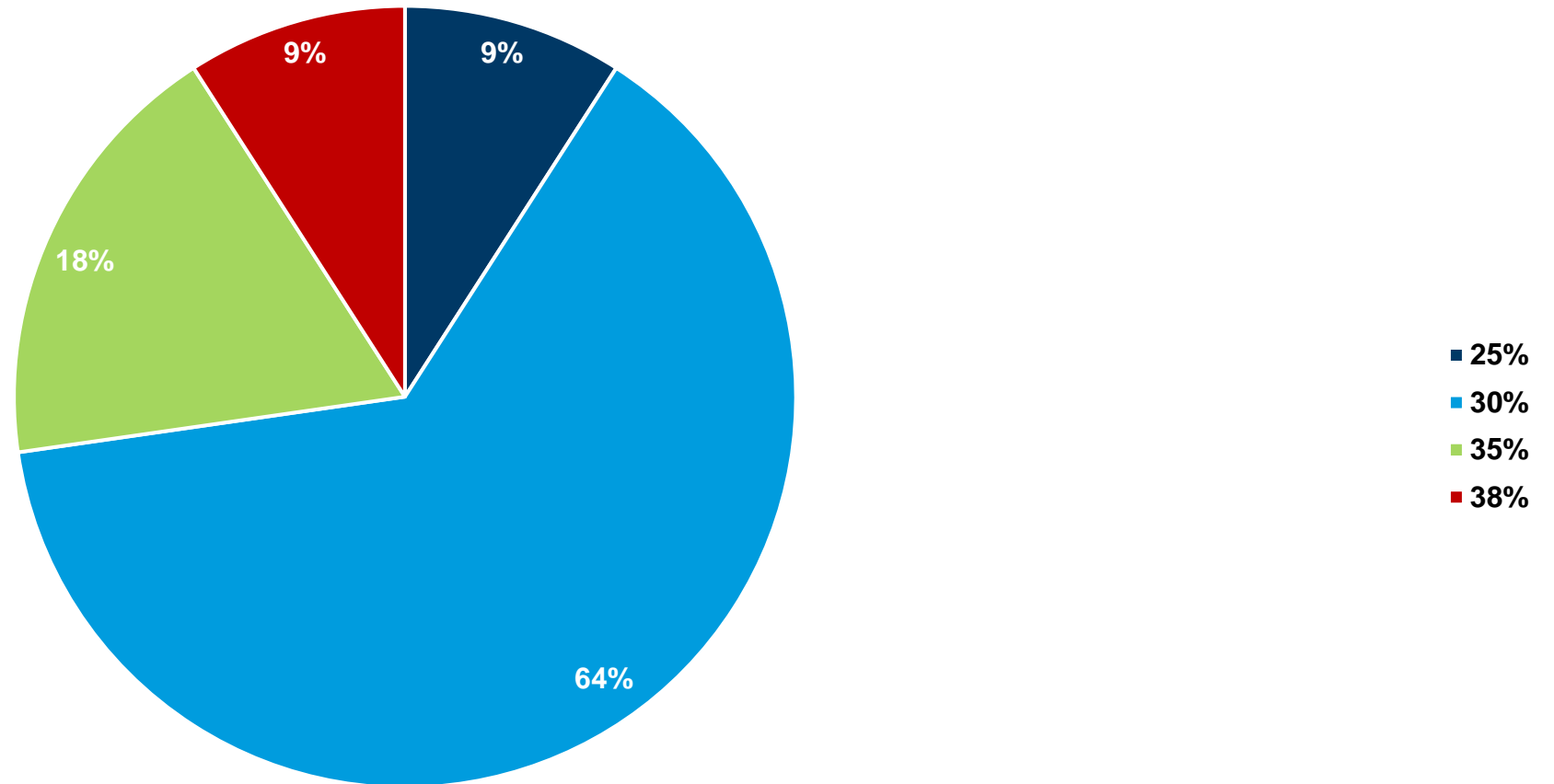
Limits on Bridge Facilities and Other Fund-Level Borrowing (% of Commitments)

>€500M-€1.5B

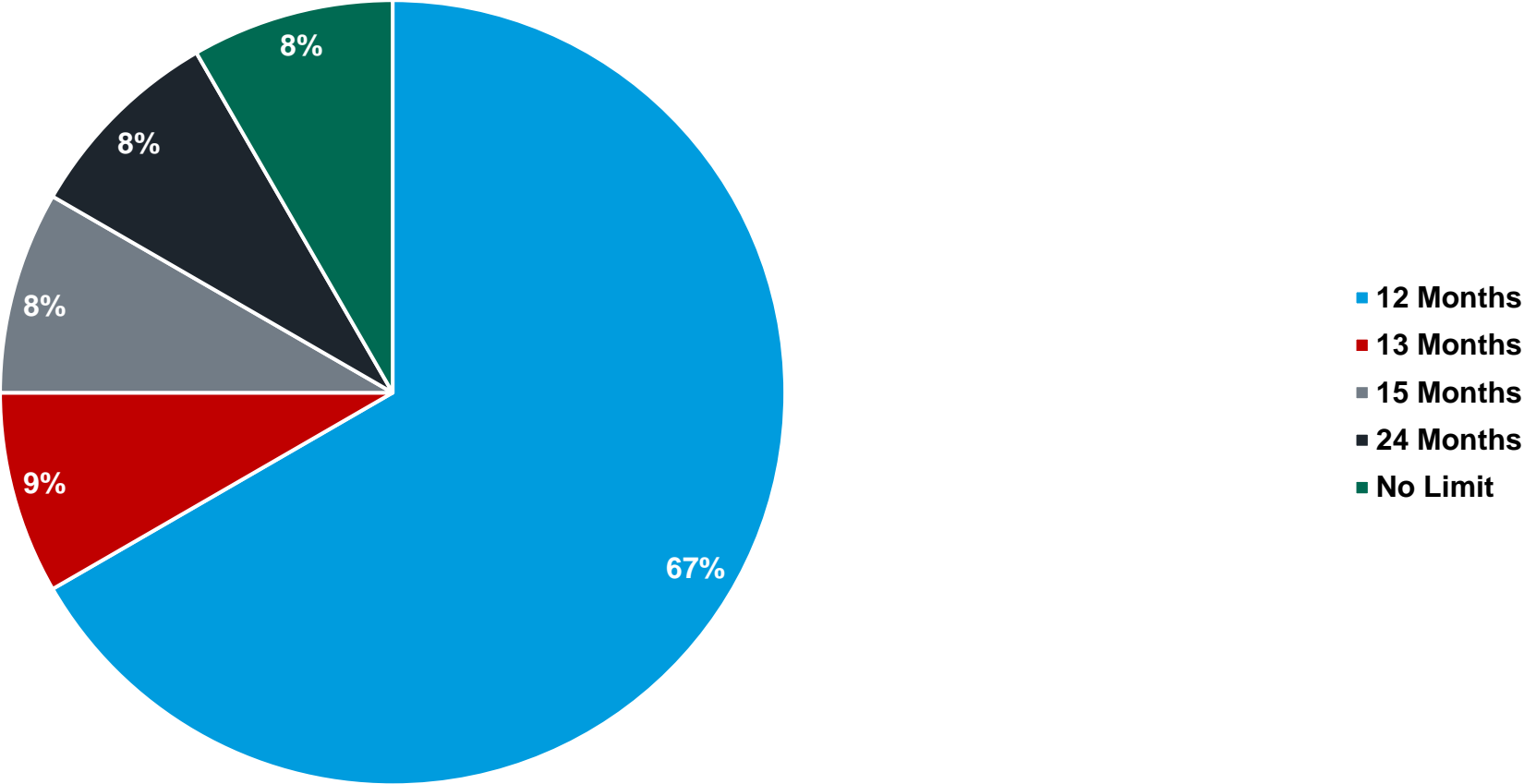


Limits on Bridge Facilities and Other Fund-Level Borrowing (% of Commitments)

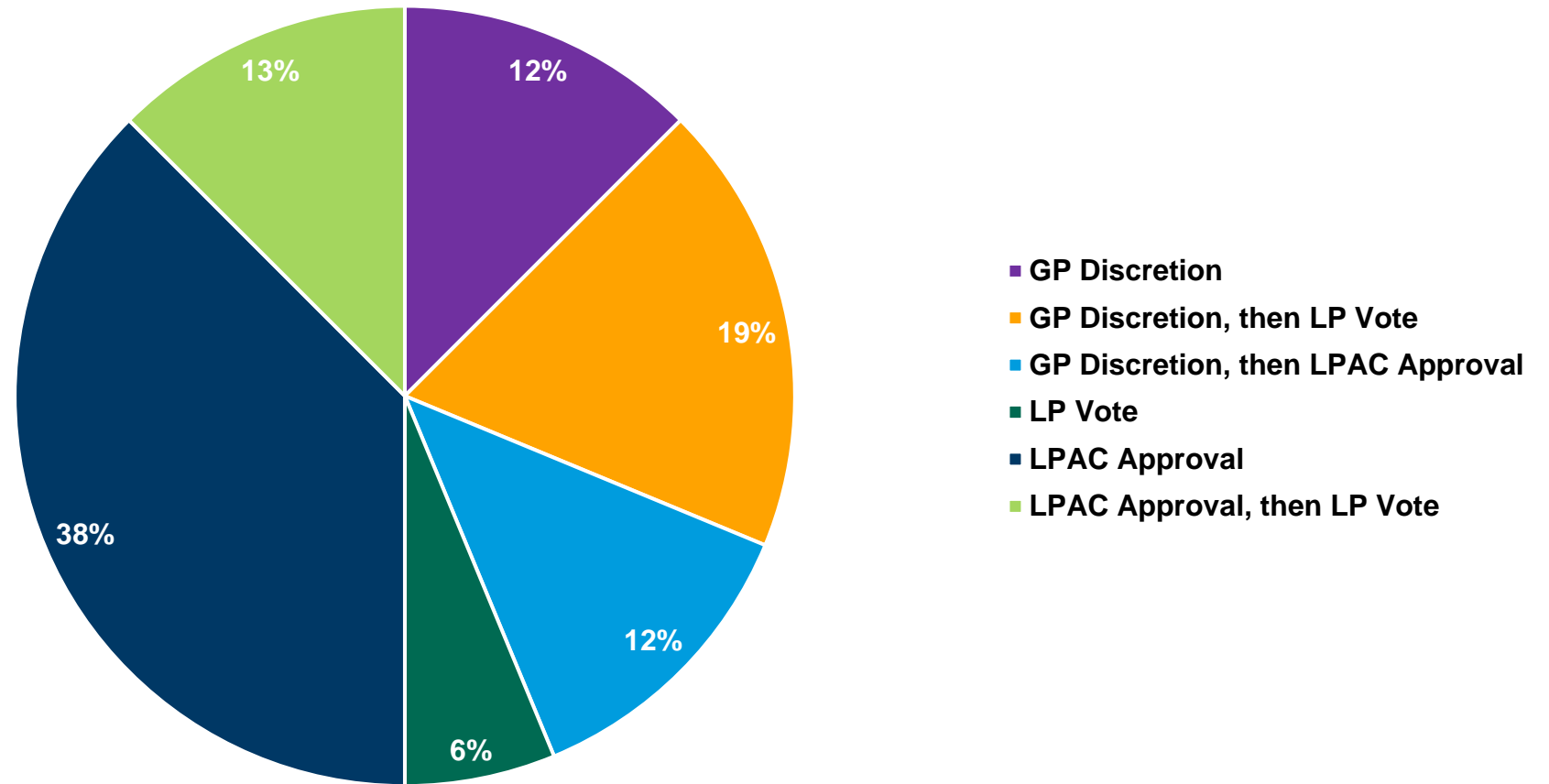
>€1.5B-€3.75B



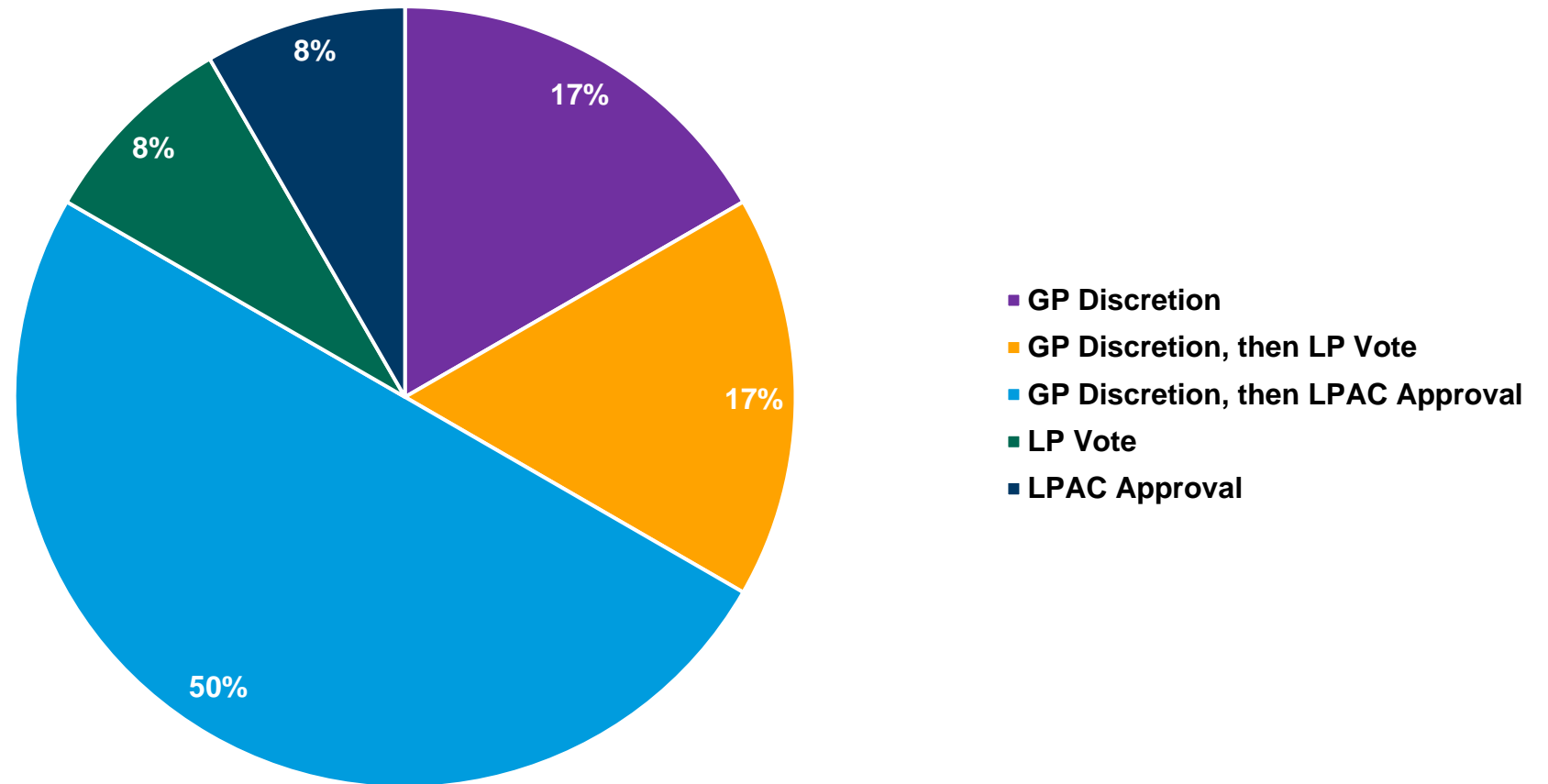
Time Limits on Borrowing
>€1.5B-€3.75B



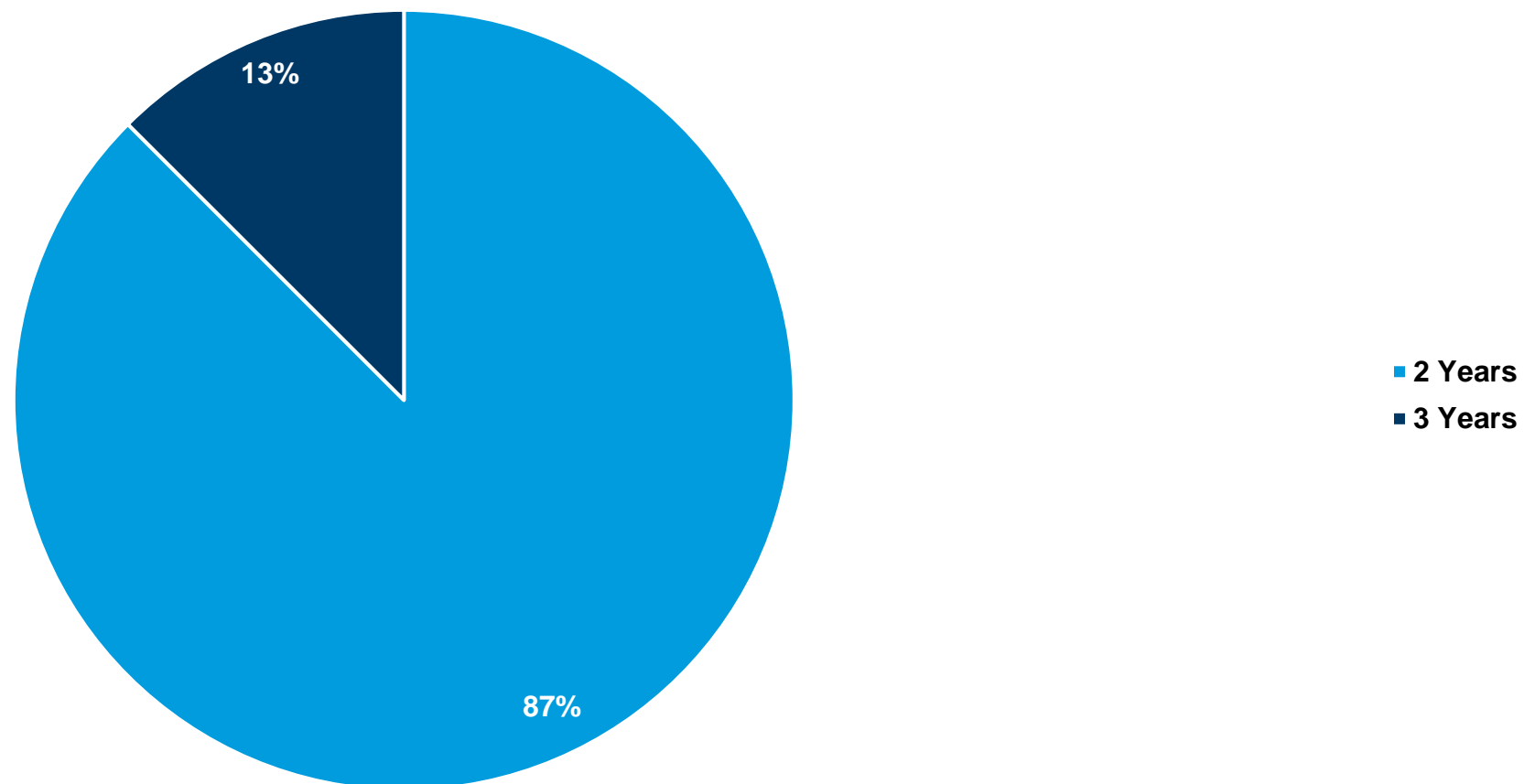
Approval Required for Extension of Term >€500M-€1.5B



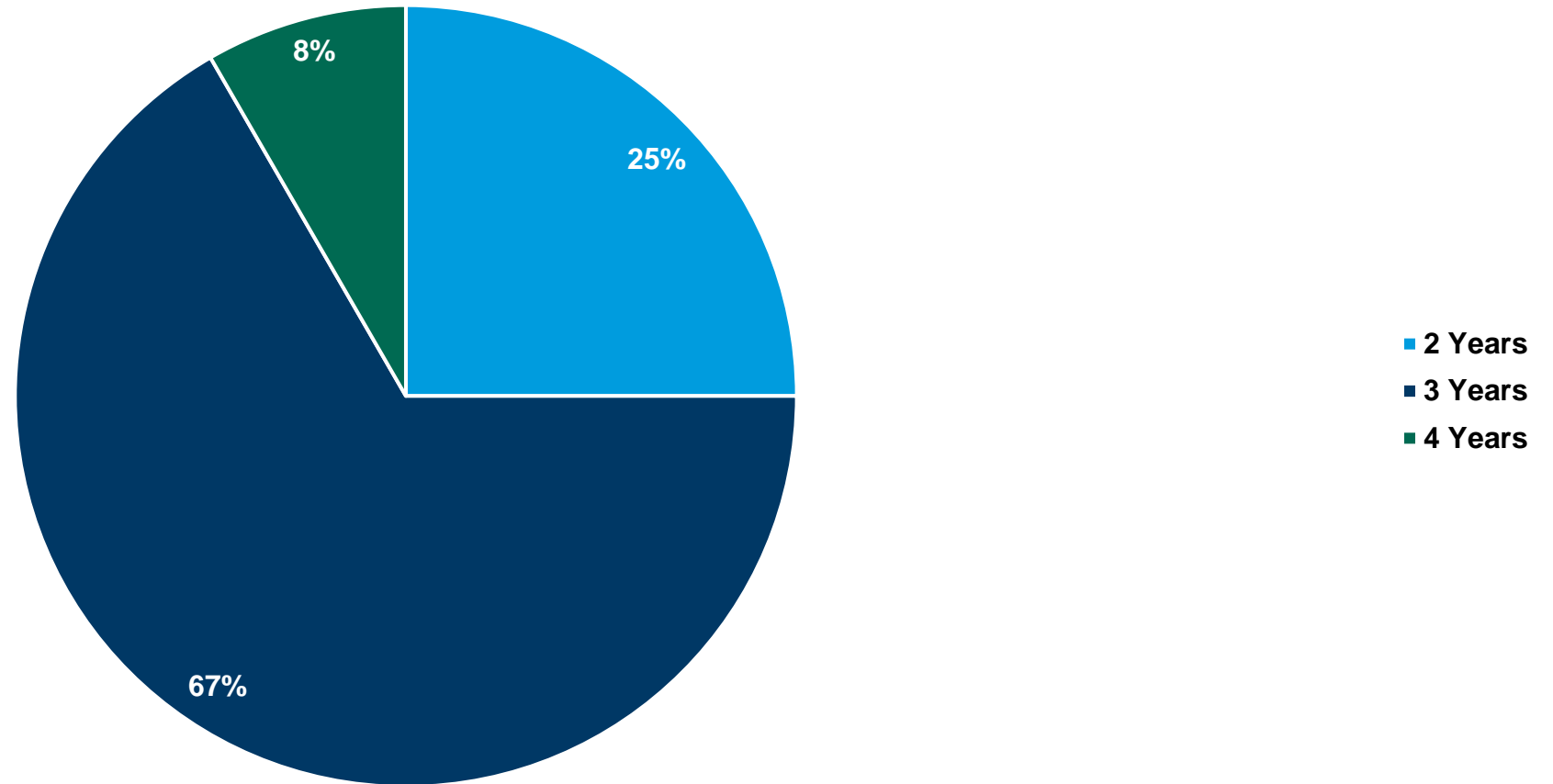
Approval Required for Extension of Term >€1.5B-€3.75B



Maximum Period of Extensions of Term >€500M-€1.5B

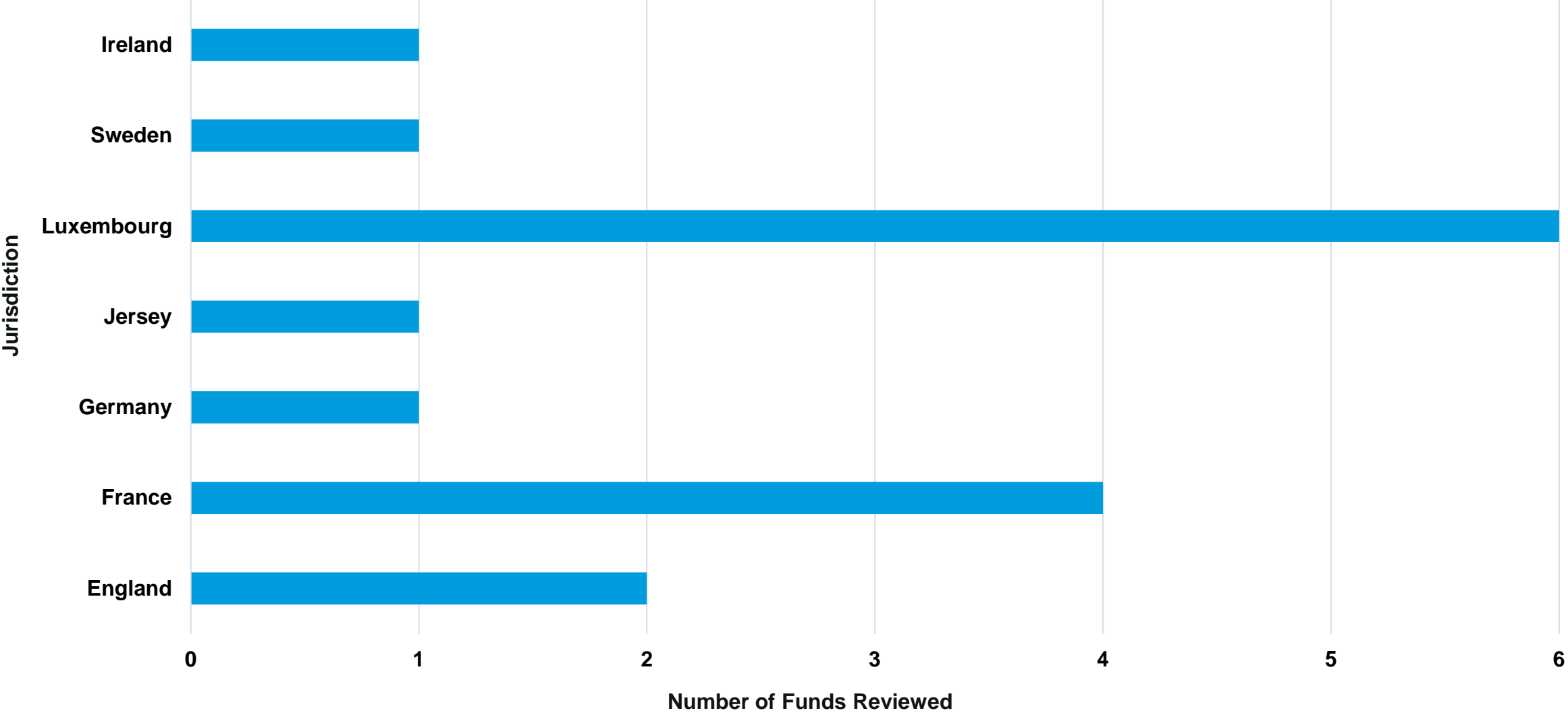


Maximum Period of Extensions of Term >€1.5B-€3.75B



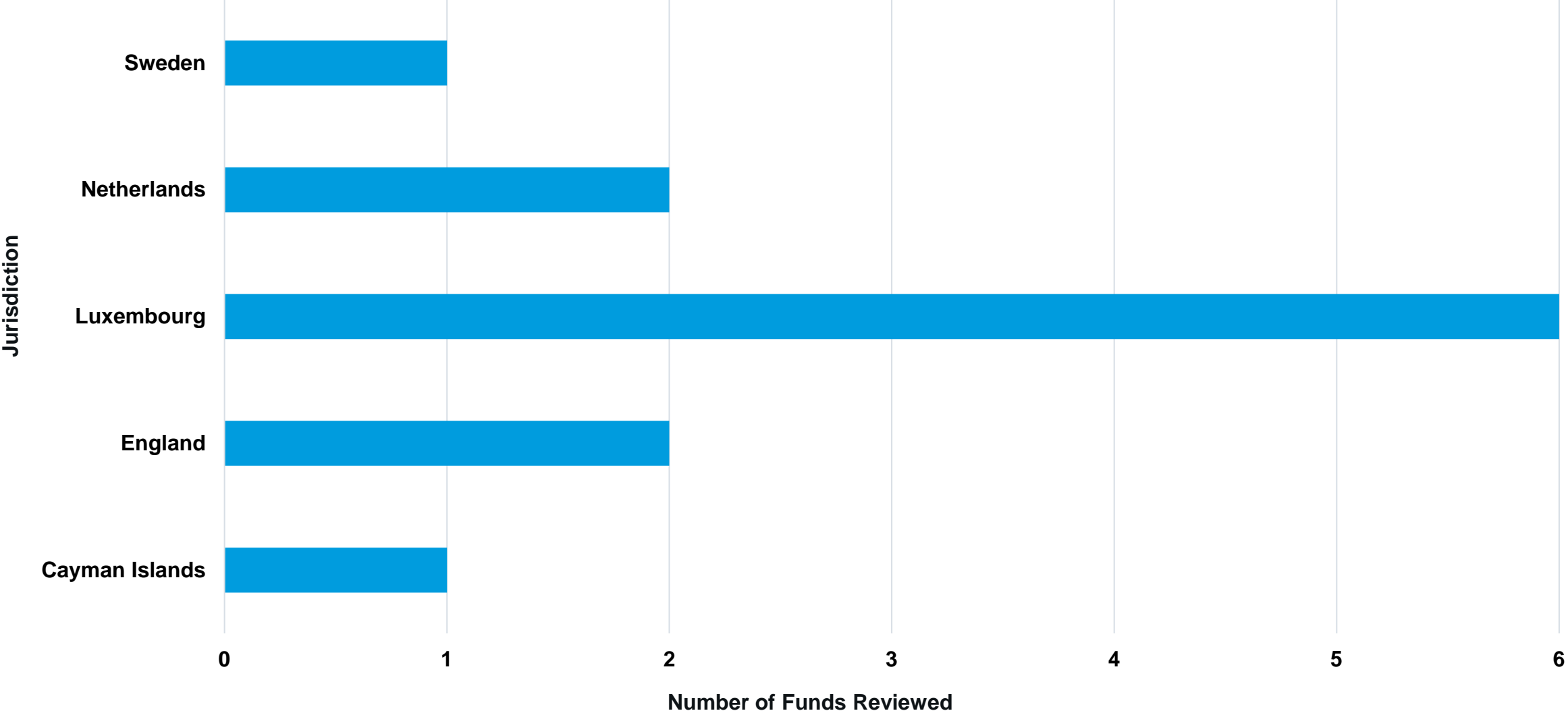
Jurisdiction of Formation

>€500M-€1.5B



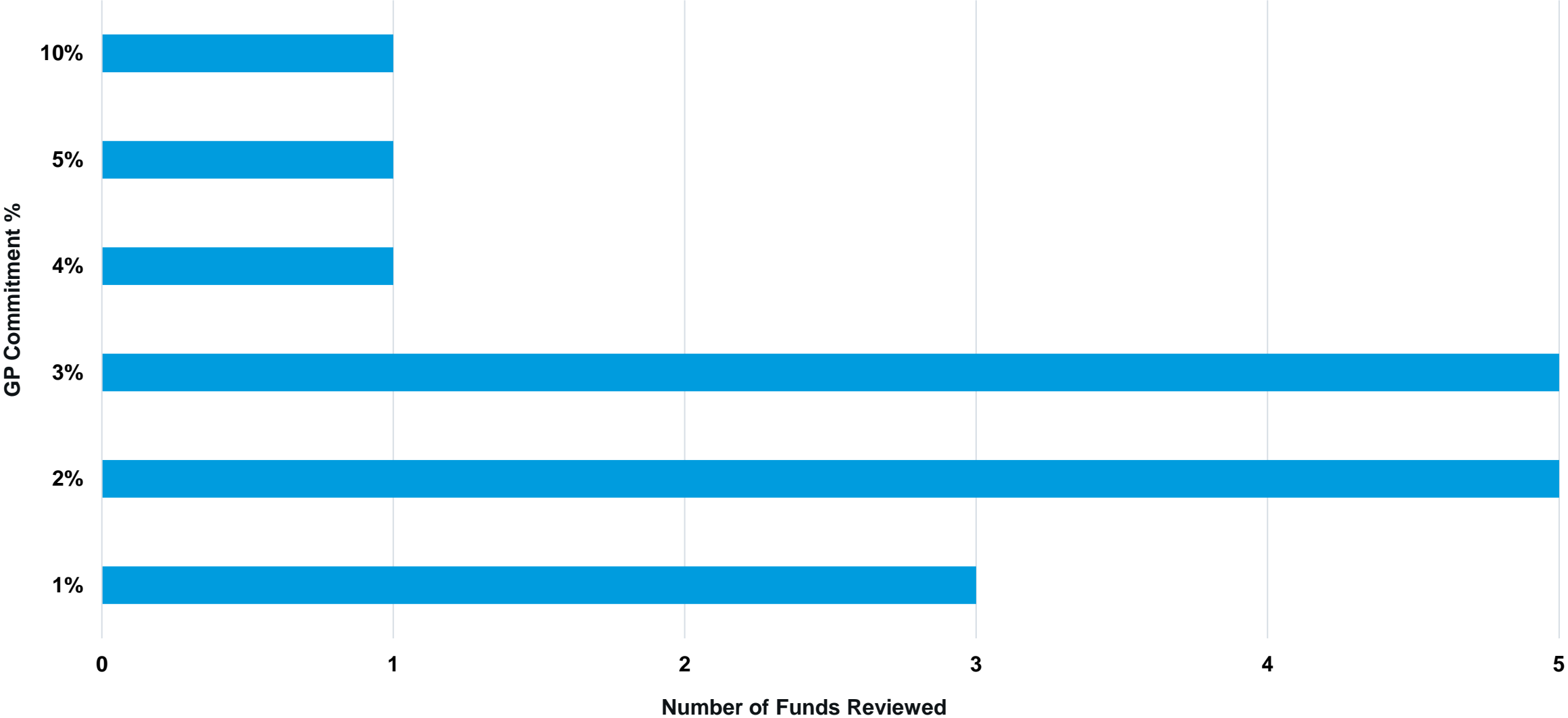
Jurisdiction of Formation

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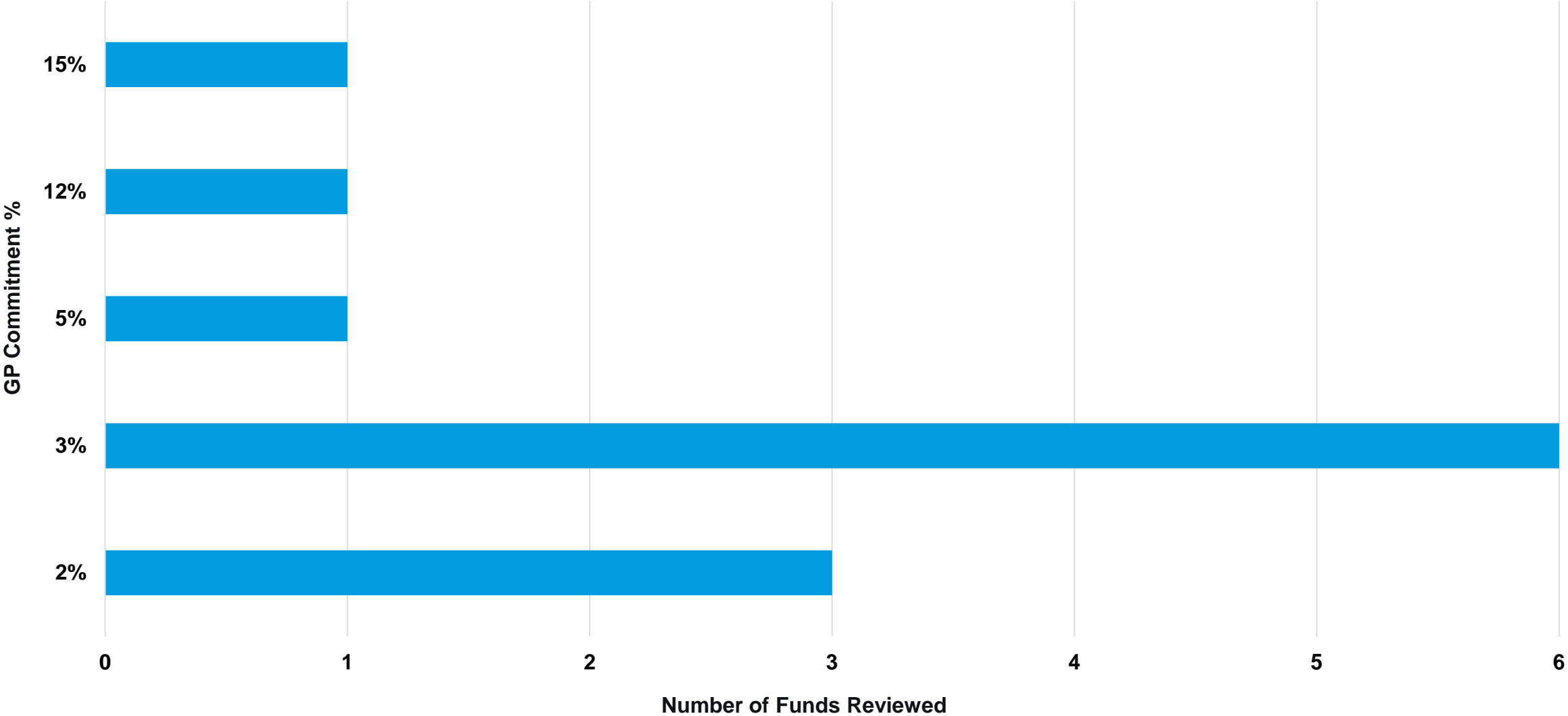
GP Commitment (% of Commitments)

>€500M-€1.5B



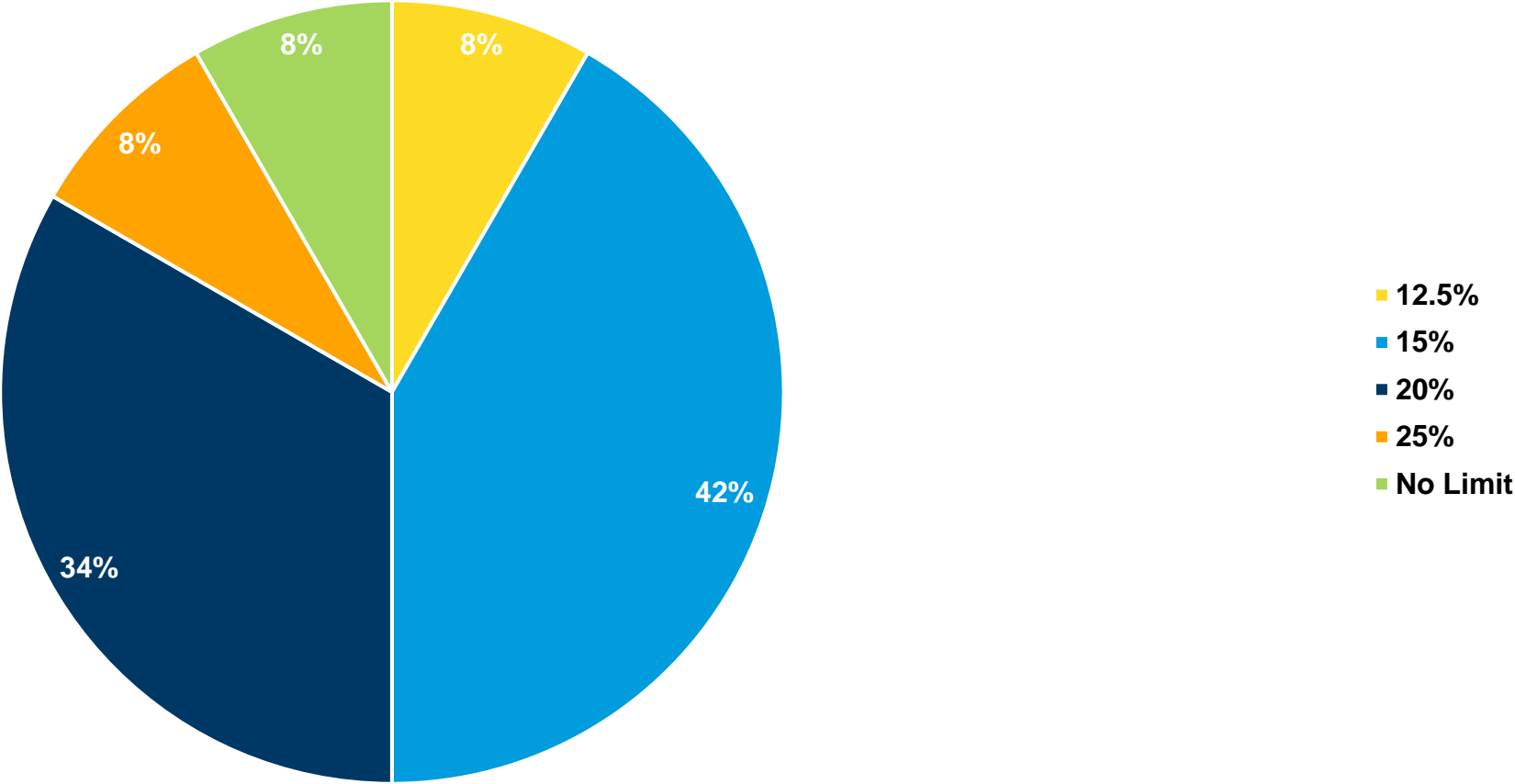
GP Commitment (% of Commitments)

>€1.5B-€3.75B



Investment Restriction – Diversification Limit (% of Commitments)

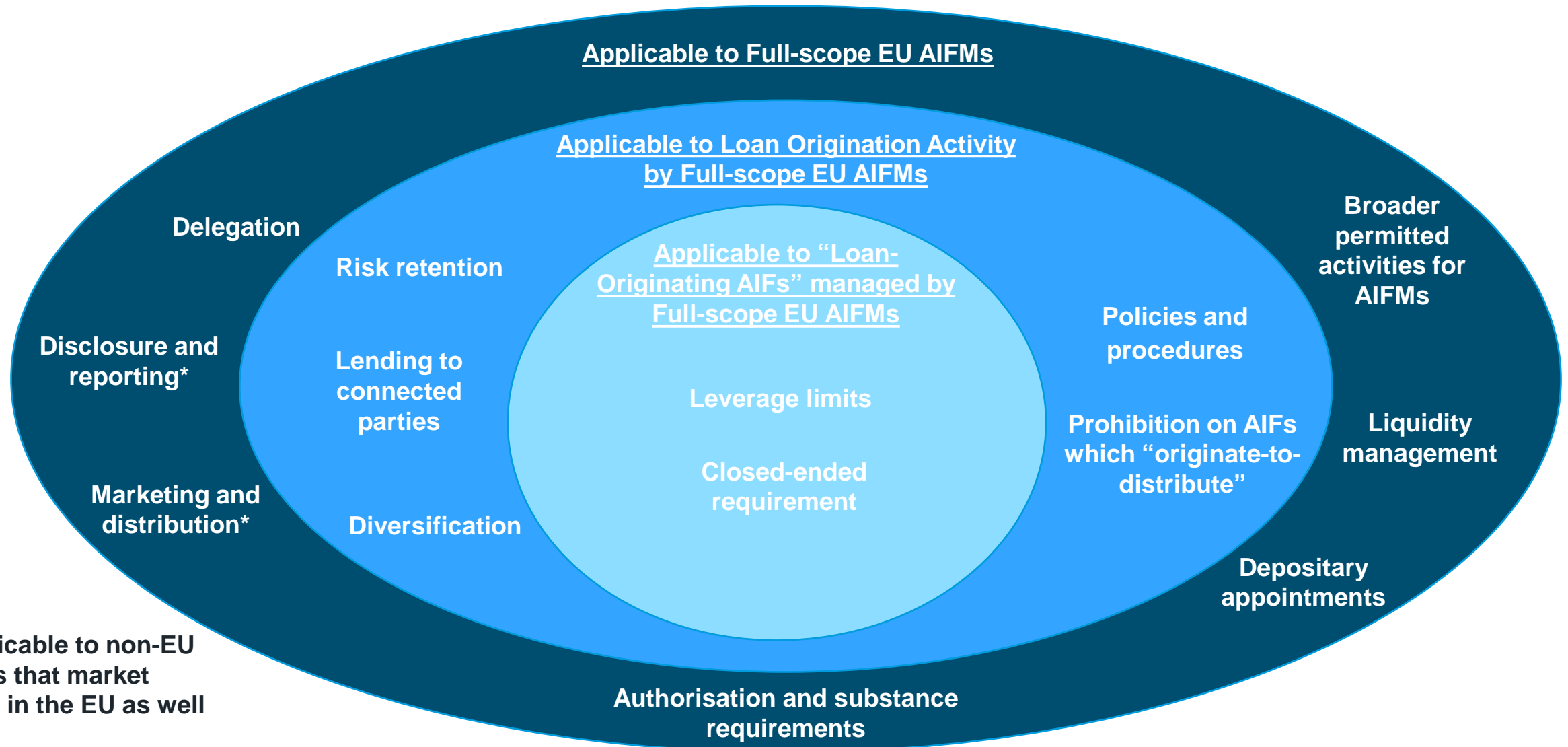
>€1.5B-€3.75B



APPENDIX 2 – Developments in regulation and the marketing of funds in Europe and beyond

Appendix 2A – AIFMD 2.0 – Further information

AIFMD II on the Horizon (in force from April 2026) – Overview of Requirements



*Applicable to non-EU AIFMs that market funds in the EU as well

Key Questions – AIFMD II

- **Are we in-scope?**
 - Applies to EU full-scope AIFMs (including Third Party AIFMs) and certain requirements will apply to funds which are marketed in EEA Member States.
- **Will AIFMD II have a big impact?**
 - Biggest impact on EU credit funds and their managers. Likely to also impact non-EU credit funds which are marketed in EEA Member States. Otherwise it is an “evolution rather than a revolution”.
- **Will AIFMD II introduce a cross-border lending “passport”?**
 - Maybe! While it is not explicitly provided for within AIFMD II, the inclusion of “originating loans on behalf of an AIF” as an ancillary AIFM activity means that this may be the case, although it is too early to tell.
- **Will AIFMD II impact UK AIFMs?**
 - No, unless the UK AIFM markets its fund(s) in the EEA.
- **Is “reverse solicitation” dead under AIFMD II?**
 - No, it remains possible to rely on “reverse solicitation” to raise capital from EEA investors where this is supported by the underlying facts.

Background / Timeline

On 26 March 2024, the final legislative text for targeted amendments to Directive 2011/61/EU (the “**AIFMD**”) and (to a certain extent) the UCITS Directive – known informally as “**AIFMD II**” – was published in the Official Journal of the European Union, with an adoption date of **15 April 2024**.

AIFMD II seeks to address (i) perceived shortfalls in the AIFMD; and (ii) new risks that have emerged, following the significant growth of the funds industry (including specific risks arising from direct lending activities).

Date	Summary
February 2024	European Parliament and European Council approved the final legislative text.
15 April 2024	AIFMD II was adopted in the Official Journal of the European Union (the “ Adoption Date ”).
16 April 2026	Following a 2-year implementation period, AIFMD II will come into force.
16 April 2029	<p>End of the grandfathering period for loan origination funds which were established prior to the Adoption Date.</p> <p>During this period, pre-existing AIFs (i.e. AIFs constituted prior to the Adoption Date) will not be required to comply with the leverage limits, diversification rules and the closed-ended requirement. However, any pre-existing AIFs which are already in breach of the leverage and/or diversification rules as at the Adoption Date must not increase their leverage or lending to the relevant borrower during this period.</p> <p>In addition, certain requirements (e.g. lending to certain parties, risk retention and the prohibition on “originate to distribute” strategies) will not apply to pre-existing loans as at the time of the Adoption Date.</p>

Applicability

Entity	Summary
Sub-threshold EU AIFMs	AIFMD II changes not applicable.
Full-scope EU AIFMs	General requirements set out on slides 5 to 9 are applicable.
Non-EU AIFMs	If AIFs are marketed in the EU under the national private placement regimes (“ NPPRs ”) (i) the disclosure and reporting; and (ii) the marketing and distribution requirements, set out slides 7 and 8 are applicable.
Full-scope EU AIFMs that carry out loan origination activity	Additional requirements set out on slides 10 to 14 are applicable (as well as the requirements set out on slides 5 to 9).
Full-scope EU AIFMs that manage “loan-originating AIFs”	Additional requirements set out on slides 15 to 17 are applicable (as well as the requirements set out on slides 5 to 14).

Appendix 2B – ESG Regulatory & Greenwashing – Further Information

Contents

- FCA Anti-greenwashing rule
 - 1. ESMA Fund Names Guidelines
 - 2. SFDR 2.0
- Addendum 1: Addendum 2: Proskauer & ESG

FCA Anti-Greenwashing Rule

FCA Anti-Greenwashing Rule

- In force 31 May 2024
- Applies to all FCA authorized firms
- Extension of existing clear, fair and not misleading requirements
 - Communications with a client (potential or actual, retail or professional) in the United Kingdom in relation to a product or service
 - Communications or approvals of financial promotions to a person in the United Kingdom
 - Where the communication/financial promotion infers or refers to the sustainability characteristics of a product or service
 - Inclusive of firm-level information which does not relate to a specific product or service which may still be in scope if considered part of 'representative picture' of a product or service

The FCA Rule

A firm must ensure that any reference to the sustainability characteristics of a product or service is:

- *consistent with the sustainability characteristics of that product or service; and*
- *fair, clear and not misleading*

Three pillars of the FCA Anti-Greenwashing Rule

1. Correct and capable of being substantiated

- Factually correct
- RobU.S.t and credible evidence
- Substantiated at the time of making the statement and on an ongoing basis
- If specific evidence is referenced, consider making that evidence available
- Avoid overstating

2. Clear and presented in a way that can be understood

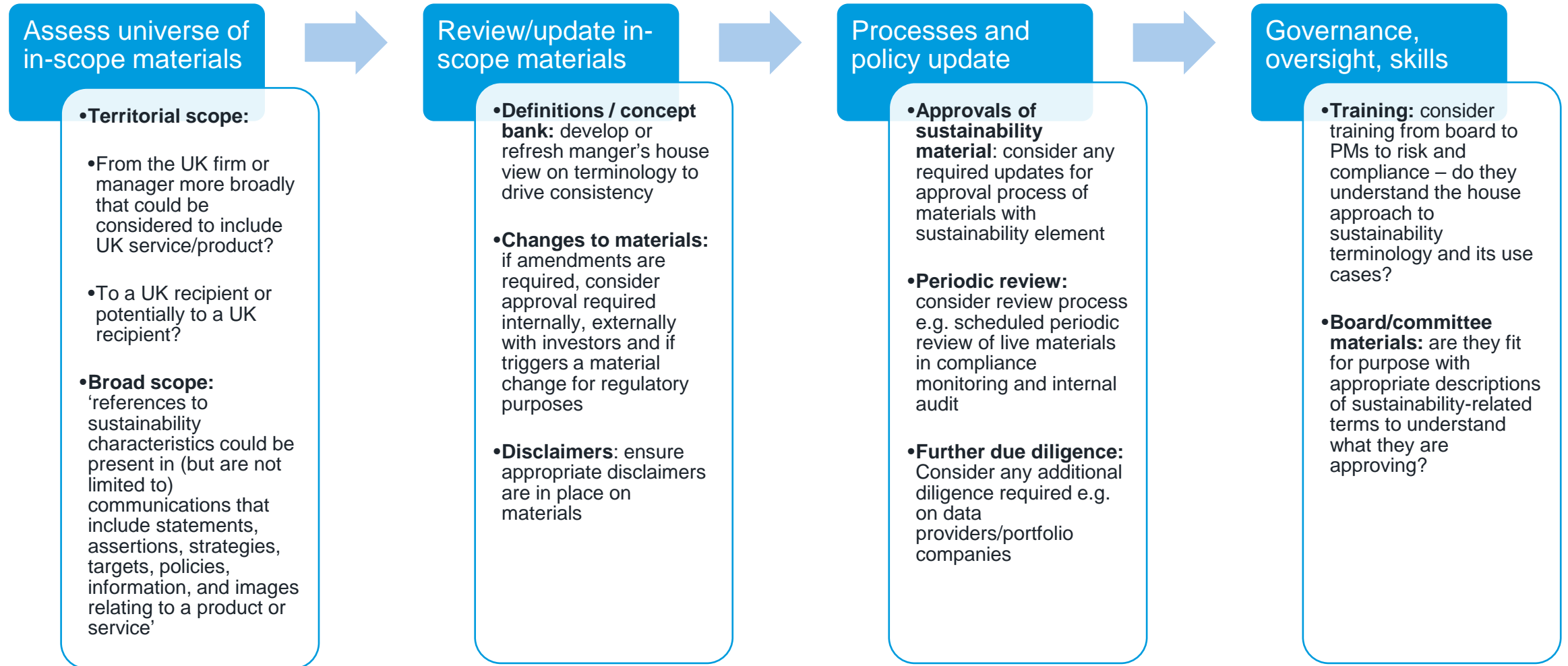
- Transparent and straightforward
- Technical terms explained
- useful to intended audience
- Images and colour to be consistent with claims
- Avoid general, broad statements
- Avoid misleading impressions through misuse of images and colours

3. Complete

- Representative of the product/service
- Prominently state conditions, caveats and limitations of data/metrics
- Present in a balanced way – include negative sustainability impacts
- Cover full life cycle – specify what applies, when
- Avoid cherry-picking

See FCA Guidance for further information and good practice examples: [FG24/3: Finalised non-handbook guidance on the Anti-Greenwashing Rule \(fca.org.uk\)](#)

Indicative steps plan to meet FCA anti-greenwashing expectations



ESMA Fund Names Guidelines

ESMA Final ESG Fund Name Guidelines (1)

Which funds are in scope?

- **All AIFs and UCITS managed by EU AIFMs/UCITS management companies**
- **Transition, social, governance, environmental, impact, sustainability-related named funds – no exhaustive list**
- No confirmed direct coverage of non-EU managers marketing funds into the EU under NPPR
- Closed funds that are no longer marketed are technically also in scope – expecting regulators to take a proportionate approach and for re-naming not to be required in all cases

What do the Guidelines require?

- **Asset allocation:** All funds with ESG-related name: Asset allocation thresholds – 80% minimum – as part of binding elements of strategy
- **Climate Transition Benchmark exclusionary criteria:** for transition, social and governance-related named funds
- **Paris-aligned exclusionary criteria:** for environmental, impact and sustainability-related names funds
- **Additional requirement for sustainability-related name:** also must invest “meaningfully” in sustainable investments – not specified
- **Additional requirement for transition-related or impact-related name:** also must have a clear and measurable path to social or environmental transition, with the objective to generate a positive and measurable social or environmental impact alongside a financial return

ESMA Final ESG Fund Name Guidelines (2)

Are the Guidelines mandatory? When do they apply?

- **For new funds from 21 Nov 2024 and for existing funds from 21 May 2025 (BaFin already applying)**
- Within two months of the publication on ESMA's website in all EU official languages, local regulators must confirm if they (i) comply; (ii) do not comply but intend to; (iii) do not comply and do not intend to
- Expectation that closed funds that are no longer marketed will have to comply nine months after the ESMA publication – but consider proportionate approach and how the regulators choose to embed them
- If possible, factor into strategy considerations now

What are the supervisory expectations?

- **No specific enforcement action or penalties recommended**
- Fund name changes may trigger a material change notification to EU regulators
- Temporary breach that is corrected in the best interests of investors should be considered a passive breach
- “Further investigation” and “supervisory dialogue” recommended, such as where there is a quantitative asset allocation breach and it is not a passive breach or even where the regulator considers an investor might be misled

Quick Reference Guide: ESMA Final ESG Fund Name Guidelines

The Fund Name Contains	80% Asset Allocation: Share of Investments in accordance with Binding Elements of the Investment Strategy	Minimum Exclusions according to the Climate Transition Benchmark (fossil fuels “allowed”)	Minimum Exclusions According to the Paris-Aligned Benchmark (very limited fossil fuels possible)	Obligation to "meaningfully" invest in Art. 2 (17) SFDR sustainable investments (no threshold set)
Transition, social or governance-related terms	•	•		
Environment- or impact-related terms	•		•	
Sustainability-related terms	•		•	•

SFDR 2.0

SFDR 2.0

On course for change

Two consultation papers launched in Sept 2023 seeking feedback on fundamental redesign and repurposing of SFDR.

Joint ESAs' Opinion

Suggested 'Sustainability' label

- Already e/s sustainable investments.
- For environmentally sustainable – minimum % of Taxonomy-aligned.
 - For non-Taxonomy aligned must follow DNSH (PAIs, minimum safeguards + good governance).
 - SFDR Article 2(17) sustainable investment only to be used if activity not included in Taxonomy Regulation.
- For socially sustainable – social metrics could be social PAI indicators.

Other concepts:

- Funds not categorised either to disclose sustainability features or have a disclaimer
- Also consider a sustainability indicator to be present.

Suggested 'Transition' label – could be Transition Impact sub-category

- Investments aiming to become sustainable over time.
- Mix of Taxonomy-alignment, transition plan reliance, decarbonisation trajectories, mitigation of PAIs and exclusions.
- Quantitative short, intermediate and long-term targets/milestones.
- No requirement for DNSH to all investments as some may be transitioning from a permanently harmful threshold, some indicators permanently harmful.

- Sustainability risks disclosures to be retained.
- Differentiate between “consider” PAIs and “information on” PAIs – and potentially some PAIs to be disclosed for all funds.

Appendix 2C – U.S. Regulatory – Developments and Trends

U.S. Regulatory

How does U.S. regulation apply to UK / European Sponsors?

- Regulation of the Manager
- Regulation of the Fund
- Regulation of the Offering to U.S. Investors

Regulation of the Manager

- **Investment Advisers Act:** Governs investment advice, including management and recommendations.
- **SEC Registration:** Where required, manager is subject to substantive rules and active oversight (significant burden).
- **Exemption Regimes** for Non-U.S. Managers:
 - **Foreign Private Adviser:**
 - No U.S. offices.
 - <\$25m from U.S. investors, <15 U.S. investors, across all funds.
 - No filing required.
 - **Exempt Reporting Adviser:**
 - Can have U.S. offices but no investment decision-making from U.S.
 - Unlimited capital from unlimited U.S. investors.
 - Filing required (Form ADV).
- **Requirements for All Advisers:** Even exempt advisers are subject to some requirements, but not as many as registered advisers (RIAs) – See Appendix 1.
- **Practical takeaways.**

U.S. Regulatory

Regulation of the Fund

- **Investment Company Act:** Primarily intended for retail-focused products.
- **SEC Registration:** Very onerous and restrictive, if required.
- **Exemptions for Privately-Offered Funds:**
 - Targeting HNW and institutional investors; more favorable if non-U.S. domiciled.
- **Primary Exemptions:**
 - **3(c)(1):** <100 U.S. owners; "look-through" may apply to count owners' owners.
 - **3(c)(7):** Unlimited owners, but all U.S. owners must be "qualified purchasers" (>\$5m for HNW, >\$25m for institutions); "look-through" may apply for QP status.
 - No filing required for either exemption.
- **Practical takeaways.**

Regulation of the Offering to U.S. Investors

- **Securities Act:** Governs U.S. securities offerings.
- **SEC Registration:** Very onerous and restrictive, if required.
- **Private Placement Exemptions:** Regulation D, Rule 506(b).
 - Restrictions on soliciting new investors.
 - All U.S. investors must be "accredited investors" (>\$1m for HNW, >\$5m for institutions).
 - Filing required (Form D).
- **Practical takeaways.**

U.S. Regulatory – Investment Advisers Act Fiduciary Duties for All Advisers

Anti-Fraud Provisions and Fiduciary Duty

- **Section 206(1) and (2):** Prohibits advisers from defrauding clients, covering all conduct within the advisory relationship (even if unrelated to securities)
- **Fiduciary Duty:** Duty of care and duty of loyalty, breached by intentional acts or by negligence
- Fiduciary duties under the Advisers Act cannot be waived or altered by contract
- Only the SEC can enforce these duties through lawsuits
- Separate fiduciary duties under the law of the fund's domicile can be modified (if allowed) and enforced by LPs through private lawsuits

Application to Private Fund Advisers:

- The fund is the client of the adviser
- **Rule 206(4)-8** extends Section 206 anti-fraud protections to cover dealings with the fund's investors
- This rule is frequently cited in SEC enforcement against private fund advisers for duty breaches

U.S. Regulatory – Advisers Act Requirements for All Advisers

Principal Transactions and Cross Transactions

- **Principal Transaction:** Purchase or sale of securities between an adviser and a client
 - Prohibited without informed client consent on a transaction-by-transaction basis (pre-consents not allowed)
 - For private funds, GPs cannot cause the fund to consent; LPACs are typically empowered to do so
- **Cross Transaction:** Transaction between two different funds or client accounts managed by the same adviser
 - Not always a “principal transaction,” but often raises conflicts of interest in illiquid strategies, affecting the duty of loyalty (Advisers Act Sec. 206)
 - Typically managed through disclosure and consent from each “client” (i.e., LPAC)

Political Contributions Rule

- **Rule 206(4)-5:** Prohibits advisers from receiving compensation for two years from a U.S. public pension plan if:
 - A "covered associate" (including control persons and marketers)
 - Makes a political contribution
 - To an official or candidate overseeing the pension plan
- Allows de minimis contributions, but thresholds are low (\$150–\$350)
- Easy to violate if not monitored, with severe consequences due to the potential fees from these investors.

U.S. Regulatory – Advisers Act Requirements for RIAs

Advisory Contracts: Consent to Assignment

- **Advisers Act Sec. 205:** Prohibits assignment of advisory contracts without client consent
- For private funds, the LPA and Management Agreement are treated as "advisory contracts"
- A change in control of the adviser is considered an indirect assignment
- The GP cannot consent on behalf of the fund; consent typically comes from the LPAC or by LP majority/super-majority vote.

Performance-Based Compensation

- **Advisers Act Sec. 205 and Rule 205-3:** Prohibit performance-based fees (including carried interest) unless the investor is a "qualified client":
 - \$2.1m net worth, or >\$1m AUM with the adviser, or
 - Fund is a 3(c)(7) fund
- Compliance is generally straightforward for fund managers unless dealing with smaller investors

U.S. Regulatory – Advisers Act Requirements for RIAs

Marketing Rule

- **Advertisement Definition:** Very broad, covering most communications related to marketing, including social media and re-postings
- **General Prohibitions:**
 - False/misleading statements
 - Unsubstantiated material claims
 - Failure to provide "fair and balanced" presentation
- **Testimonials and Endorsements:**
 - Trigger disclosures and requirements
 - Placement agents are considered compensated endorsers

Performance Advertising Requirements:

- Performance must be shown net of fees (including individual investments/subsets)
- Model fees allowed; required if advertising performance of assets managed without fees
- Special rules for "hypothetical performance" (e.g., projected returns):
 - Disclosure of assumptions and adoption of policies
 - Additional requirements for performance achieved at other firms
- Must maintain records of advertised performance

U.S. Regulatory – Advisers Act Requirements for RIAs

Custody Rule

- **Rule 206(4)-2:** Requires specific procedures for client assets when an adviser has custody
 - Custody includes authority to take possession of assets or pay from client accounts
 - Most GPs/Managers of private funds have this authority
- **Safekeeping:** Client cash and securities must be held with "qualified custodians" (e.g., banks, brokers)
- **Third-Party Verification:**
 - Annual audit by an external firm is required to verify custody
 - For private funds, an annual U.S. GAAP audit within 120 days of FYE satisfies this requirement

Form PF:

- Requires RIA private fund advisers to file confidential reports with the SEC
- Applies to RIAs with at least \$150m in private fund AUM
- Provides data on private fund risk exposures, leverage, and liquidity
- Quarterly filing for large hedge fund advisers, annually for smaller advisers and closed-end fund managers
- Also requires notice filings:
 - Large hedge fund managers: Within one business day for certain significant events, such as large losses, margin or default events or key operational disruptions
 - Private equity fund managers: On a more delayed basis, adviser-led secondary transactions, GP removals and early termination of investment period or fund

U.S. Regulatory – Advisers Act Requirements for RIAs

Compliance Program

- **Rule 206(4)-7** requires RIAs to:
 - Adopt written compliance policies tailored to prevent Advisers Act violations
 - Designate a Chief Compliance Officer (CCO) to oversee the program
 - Conduct and document annual reviews of the program's effectiveness
- **Code of Ethics Rule (206(4)-7):** Requires RIAs to adopt a code of ethics, including standards for personal trading and reporting by "access persons"

Chief Compliance Officer Requirements

- Must be "knowledgeable and competent" on the Advisers Act and rules
- Must have authority within the firm to enforce the compliance program
- Acts as the primary SEC contact
- Often a dual-hatted role in smaller firms, not necessarily dedicated

U.S. Regulatory – Advisers Act Requirements for RIAs: Limited Application to “Offshore” Advisers

SEC’s Limited Extraterritorial Application of Advisers Act

- Most substantive requirements do not apply to advisers with principal offices outside the U.S. advising non-U.S. clients
- All provisions apply when advising U.S. clients
- For private funds, domicile determines U.S./non-U.S. status, regardless of investor nationality

Requirements Not Applicable to Offshore Advisers Advising Offshore Clients

- Client consent for principal transactions
- Marketing Rule
- Custody Rule
- Client consent for adviser assignments
- Performance-based fee prohibition (non-qualified clients)
- Form PF (for non-U.S. funds with no U.S. investors)
- Compliance Program and Code of Ethics (limited applicability)
 - Some recordkeeping still required
 - Must collect/retain personal securities reports from "access persons"

U.S. Anti-Greenwashing

U.S. Greenwashing

SEC General Approach

- Proposed rulemaking
- Scrutiny by three SEC Divisions (Enforcement, Exams, Corp Fin)

Sources of Inquiry

- Routine exams/reviews
- Referrals from other Divisions
- Targeted sweeps, ESG Taskforce
- Civil lawsuits, press reports
- Whistleblower complaints

Cases/Current Investigations

- Disclosure focused
 - *Are you doing what you say and saying what you do*
 - *Focus on strict compliance with the facts that are disclosed*
- Materiality is presumed
- No requirement for investor harm
- Also focused on ESG-specific policies and procedures
- Scrutiny of ESG policies and disclosures may expand into other issues

An uptick in regulatory risk for greenwashing

Fertile ground for greenwashing

- ❑ Even when unintentional, which translates into the following key risks, both of which have potential to pose financial risk:
 - ❑ **Legal risk** (such as litigation and regulatory enforcement)
 - ❑ **Reputational risk**

FCA anti-greenwashing rule

- ❑ In force from 31 May 2024 – applicable to all FCA authorized firms – must be a UK nexus to the communication
- ❑ Very broad range of communications – even pictures and imagery within the FCA's sights
- ❑ Extension of existing clear, fair and not misleading requirements – with a specific Rule the FCA could enforce

ESMA Final Paper on Greenwashing

- ❑ Request for NCAs to supervise more closely – call for scrutiny and challenge with the following areas, in particular focus:
 - ❑ Claims about product level sustainability, real-world impact or engagement activities
 - ❑ Entity-level net zero targets and transition plans
 - ❑ Sustainability-based remuneration systems

SEC investigation and enforcement

- ❑ Lack of formal rules, but with the highest rate of enforcement
- ❑ Investigations focus on misalignment between marketing materials and underlying fund documentation or policies and procedures
- ❑ Investigations have also focused on establishing disclosures, such as on screening, are not misleading in terms of impact on the portfolio construction

SEC's Climate and ESG Task Force

Sept. 12, 2024, 1:48 PM EDT; Updated: Sept. 12, 2024, 3:17 PM EDT

SEC Abandons ESG Enforcement Group Amid Broader Backlash (1)

EXCLUSIVE



Andrew Ramonas
Senior Reporter



► Listen     

- SEC ended task force within past few months, spokesperson said
- Agency launched group in 2021 with nearly two dozen staffers

The SEC has quietly disbanded a group of enforcement lawyers who helped bring litigation fighting misleading environmental, social and governance disclosures for more than three years.

The Securities and Exchange Commission shut down its Enforcement Division's Climate and ESG Task Force within the past few months, an agency spokesperson told Bloomberg Law Thursday.

Enforcement's ESG Task Force launched in March 2021

Nearly two dozen staff members

Announced focus: public company disclosures of climate risks.

Actual cases: more focused on Investment Advisers

SEC's ESG Timeline

- 2019-2020: ESG-focused “sweep” examinations of advisers
- March 2021: Division of Enforcement launched Climate and ESG Task Force
- April 2021: Division of Examinations ESG Risk Alert for Investment Advisers
- March 2022: Enforcement action filed against Vale S.A.
 - Brazilian mining company, U.S. ADR issuer
- May 2022: ESG Enforcement case against BNY Mellon Investment Adviser
- May 2022: SEC proposes ESG Reporting and Disclosure Rules for Advisers
 - No final rule (yet)
- September 2023: Names Rule Amendments (RICs and BDCs)
- 2024: ESG Task Force dissolved

Sample SEC Exam Requests with ESG Focus

Pertaining to ESG:

- i. state the internal definition of any terms that relate to ESG that are also used in disclosure or marketing materials provided to prospective or current clients or investors;
- ii. list and provide a description for all ESG criteria that are utilized (e.g., environmental, social, governance, etc.); and
- iii. provide copies of any written policies and procedures relating to the application of ESG criteria to the investment process. Include versions currently in use and any previous versions utilized during the Examination Period.

State whether Registrants adhere to, or is a signatory to, any ESG industry standard(s) (e.g., UN Principles for Responsible Investment, Equator Principles, etc.). If so, please:

- i. Provide written documentation of any consideration of the standard(s) in its investment/manager selection, portfolio management processes and proxy voting/issuer engagement practices.
- ii. Provide copies of any initial application and subsequent periodic reports transmitted during the Examination Period by Registrants to the applicable ESG industry standard association(s), as well as any comments or evaluations received from the industry standard association(s), as applicable.
- iii. Provide any policies and procedures associated with compliance oversight of adherence such ESG frameworks/standards.

Sample SEC Exam Requests with ESG Focus

For ESG Funds, state whether a proprietary scoring system (or scoring by an affiliated entity) is used. If so:

- i. indicate whether the proprietary scoring system is based, in whole or in part, on ESG criteria;
- ii. provide a written explanation describing the methodology used to derive the score;
- iii. describe the factors underlying each score level;
- iv. state how often the score is evaluated;
- v. state whether prospective or current clients or investors are provided with the score(s); and
- vi. provide copies of any formal, written procedures pertaining to the scoring system. If not included in the formal written procedures, please include or identify existing records that contain the explanations and descriptions sought in this request.

Similar questions for third-party ESG scoring systems or sub-advised strategies.

SEC Enforcement Actions – Investment Advisers

BNY Mellon Investment Adviser (May 2022)

- Adviser (and sub-adviser) didn't conduct written ESG quality reviews for all fund investments
- Misleading practices under the Advisers Act (and 40 Act prospectus violations).

Goldman Sachs Asset Management (Nov 2022)

- Failure to adopt written ESG policies and procedures, then later failure to routinely follow the procedures as to ESG questionnaires for ESG SMA strategies and mutual funds.
- Compliance Rule violations only.

DSW Investment Management (Sep 2023)

- Failure to fully implement written statements and policies, including considering ESG aspects in recommendations or documenting those reviews. Funds and SMAs.

Inspire Investing (Sep 2024)

- “Biblical values” ETF manager – failed to consistently apply its disclosed investment criteria.

SEC Enforcement Approach – Current Status

- The politicized term “ESG” may be falling out of favor ...
 - “Red state” issues:
 - AG investigations
 - Divestment
- Current Investigations:
 - ESG-related concerns regarding disclosure obligations are alive and well.
 - “Do what you say and say what you do”
 - Focus is on complying strictly with facts that are disclosed.
 - Enforcement path: fiduciary obligations of U.S. Investment Advisers
 - ESG-Specific Policies and Procedures (required?)

Common greenwashing actions and locations

How greenwashing can occur

- ☐ Cherry-picking the most “ESG friendly” information to report on
- ☐ Omission, through being partial, selective, unclear, unintelligible, vague
- ☐ Oversimplistic, ambiguous or untimely information and unsubstantiated statements
- ☐ Empty or unsubstantiated claims (including exaggeration) where it is false, deceives or is likely to deceive including mislabelling, misclassification, mis-targeted marketing and inconsistent information
- ☐ Misleading use of ESG terminology such as naming
- ☐ Outdated information
- ☐ Focus on ESG process, without being clear on what the ESG result is
- ☐ Greenbleaching – playing down ESG profile

Where greenwashing can occur

- ☐ PPM/pre-contractual disclosures
- ☐ Fund periodic reports
- ☐ Annual reports at entity level
- ☐ Press releases
- ☐ Reporting under frameworks
- ☐ Marketing materials – website, social media, presentations to investors
- ☐ Pictures and colours - non-textual imagery or excessive imagery
- ☐ Placement agent/distributor material

Key anti-greenwashing takeaways

Very broad range of materials in scope of UK regulatory perimeter – must be substantiated claims on an ongoing basis

Regulatory action leads to higher litigation risk e.g. side letter, contractual review following parties alerted to regulatory scrutiny

European/UK regulators to gear up to enforce over coming years – SEC rules for funds tbc, whilst investigations continue apace



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