

EFAMA'S RESPONSE TO THE COMMISSION'S DRAFTS AMENDMENTS INTEGRATING SUSTAINABILITY CONSIDERATIONS INTO UCITS AND AIFMD

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EXECUTIVE SUMMARY

EFAMA² welcomes the opportunity to share views on the EC draft Delegated Acts on the obligation for mutual funds and alternative investment funds to advise clients on social and environmental aspects. Since the outset, EFAMA has been a strong supporter of creating a solid framework for sustainable finance which facilitates the transition to a more sustainable European economy. European asset managers have been integrating ESG into their investment processes in different forms for some time to achieve the diverse sustainability goals of individuals and institutional asset owners. This remains part of asset managers' mission to achieve long-term financial returns for their investors, and a key element of their operational excellence and competitive advantage.

The question is now whether we apply a tick the box approach, putting sustainability in a niche, or whether we opt for **an approach promoting further the dynamic development in sustainable investing, fostering a race to the top with a big push to transition our economy.** The Delegated Acts under UCITS, AIFMD (as well as MiFID) **should ensure mainstreaming of sustainable investing, while at the same time allowing investors a meaningful product choice.** In this respect, it is important to avoid any conflicts **between an asset manager's regulatory obligations and their fiduciary duty to pursue its investment strategy in the best interest of the clients.**

EFAMA fully supports the integration of sustainability risks as part of risk management policy at fund level, but we believe **that from a risk management perspective there is no reason to single out sustainability risks vis a vis all the other types of risks** and introduces an artificial ranking amongst those different risks. In addition, and as already recognised by a number of public authorities, we would also like to see the possibility for **sustainability risks to be assessed also on a qualitative basis.**

Finally, the sequencing in the implementation of the various elements of the sustainable finance framework is extremely important. The 12 months period for implementing substantive requirements for investment funds in terms of integrating sustainability risks and principal adverse impact is necessary and very much welcome. **Ideally a symmetrical approach across the whole framework** should allow coherent timelines with the disclosure requirements under Regulation 2019/2088 on sustainability-related disclosures in the financial sector (SFDR), and the latter ones with those on the Non Financial Reporting Directive, which set the basis for the necessary, reliable and transparent ESG data, whose availability is crucial for asset managers to properly account for sustainability risk within their risk management arrangements.

¹ European Commission consultations on

- amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for Undertakings for Collective Investment in Transferable Securities (UCITS)
- amending Delegated Regulation (EU) No 231/2013 as regards sustainability risks and sustainability factors to be taken into account by Alternative Investment Fund Managers

²EFAMA, the voice of the European investment management industry, represents 28 member associations and 59 corporate members. At end 2019, total net assets of European investment funds reached EUR 17.8 trillion. These assets were managed by close to 34,200 UCITS (Undertakings for Collective Investments in Transferable Securities) and 29,000 AIFs (Alternative Investment Funds). More information available at www.efama.org.

Last but not least, due to its many interlinkages, we ask the Commission to also consider our submission to the draft delegated acts on MiFID II.

DETAILED ANALYSIS AND SUGGESTED CHANGES

We have set out our key arguments below, including specific wording suggestions.

1. Risk of conflict with managers' fiduciary duties

- We believe that the Delegated Acts under MiFID, UCITS and AIFMD should **ensure mainstreaming of sustainable investing, while at the same time allowing investors a meaningful product choice.**
- As set out in the recitals of UCITS and AIFMD Delegated Acts, the purpose of the rules is to ensure that management companies and AIFMs meet high investor protection standards. In particular, the due diligence requirements state that **due diligence needs to take into account the objectives and investment strategy of the relevant portfolio.**
- Therefore, **we would challenge the idea that due diligence requirements need to include integration of principal adverse impact regardless of the existence of a connection to the investment strategy and objective.** Art. 7 SFDR explicitly states that entities must disclose '*whether and if so, how*' products consider PAI. This optionality must be reflected in the Delegated Acts to ensure that Management Companies and AIFMs remain aligned with the investment objectives of underlying investors and the fund's strategy.
- The current texts ignores the principal adverse impact framework, including the principle of materiality and proportionality set by Recital 18 of SFDR ("*...consider principal adverse impacts, whether material or likely to be material, of investment decisions on sustainability factors...*") and Art. 4(1)(a) of the same text ("*...taking due account of their size, the nature and scale of their activities and the types of financial products they make available;...*").
- By failing to adjust the language and asking that due diligence process for every investment strategy creates a **conflict between the asset manager's regulatory obligations and their fiduciary duty to pursue its investment strategy in the best interest of their clients.**
- We believe a way to address our concern could look as follows: delete paragraph 3 of Art. 17 and include a direct reference to Art. 4 of SFDR within Art. 23 (3) of Delegated Directive 2010/43/EU so to reference principal adverse impact directly to due diligence requirements and limiting principal adverse impacts considerations by the objectives, investment strategy and risk limits. The same amendments should be made to the Delegated Regulation (EU) No 231/2013, with the deletion of paragraph 6 of Art. 18.

Suggested changes

Art. 23(3) of Delegated Directive 2010/43/EU

"Member States shall require management companies to establish written policies and procedures on due diligence, including, where applicable, considerations on the principal adverse impacts on sustainability factors as required by Article (4) of Regulation (EU) 2019/2088, and implement effective arrangements for ensuring that investment decisions on behalf of the UCITS are carried out in compliance with the objectives, investment strategy and risk limits." (and those take the precedent)

~~*6. Member States shall ensure that where management companies, or, where applicable, investment companies, consider principal adverse impacts of investment decisions on sustainability factors as described in Article 4(1), point (a), of Regulation (EU) 2019/2088, or as required by paragraphs 3 or 4 of Article 4 of that Regulation, those management companies or investment companies take into account*~~

~~such principal adverse impacts when complying with the requirements set out in paragraphs 1 to 4 of this Article.”;~~

Art. 18(3) of Delegated Regulation (EU) No 231/2013

“AIFMs shall establish, implement and apply written policies and procedures on due diligence, including, where applicable, considerations on the principal adverse impacts on sustainability factors as required by Article (4) of Regulation (EU) 2019/2088, and implement effective arrangements for ensuring that investment decisions on behalf of the AIFs are carried out in compliance with the objectives, the investment strategy and, where applicable, the risk limits of the AIF”

~~6. Where AIFMs consider principal adverse impacts of investment decisions on sustainability factors as described in Article 4(1), point (a) of Article 4 of Regulation (EU) 2019/2088, or as required by paragraphs 3 or 4 of Article 4 of that Regulation, those AIFMs shall take into account such principal adverse impacts when complying with the requirements set out in paragraphs 1 to 3 of this Article.”;~~

2. Sustainability risk should not be singled out compared to other types of risks

EFAMA fully supports the integration of sustainability risks as part of risk management policy at fund level, **but we believe there is no reason to introduce this specific risk in the context of provisions not related to risks but to general organisational, due diligence or conflict of interest requirements which by nature are not related to risks.**

- Having sustainability risks in such general provisions, **seems to imply a different weighting for sustainability risk vis a vis all the other types of risks and introduces an artificial ranking amongst those different risks.**
- Furthermore SFDR, which requires fund managers to inform how they assess sustainability risks, already tackles significant regulatory changes to be made in organisation, resources, management and due diligence requirements within UCITS & AIFMD management companies. **Singling out sustainability risks here is therefore not only inappropriate from a risk management perspective, it is also unnecessary from a regulatory policy development.**

Suggested wording to recital 3 (UCITS and AIFMD) DAs:

- (...) Management companies (AIFMs) should therefore assess ~~not only~~ all relevant financial risks on an ongoing basis, ~~but also including~~ all relevant sustainability risks as referred to in Regulation (EU) 2019/2088 of the European Parliament and of the Council¹⁵ that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Delegated Regulation (EU) No 231/2013¹⁶ does not explicitly refer to sustainability risks. For that reason ~~and to ensure that internal procedures and organisational arrangements are properly implemented and adhered to~~, it is necessary to clarify that ~~processes, systems and internal controls~~ risk management policies of management companies (AIFMs) ~~reflect explicitly~~ consider sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks.

Suggested changes to the definition of sustainability risks in both texts

‘sustainability risk’ means sustainability risk as defined in Article 2, point (22), of Regulation (EU) 2019/2088 of the European Parliament and of the Council ~~that should be considered as subset of other financial risks;~~

~~where appropriate, the assessment of sustainability risks shall be based on Article 45(3), upon the availability of public, transparent, relevant and reliable information related to ESG considerations. Those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms, as consistent with Recital 15 under SFDR.”~~

Suggested amendments under UCITS DAs, to ensure the reference to sustainability risk is kept within the appropriate provisions, i.e. those related to risks that we support (amended Art. 38(1))

(2) in Article 4(1), the following subparagraph is deleted:

~~“Member States shall ensure that management companies take into account sustainability risks when complying with the requirements laid down in the first subparagraph.”;~~

(3) in Article 5, the following paragraph 5 is deleted:

~~“5. Member States shall ensure that for the purposes laid down in paragraphs 1, 2 and 3, management companies retain the necessary resources and expertise for the effective integration of sustainability risks.”;~~

(5) in Article 9(2), the following point (g) is deleted:

~~“(g) is responsible for the integration consideration, among other risks, of sustainability risks in the activities referred to in points (a) to (f).”;~~

(6) in Article 17, the following paragraph 3 is deleted:

~~“3. Member States shall ensure that, when management companies identify the types of conflicts of interest the existence of which may damage the interests of a UCITS, those management companies include those types of conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls.”;~~

(7) in Article 23, the following paragraphs 5 is deleted:

~~“5. Member States shall require that management companies take into account sustainability risks when complying with the requirements set out in paragraphs 1 to 4.”;~~

Suggested amendments under AIFMD DAs, to ensure the reference to sustainability risk is kept within the appropriate provisions, i.e. those related to risks , that we support (amended Art. 40(2))::

(2) in Article 18, the following paragraphs 5 is deleted:

~~“5. AIFMs shall take into account sustainability risks when complying with the requirements set out in paragraphs 1 to 3.”;~~

(3) in Article 22, the following paragraph 3 is deleted:

~~“3. For the purposes of paragraph 1, AIFMs shall retain the necessary resources and expertise for the effective integration of sustainability risks.”;~~

(4) in Article 30, the following subparagraph is deleted:

~~“AIFMs shall ensure that when identifying the types of conflicts of interest, the existence of which may damage the interests of an AIF, they shall include those types of conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls.”;~~

(6) in Article 57(1), the following subparagraph is deleted:

~~“AIFMs shall take into account sustainability risks when complying with the requirements laid down in the first subparagraph.”;~~

(7) in Article 60(2), the following point (i) is deleted:

~~“(i) is responsible for the integration of sustainability risks in activities referred to in points (a) to (h).”;~~

3. Recognition of possible qualitative approach regarding sustainability in risk management

- The relevant requirements for sustainability risk management underscore the **need for such risk management to be based on reliable information**. While we hope that changes to NFRD will bring about an improvement in the availability and reliability of ESG data, this will not be in place in time for these UCITS & AIFMD amended rules to take effect. Until at least 2023-2024, the disclosure by issuers is done on a ‘comply and explain’ , and not standardised basis.
- Until the revised NFRD is in place, **sustainability risks should be allowed to be assessed also on a qualitative basis**, when firms set up their risk management frameworks. This needs to be reflected in the text (suggestion below).
- This practical challenge was recently officially acknowledged by the European Central Bank itself in its May 2020 draft Guide on climate-related and environmental risks, where qualitative assessment is recognised as intermediate step³ “*The ECB expects institutions to assign quantitative metrics to climate-related and environmental risks, particularly for physical and transition risks. However, it also acknowledges that **common definitions and taxonomies in these risk areas are still under development, and that qualitative statements can be used as intermediate steps while the institution is developing appropriate quantitative metrics.***”
- Similar approach is taken by [ESMA in the technical advice to the Commission on the integration of sustainability risks in UCITS and AIFMD](#), where it states that **there are operational challenges involved with ‘getting reliable data on sustainability risks and factors’** (Para 29). In addition, in its original [consultation paper](#), ESMA recognises that **‘the availability and quality of the data on sustainability risks and factors poses additional challenges at this stage’** (Para 33).
- The Eurosystem reply from the ECB⁴ to the European Commission’s public consultation on the Renewed Sustainable Finance Strategy and the revision of the NFRD clearly states a need to improve the quality of sustainability and climate-related information. In particular, the ECB emphasises that **available sustainability and climate-related data and scores suffer from a lack of standardisation and comparability**. The ECB highlights this as an impediment to the consistent use of ESG data by financial institutions and market participants and stresses that unreliable ESG data and ratings limit users in their capacity to conduct granular financial risk analyses.
- National Competent Authorities – such as BAFIN⁵ - have also echoed the need to consider qualitative assessment on sustainability risks.
- As sustainability risks assessment is dependent on public, transparent, relevant and reliable information, and as at the level of disclosure of the sustainability risk assessment such a disclosure can done in quantitative or qualitative terms, **we suggest to ensure consistency and allow for the assessment itself to be carried out either in quantitative or qualitative terms.**

New Recital in both UCITS and AIFMD Delegated Texts:

The capability of (UCITS and AIF) management companies to account for sustainability risk within their risk management arrangements depends to a great extent upon the availability of public, transparent, relevant and reliable information related to ESG considerations.

³ ECB Guidance note available here -

https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/climate-related_risks/ssm.202005_draft_guide_on_climate-related_and_environmental_risks.en.pdf

⁴

https://www.ecb.europa.eu/pub/pdf/other/ecb.eurosystemreplyeuropeancommissionpublicconsultations_20200608~cf01a984aa.en.pdf

⁵ See BAFIN Guidance note -

https://www.bafin.de/SharedDocs/Downloads/EN/Merkblatt/dl_mb_Nachhaltigkeitsrisiken_en.pdf?__blob=publicationFile&v=5

Suggested changes in Article 1(4) (UCITS) DA:

“Article 5a

Obligation for investment companies to integrate sustainability risks in the management of UCITS

Members States shall ensure that investment companies integrate sustainability risks in the management of UCITS, taking into account the nature, scale and complexity of the business of the investment companies. *Where appropriate, the assessment of sustainability risks shall be based on Article 40(2)a, upon the availability of public, transparent, relevant and reliable information related to ESG considerations. Those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms, as consistent with Recital 15 of SFDR.*

Suggested changes in AIFMD Delegated Regulation :

Justification:

We support a proportionate approach that takes into consideration the investment strategy and the nature of the underlying assets of each investment product, as well as the absence of reliable data in relation to long-term aspects and other sustainability indicators.

We praise the inclusion in Art 5a of the UCITS Delegated Act that the integration of sustainability risks in the management of the UCITS should take into account ‘the nature, scale and complexity of the business of the investment companies’.

In order to ensure consistency, **the same wording including the possible qualitative assessment of sustainability risks, should also be added in the AIFMD Delegated Regulation** (as suggested below).

New Article 5a in AIFM Delegated Regulation

Obligation for investment companies to integrate sustainability risks in the management of AIF

Investment companies shall integrate sustainability risks, in the management of AIF, taking into account the nature, scale and complexity of the business of the investment companies. Where appropriate, the assessment of sustainability risks shall be based on Article 45(3), upon the availability of public, transparent, relevant and reliable information related to ESG considerations. Those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms, as consistent with Recital 15 under SFDR.”

4. Other comments:

- **Conflicts of interest:** These rules relate to the internal governance and processes of Management Companies and AIFMs, hence the inclusions of references to “*greenwashing, mis-selling or mis-representation of investment strategies*” is not relevant. We believe that the Sustainable Disclosure Regulation, which requires all Management Companies and AIFMs to disclose their approach to the integration of sustainability risks both on their websites and in pre-contractual disclosures, is the appropriate means to counter any such risks. We therefore do not believe that including this in the firm’s conflict of interest policy would add value and would suggest deleting these words from the recital.

Suggested changes in Recital 5 of both draft delegated acts:

To maintain a high standard of investor protection, management companies (AIFMs) should, when identifying the types of conflicts of interest the existence of which may damage the interests of an AIF,

include conflicts of interest that may arise as a result of the integration of sustainability risks in their processes, systems and internal controls. Those conflicts may include conflicts arising from remuneration or personal transactions of relevant staff, and conflicts of interest ~~that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies and conflicts of interests~~ between different UCITS (AIFs) managed by the same AIFM.