

CONSULTATION AFIG'S RESPONSE

Response to the drafts

Amendments integrating

Sustainability considerations into

UCITS & AIFMD

July 2020



The Association Française de la Gestion financière (AFG) represents and promotes the interests of third-party portfolio management professionals. It brings together all asset management players from the discretionary and collective portfolio management segments. These companies manage at end 2019 more than €4,000 billions in assets, i.e. a quarter of continental Europe's assets under management.

The AFG's remit:

- Representing the business, financial and corporate interests of members, the entities that they manage (collective investment schemes) and their customers. As a talking partner of the public authorities of France and the European Union, the AFG makes an active contribution to new regulations,
- Informing and supporting its members; the AFG provides members with support on legal, tax, accounting and technical matters,
- Leading debate and discussion within the industry on rules of conduct, the protection and economic role of investment, corporate governance, investor representation, performance measurement, changes in management techniques, research, training, etc.
- Promoting the French asset management industry to investors, issuers, politicians and the media in France and abroad. The AFG represents the French industry – a world leader – in European and international bodies. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA), of PensionsEurope and of the International Investment Funds Association (IIFA).

41 rue de la Bienfaisance - 75008 Paris - Tél. +33 (0)1 44 94 94 00
45 rue de Trèves - 1040 Bruxelles - Tél. +32 (0)2 486 02 90
www.afg.asso.fr - @AFG_France

Interest representative register number: 5975679180-97

Executive Summary

AFG 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, AFG has been a strong supporter of creating a strong framework for sustainable finance which facilitates the transition to a more sustainable European economy. French 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 clients, 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 investments, 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 investments, while at the same time allowing investors a meaningful product choice.

AFG would like to share some important comments on the draft texts, and remain available for discussion.

Part 1. Sustainability risk should not be singled out as compared to other types of risks

- AFG support the integration of sustainability risks as part of risk management policy at fund level, **but we believe there is no reason to single out this risk in the context of provisions not related to risks but to general organisational, due diligence or conflict of interest requirements where the other risks are not mentioned.**
- Having explicit reference to sustainability risk in such general provisions, contrary to all the other risks, **seems to give 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 the significant regulatory changes to be made in organisation, resources, management and due diligence within UCITS and AIF management companies. **Singling out sustainability risks is therefore not only inappropriate from a risk management perspective, it also unnecessary from a regulatory policy development. It should be taken into account among the various risks, due to its definition in SFDR Level 1.**

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

- (...) Management companies 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 that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Directive 2010/43/EU14 does not explicitly refer to sustainability risks.

Suggested deletion as a specific reference in Article 1 (UCITS) DA:

~~(2) in Article 4(1), the following subparagraph is added:-~~

~~“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 added:-~~

~~“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 added:-~~

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

~~(6) in Article 17, the following paragraph 3 is added:-~~

~~“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 and 6 are added:-~~

~~“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 deletion as a specific reference in Article 1 (AIFM) DA:

~~(2) in Article 18, the following paragraphs 5 and 6 are added:-~~

~~“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 added:-~~

~~“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 added:-~~

~~“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 added:-~~

~~“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 added:-~~

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

Part 2. Availability of data and recognition of possible qualitative approach regarding sustainability risk assessment

- 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 the Non-Financial Reporting Directive (NFDR) will bring about an improvement in the availability and reliability of ESG data, this will not be in place in time for these UCITS and AIFM amended Level 2 rules to take effect: until at least 2023-2024, the disclosure by issuers is done on a ‘comply and explain’ basis and even less in a compulsory standardised manner.
- Until the revised NFRD is in place, **sustainability risks should be allowed to be assessed on a qualitative basis**, when firms set up their risk management frameworks. This needs to be reflected in the text (suggestion below).
- This practical issue was recently 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 step: *“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.**”*
- Because sustainability risks assessment is dependent on public, transparent, relevant and reliable data, as at the level of disclosure of the sustainability risk assessment, such a disclosure can be done in quantitative or qualitative terms, we suggest to allow the same approach at the level of the carrying of the sustainability risk assessment itself.
- For AIFMD Level 2, a provision similar to the draft new UCITS Level 2 Art. "5a" is missing, and therefore AIFMD Level 2 should be amended accordingly: therefore, for the sake of clarity and level playing field between texts, a similar provision and wording should be introduced in AIFMD Level 2.

New Recital:

‘Management Companies (and AIFMs) should ensure that risk management arrangements, including in relation to sustainability risks, where appropriate, are based on the availability of public, transparent, relevant and reliable data related to ESG considerations.

Sustainability risks should be allowed to be assessed on a quantitative or qualitative basis’.

Suggested changes in Article 1 (AIFM) DA:

Delegated Regulation (EU) No 231/2013 is amended as follows:

in Article 1, the following points (6), ~~and (7)~~ **and (8)** are added:

“(6) ‘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*;

(7) Sustainability risks, where appropriate, are based on the availability of public, transparent, relevant and reliable data related to ESG considerations. Sustainability risks should be allowed to be assessed on a quantitative or qualitative basis.

~~(7)~~ (8) ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.

Suggested changes in Article 1 (UCITS) DA:

in Article 3, the following points 11, 12 and 123 are added:

“11. ‘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*;

12. Sustainability risks, where appropriate, are based on the availability of public, transparent, relevant and reliable data related to ESG considerations. Sustainability risks should be allowed to be assessed on a quantitative or qualitative basis.

123. ‘sustainability factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.

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, where appropriate, based on the availability of public, transparent, relevant and reliable data related to ESG considerations, in the management of UCITS, taking into account the nature, scale and complexity of the business of the investment companies.”

Add a new paragraph to Article 5a:

“The assessment of the sustainability risks shall be based on reliable and comparable data from issuers, through the relevant standardized and certified sustainable indicators specifically disclosed by the issuers. In any case [by consistency with the SFDR Level 1 Recital 15], those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms”.

Suggested addition to AIFMD DA:

“Article XX

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

Members States shall ensure that investment companies integrate sustainability risks, where appropriate, based on the availability of public, transparent, relevant and reliable data related to ESG considerations, in the management of AIFs, taking into account the nature, scale and complexity of the business of the investment companies.”

Add a new paragraph to Article 5a:

“The assessment of the sustainability risks shall be based on reliable and comparable data from issuers, through the relevant standardized and certified sustainable indicators specifically disclosed by the issuers. In any case [by consistency with the SFDR Level 1 Recital 15], those sustainability risks might be assessed by investment companies either in qualitative terms or quantitative terms”.

Part 3. Need for proportionality

- 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.

- This is why 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’**.
- However, in order to ensure consistency, the **same wording (as well as for the possible qualitative assessment of the sustainability risk) should be added in the AIFMD Delegated Acts** (as currently missing in the draft text).

Part 4. Alternative proposal for display of alignment between Delegated Acts and SFDR

- AFG proposes to delete the new paragraph 6 of Art. 23, and instead include below in art. 23 (3) – same amendments mirrored in AIFMD DAs – a link referencing Principal Adverse Impact to due diligence requirements.

Suggested changes

“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.”

~~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.”;~~