AMIC response: EC consultation on the integration of sustainability risks
6 July 2020

Integration of sustainability risks in UCITS

a) Sustainability risks should not be singled out

AMIC supports the integration of sustainability risks among other risks to be considered by fund managers (i.e. risk management policy under article 38 of the Commission Directive 2010/43/EU) but is opposed to other amendments singling out sustainability risks in several general articles:

- Art. 4 (1) which relates to General Organization of management companies
- Art. 5 which relates to Resources
- Art. 9(2) [referred to by new Art. 5a] which relates to Senior Management
- Art. 17 [referred to by new Art. 5a] which relates to conflicts of interest
- Art. 23 paragraph 5 [referred to by new Art. 5a] which relates to due diligence

We believe the references to these articles should be deleted, as singling out sustainability risks in such general articles could have implications regarding the weighing of other risks and potential unintended consequences. For instance, all risks need to be considered when assessing potential conflict of interests and not predominantly sustainability risks.

Furthermore SFDR, which requires fund managers to inform clients how they assess sustainability risks, already implies significant changes from organisation, resources, and management and already covers due diligence requirements. Singling out sustainability risks in such broad articles is therefore not only inappropriate from a risk management perspective, it also seems unnecessary from a regulatory policy development perspective.

From a proportionality perspective, **we do not think it is necessary to expressly require specific resources to manage sustainability risks** as firms may wish to consider different set ups, according to their size and core focus, including the possibility to delegate part of the performance of risk management or portfolio management activities.

b) Sustainability risks assessment on a qualitative basis

Sustainability risks under SFDR

According to Article 6 of the Sustainable Finance Disclosure Regulation (SFDR), financial market participants shall include descriptions in pre-contractual disclosures of the following:

(…) (b) the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.

SFDR Article 2 (22) defines 'sustainability risk' as "an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment".

Finally, according to Recital 15, "where the assessment leads to the conclusion that those risks are relevant, the extent to which those sustainability risks might impact the performance of the financial product should be disclosed either in qualitative or quantitative terms."

There is currently no standardized and audited data that fund managers could rely on to perform the quantitative assessment required under SFRD. This mainly due to the fact that under NFRD each company can ultimately determine which disclosures are most relevant to its own stakeholders and rely on a "comply or explain" provision. As raw data disclosed by issuers are still very limited in scope and quality, asset managers rely significantly on ESG data providers. But equity ESG scorings are still mainly focusing on the impact of issuers on their environment rather than on "sustainability risks" and can differ significantly from one provider to another. If credit agencies are now trying to integrate some ESG factors when assessing the creditworthiness of issuers, this is not done systematically and they also each have their own methodology.

Beyond the lack of data from issuers and uncertainty on ESG ratings, prudential supervisors themselves recognise the difficulty in assessing quantitatively sustainability risks. Even for climate-risks, where we can at least rely on the Co2 ton price it is not straightforward. This was recently acknowledged by the ECB in its May 2020 draft Guide on climate-related and environmental risks: "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."** For asset managers this will be even more challenging as sustainability risks involve not only the E but also the S and G, underlying data are often missing and a common methodology to assess financial impact are yet to be established.

Until the revised NFRD becomes applicable (at the earliest 2023-2024) and progress is made on a common standard, the disclosure of sustainability risks on a qualitative basis only should be clearly allowed. The EC could rely on the recital 15 of SFDR quoted above and the upcoming delegated acts on the integration of sustainability risks to clarify expectations. This needs to be done for all actors in the scope of SFDR.

c) **Consideration of principal adverse impacts**

There is legally no need to cross-reference UCITS and SFDR when it comes to the consideration of principal adverse impact. To avoid any confusion and from a "better-regulation perspective" we suggest to strictly limiting this proposal to the integration of sustainability risks.

d) Amendments proposed:

Recital 3

(…) Management companies should therefore assess ~~not only~~ all relevant ~~financial~~ risks on an ongoing basis, ~~but also all relevant~~ ***including*** 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/EU[14] 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 ***risk management policies*** ~~processes, systems and internal controls~~ of management companies ~~reflect~~ ***consider*** sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks. ***In the absence of standardized and certified data and audited from issuers and in accordance with Recital 15 of SFDR, sustainability risks may be assessed by management companies, or where relevant by investment companies, on a qualitative basis.***

Recital 5

~~To maintain a high standard of investor protection, management companies should, when identifying the types of conflicts of interest the existence of which may damage the interests of a UCITS, 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, conflicts of interest that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies and conflicts of interests between different UCITS managed by the same management company.~~

(…)

Article 1

Amendments to Directive 2010/43/EU

Directive 2010/43/EU is amended as follows:

(1) in Article 3, the following points 11 and 12 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 factors' means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.~~

~~(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.";~~

~~(4) the following Article 5a is inserted:~~

"Article 5a

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

Member States shall ensure that investment companies integrate among other risks sustainability risks in the management of UCITS, taking into account the nature, scale and complexity of the business of the investment companies.";

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

"(g) is responsible for the ~~integration~~ **consideration, among other risks,** of sustainability risks in the activities referred to in point~~s (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.~~

~~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.";~~

(8) in Article 38(1), the second subparagraph is replaced by the following:

"The risk management policy shall comprise such procedures as are necessary to enable the management company to assess for each UCITS it manages the exposure of that UCITS to market, liquidity, sustainability and counterparty risks, and the exposure of the UCITS to all other risks, including operational risks, which may be material for each UCITS it manages. ***In the absence of standardized and certified data and audited from issuers and in accordance with Recital 15 of SFDR, sustainability risks may be assessed by management companies, or where relevant by investment companies, on a qualitative basis.***

Integration of sustainability risks in AIFMD

In line with the points raised under the UCITS section, we would suggest to the EC to consider the following changes regarding the integration of sustainability risks in AIFMD.

Recital 3

(…) AIFMs should therefore assess not only all relevant financial risks on an ongoing basis, but also all relevant sustainability risks as referred to in Regulation (EU) 2019/2088 of the European Parliament and of the Council[15] that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Delegated Regulation (EU) No 231/2013[16] 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 ***risk management policies*** ~~processes, systems and internal controls~~ of AIFMs ~~reflect~~ ***consider*** sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks.

Recital 4

~~Pursuant to Regulation (EU) 2019/2088 AIFMs that are obliged to consider principal adverse impacts of investment decisions on sustainability factors, or consider those principal adverse impacts voluntarily, are obliged to disclose how their due diligence policies take those principal adverse impacts into account. To ensure consistency between Regulation (EU) 2019/2088 and Regulation 231/2013, that obligation should be reflected in Regulation 231/2013.~~

Recital 5

~~To maintain a high standard of investor protection, 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, conflicts of interest that could give rise to greenwashing, mis-selling or misrepresentation of investment strategies and conflicts of interests between different AIFs managed by the same AIFM.~~

(…)

HAS ADOPTED THIS REGULATION:

Article 1

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

(1) in Article 1, the following points (6) and (7) 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 factors’ means sustainability factors as defined in Article 2, point (24), of Regulation (EU) 2019/2088.~~

~~(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.~~

~~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.”;~~

~~(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.”;~~

(5) in Article 40, paragraph 2 is replaced by the following:

“2. The risk management policy shall comprise such procedures as are necessary to enable the AIFM to assess for each AIF it manages the exposure of that AIF to market, liquidity, sustainability and counterparty risks, and the exposure of the AIF to all other relevant risks, including operational risks, which may be material for each AIF it manages. ***In the absence of standardized and certified data and audited from issuers and in accordance with Recital 15 of SFDR, sustainability risks may be assessed by fund managers on a qualitative basis.***”;

~~(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)~~ **g”.**

Integration of sustainability risks in investment firms and sustainable preferences (MiFID)

In line with the points raised in under the UCITS section, we would suggest to the EC to consider similar changes regarding the integration of sustainability risks in investment firms (MiFID).

In addition, we urge the EC not to limit the scope of article 8 products via distribution rules (Recital 6 and article 1). The consideration of adverse impacts is not yet well defined and its implication for the product supply is not well understood. Furthermore, article 8 products under SFDR are not obliged to consider these factors but simply required to disclose whether and if so how it does consider it. We are concerned that the EC is proposing to crowd investors into sustainable products of which there are expected to an extremely limited number given the stringent requirements anticipated under the draft RTS (do no significant harm objective to be assessed against 50 indicators). The benefit of ESG products should not be dismissed: they are contributing to channel assets towards sustainable or neutral investments on a larger scale, while offering a great level of diversification and investor protection. We strongly believe that policymakers can and should allow a diversity of sustainable products, providing a range of different approaches to sustainable investment to suit an array of asset owner needs and motivations. Some flexibility is needed to allow for new products, which may achieve sustainability goals by different routes and meet different needs and preferences from investors (notably from a risk management perspective).

Recital 3

Investment firms should therefore consider not only all relevant financial risks on an ongoing basis, but also all relevant sustainability risks as referred to in Regulation (EU) 2019/2088 of the European Parliament and of the Council[12] that, where they occur, could cause an actual or potential material negative impact on the value of an investment. Commission Delegated Regulation (EU) 2017/565[13] 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 ***risk management policies*** ~~processes, systems and internal controls~~ of investment firms ~~reflect~~ ***consider*** sustainability risks, and that technical capacity and knowledge is necessary to analyse those risks.

(…)

Recital 6

Sustainable products with various degrees of ambition have been developed so far. To enable clients to better understand those products, investment firms that provide investment advice and portfolio management services should clearly explain the distinction between financial products that promote environmental or social characteristics and financial products that pursue sustainable investment objectives. ~~Whilst financial products that pursue sustainable investment objectives guarantee the attainment of certain level of sustainability, financial products that promote environmental or social characteristics do not necessarily achieve that.~~ ~~That is why the identification of the client's sustainability preferences should in case of financial products that promote environmental or social characteristics take into account those financial products that at least to some extent pursue sustainable investment objectives, or consider principal adverse impacts on sustainability factors, as laid down by Regulation (EU) 2019/2088. Since, in accordance with that Regulation, certain manufacturers of financial products should be obliged to provide information on how their financial products consider principal adverse impacts on sustainability factors at the latest as of 30 December 2022, investment firms should be able to increasingly recommend also those products as suitable in terms of clients' sustainability preferences after that day.~~

Recital 5

Investment firms that provide investment advice and portfolio management should be able to recommend suitable products to their clients and should therefore be able to ask questions to identify the client's individual sustainability preferences. In accordance with the investment firm's obligation to act in the best interest of its client, recommendations to clients should reflect both the financial objectives and any sustainability preferences expressed by those clients. It is therefore necessary to clarify that investment firms should have in place appropriate arrangements to ensure that the inclusion of sustainability factors in the advisory process and portfolio management does not lead to mis-selling practices or to the misrepresentation of instruments or strategies as fulfilling sustainability preferences where they do not. In order to avoid such practices or misrepresentations, investment firms providing investment advice should first assess the investor's' investment objectives, time horizon and individual circumstances, before asking their clients for their potential sustainability preferences, **which should not take precedence over a client's personal investment objectives. For existing clients, for whom a suitability assessment has already been undertaken, investment firms should be able to rely on the existing suitability assessment.**

(...)

HAS ADOPTED THIS REGULATION:

Article 1

Delegated Regulation (EU) 2017/565 is amended as follows:

(1) in Article 2, the following points (7), (8) and (9) are added:

"(7) 'sustainability preferences' means a client's or potential client's choice as to whether either of the following financial instruments should be integrated into his or her investment strategy:

(a) a financial instrument that has as its objective sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council;

(b) a financial instrument that promotes environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088 ~~and that either~~:

~~(i) pursues, among others, sustainable investments as defined in Article 2, point (17), of that Regulation; or~~

~~(ii) as of 30 December 2022, considers principal adverse impacts on sustainability factors, as referred to in Article 7(1), point (a), of that Regulation; or~~

(c) *a financial product as defined by Article 9* of Regulation (EU) 2019/2088 of the European Parliament and of the Council;

(d) *a financial product* that promotes environmental or social characteristics as referred to in Article 8 of Regulation (EU) 2019/2088;

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

(9) ‘sustainability risks’ means sustainability risks as defined in Article 2, point (22), of Regulation (EU) 2019/2088.

(e) the second subparagraph is replaced by the following:

“Investment firms shall take into account sustainability risks when complying with the requirements set out in this paragraph.”;

(f) the following subparagraph is added:

“When complying with the requirements set out in this paragraph, investment firms shall take into account the nature, scale and complexity of the business of the firm, and the nature and range of investment services and activities undertaken in the course of that business.”;

(2) in Article 23(1), point (a) is replaced by the following:

“(a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems, and, where appropriate, set the level of risk tolerated by the firm. In doing so, investment firms shall take into account, ***among other risks***, sustainability risks;”;

(…)

Integration of sustainability risks in product governance obligations (MiFID)

In line with the points raised under the previous MiFID section, we would suggest the EC to introduce similar changes regarding the definition of sustainability preferences (MiFID). On top of this point we would suggest amending Recital 5 to reflect the fact that not all manufacturers distribute their product: “Investment firms manufacturing **and/or** distributing financial instruments should consider sustainability factors in their respective product governance and oversight arrangements for each financial instrument that is intended to be distributed to clients (…).”