

MEMO# 31526

December 20, 2018

ESMA Consultation on ESG Integration

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December 20, 2018 TO: ICI Global Members
Global ESG Task Force
ICI Global Regulated Funds Committee SUBJECTS: Compliance
Disclosure
International/Global
Investment Advisers
MiFID, EMIR, AIFMD, UCITS V RE: ESMA Consultation on ESG Integration

The European Securities and Markets Authority (ESMA) released a [consultation paper](#) yesterday on draft technical advice to the European Commission on potential amendments to delegated acts under the UCITS Directive and AIFMD. These potential amendments concern the integration of sustainability risks and factors in the internal processes and procedures of UCITS management companies and alternative investment fund managers (AIFMs). This is in response to the Commission's July request for ESMA and EIOPA to prepare technical advice on potential amendments to delegated acts under the UCITS, AIFMD, MiFID II, Solvency II, and IDD frameworks, with the goal of explicitly requiring financial market participants to integrate ESG risks in their decision-making or advisory processes as part of their duties to investors and/or clients.

We note that ESMA similarly released a [consultation paper](#) on potential amendments to delegated acts under MiFID II. **The deadline for responses on both consultations is 19 Feb 2019.**

We will schedule an ESG Task Force call in early January to discuss the UCITS/AIFMD consultation paper and ICI Global's response. We were encouraged to see ESMA state its view that the integration of sustainability risks within the UCITS and AIFMD frameworks is better done through a high-level principles-based approach, similar to that already followed for a number of other relevant risks (e.g., interest rate or credit risk).

Below is a brief summary of the consultation paper:

Goal. ESMA's recommended amendments aim to clarify that asset managers need to incorporate sustainability risks in their due diligence processes and assess and manage the sustainability risks stemming from their investments along with all other relevant risks such as market, interest, or credit risk. To this end, ESMA believes that sustainability risks need to be captured by the due diligence process and risk management systems in a way and to the extent that is appropriate to the size, nature, scope and complexity of their activities

and the relevant investment strategies pursued.

Fiduciary duty. ESMA's draft technical advice does not explicitly mention the term "fiduciary duty."

Definition of sustainability risk. ESMA understands "sustainability risk" to mean the risk of fluctuation in the value of positions in a fund's portfolio due to ESG factors. We have previously discussed with ESMA our concerns around including the concept of sustainability impact within the definition of "sustainability risk," and we were pleased to see ESMA's definition focuses on returns rather than impact.

Proposed amendments. ESMA is proposing changes in the following areas of the UCITS and AIFMD framework:

- General organisational requirements: incorporation of sustainability risks within organisational procedures, systems and controls to ensure that they are properly taken into account in the investment and risk management processes.
- Resources: consideration of the required resources and expertise for the integration of sustainability risks.
- Senior management responsibilities: clarification that the integration of sustainability risks is part of the responsibilities of senior management.
- Conflicts of interest: consideration of the types of conflicts of interest arising in relation to the integration of sustainability risks and factors.
- Due diligence requirements: consideration of sustainability risks when selecting and monitoring investments, designing written policies and procedures on due diligence and implementing effective arrangements.
- Risk management: explicit inclusion of sustainability risks when establishing, implementing and maintaining an adequate and documented risk management policy.

Consultation questions. ESMA posed the following questions in the consultation paper:

- **Q1:** How do you understand or how would you define the notion of "sustainability risks" for the purposes of the delegated acts adopted under the UCITS Directive and AIFMD?
- **Q2:** Do you agree with the proposed amendments relating to organizational requirements included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.
- **Q3:** Do you see merit in expressly requiring or elaborating on the designation of a qualified person within the authorised entity responsible for the integration of sustainability risks and factors (e.g., under Article 5 of the Commission Directive 2010/43/EU and Article 22 of the Commission Delegated Regulation (EU) 231/2013)?
- **Q4:** Would you propose any other amendments to the provisions on organizational requirements in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risks and factors?
- **Q5:** Do you agree with the proposed amendments to provisions relating to due diligence included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.
- **Q6:** Do you see merit in further elaborating in the provisions above on the identification and ongoing monitoring of sustainability risks, factors and indicators that

are material for the financial return of investments?

- **Q7:** Do you agree with the proposed inclusion of recitals relating to conflicts of interest? Should the technical advice cover specific examples? If so, what would be specific examples of conflicts of interests that might arise in relation to the integration of sustainability risks and factors and should be covered in the advice?
- **Q8:** Would you propose any other amendment to the provisions on operating conditions in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risks and factors?
- **Q9:** Do you agree with the proposed amendments to provisions relating to the risk management included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.
- **Q10:** Do you see merit in further specifying the content of the risk management policy by expressly listing key elements for the effective integration of sustainability risks (e.g., techniques, tools and arrangements enabling the assessment of sustainability risks, probability of occurrence and time horizon of sustainability risks with regard to the expected time of holding of the positions bearing the risks, quality of underlying data and methodologies etc.)?
- **Q11:** Do you see merit in amending risk management provisions relating to regular review of risk management policies and systems in order to more specifically refer to elements related to sustainability risks (e.g. quality of the arrangements, processes, techniques and data used, need for authorised entities to highlight the limitations, and demonstrate the absence of available alternatives)?
- **Q12:** Would you propose any other amendment to the provisions on risk management in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risk and factors?
- **Q13:** What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

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