

CONSULTATION AFG'S RESPONSE

ESMA Consultation Paper
On integrating sustainability
risks and factors in the
UCITS Directive and AIFMD

19 February 2019



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 2017 €4,000 billion in assets, including €1,950 billion in French funds and €2,050 billion in discretionary portfolios and foreign funds.

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

ESMA Consultation Paper On integrating sustainability risks and factors in the UCITS Directive and AIFMD

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?

We have some reservations about the definition of sustainability risks proposed in the consultation.

We think “sustainability risk” should mean the risk of fluctuation in the value of sustainable factors arising from environmental, social and governance considerations. This risk may have for instance a material financial impact on the investment measured at the level of the overall portfolio, subject to data availability. This has to be clearly distinguished from the process of integrating ESG criteria (extra-financial analysis) in the investment decision-making process.

Q2: Do you agree with the proposed amendments relating to organisational 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.

We agree with the proposed amendments aiming at including a reference to sustainability risks with no further prescriptive approach as to their identification or requirements.

We would like to draw your attention to two very important points: proportionality and progressiveness.

Today, while most large management companies take ESG issues into account, many small management companies have not yet set up a system to take sustainability risks into account, let alone integrate them.

These two major points must therefore be taken into account in the proposed amendments and too restrictive rules must not be imposed. Smaller management companies will need time to integrate these new issues.

All these rules should be appropriate to the size, nature, scope and complexity of their activities and the relevant investment strategies pursued and this should be reflected clearly in the amendments.

“Member States shall ensure that management companies take into account the nature, scale and complexity of the business of the management company, and the nature and range of services and activities undertaken in the course of that business. Member States shall ensure that management companies take into account sustainability risks and factors when complying with the requirements laid down in the first subparagraph, ie 1a).”

Because of necessary ulterior translations in other Member States languages, the targeted “subparagraph” should be clearly mentioned.

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)?

As just mentioned in the previous question, the designation of a qualified person responsible for the integration of sustainability risks and factors should remain the sole responsibility of the management company and must not be imposed. The proportionality rules must be applied.

“5. Member States shall ensure that for the purposes laid down in paragraphs 1, 2 and 3, management companies take into account the necessary resources and expertise for the effective integration of sustainability risks and factors, **where appropriate, depending on the size, nature, scope and/or complexity of their activities and the relevant investment strategies pursued.**”

It could be possible that senior management could be responsible for the sustainability risks and factors policy but not for their integration.

“(g) is responsible **for the company’s policy with regards to** the integration of sustainability risks and factors.”

Q4: Would you propose any other amendments to the provisions on organisational 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?

No - please see our response to question 2 on high-level approach.

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.

We agree with the high-level-principles-based approach overall and also for the provisions relating to due diligence but wish to stress that there are no particular risks with specific sustainability considerations linked to due diligence.

We do not want the consideration of sustainability risks to lead in practice to exclusion.

We agree to identify and analyse sustainability risks, but we do not want these sustainability risks to lead to investment constraints. All this in accordance with proportionality already mentioned above.

Concerning the suggested additions in article 23 para 5 of Commission’s Directive 2010/43/EU and article 18 para 5 of Commission’s Delegated Regulation 231/2013 management companies and AIFMs respectively are required to take into account sustainability risks and factors in respect to their due diligence requirements. However, as sustainability risks are not always relevant for the investment, the underlying assets and the investment strategy. We would suggest adding the following wording:

« Members states shall require that management companies take into account **where**

appropriate sustainability risks and factors when complying with the requirements set out in paragraphs 1 to 4. »

« AIFMs shall take into account **where appropriate** sustainability risks and factors when complying with the requirements set out in paragraphs 1 to 3. »

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?

As already said, we consider it important to take into consideration that sustainability risks are not a priori relevant for all investments and portfolios and therefore they should be taken into consideration when it is considered appropriate based on the investment, the underlying assets and the overall strategy of the portfolio.

Regarding #28 on page 16, we believe that when ESMA designs voluntarily such a large scope of integrating sustainability risks and factors, the degree of exigence cannot be so high as to ask companies to develop specific methodologies. Companies should be able to outsource, if they wish to, or to decide not to proceed to such an integration due to documented considerations pertaining to the size, nature, scope and/or complexity of their activities and/or the relevant investment strategies pursued.

Regarding #29 on page 16, AFG believes that it is too intrusive to ask, without any introduction of proportionality, companies to explain the changes in the portfolio as regards to the integration of sustainability risk. This should only happen when meaningful, this is why “if any” should be added to the ESMA’s text. The materiality of the effects of sustainability considerations should not be misunderstood. In the same way as ESMA recognises in the CRA consultation on sustainability risks, the guidance should be focused on improving how the consideration of ESG factors is explained when they are a key underlying element of a change and it should not mandate or recommend that these factors be considered in any case.

Like for credit ratings, ESMA’s recommendations should not be understood as suggesting that the consideration of ESG factors are systematically relevant or more relevant than the consideration of non-ESG (financial) factors and risks to the portfolio management. Indeed, the integration of sustainability risks and factors should not lead to structural exclusions.

Excerpt from the CRA consultation:

ESMA does not intend to provide guidance in this area at this juncture. However, with a view to facilitating the European Commission’s Action Plan on Sustainable Finance, ESMA is providing guidance as to how CRAs can better meet their requirements of explaining whether and how ESG factors were considered as part of a specific credit rating issuance. For this guidance please see Chapter 4. In this regard it is important to highlight that in providing this guidance ESMA is not indicating that the consideration of ESG factors is more important than the consideration of other factors relevant to a creditworthiness assessment.

57. In doing so it is worthwhile to remind readers that in no way does this guidance recommend or mandate what factors a CRA should be considering as part of their creditworthiness

assessments nor does it suggest that the consideration of ESG factors are more important than other factors to the creditworthiness assessment of an entity or issuer.

58. The CRA Regulation requires CRAs to ensure that their credit ratings and rating outlooks are based on an analysis of all the information that is available to it and that is relevant to its analysis according to the applicable methodologies. As such, ESMA recognises that ESG factors may not be a key underlying element of a credit rating action if the CRA does not consider them relevant according to the applicable methodology.

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?

We do not see conflicts of interest that are linked in particular with sustainability risks.

Therefore, singling out these particular risks in the case of conflicts of interest seems unnecessary and we would be in favor of deleting this recital.

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?

No

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.

We agree with the high-level-principles-based approach but it appears to us that sustainability oversight at a second level of control should be left to the discretion of the management company to choose whether such necessary second level controls are monitored at the Risk Management, Compliance level or through outsourcing.

There is today a real difficulty for Risk management to control sustainability risks and factors, as they are not easily quantifiable because of very scarce source of reliable data or methodological sufficient knowledge (the subject is yet very immature). French asset management companies would be unable to set it up given the complexity of the situation.

We suggest that, in the first instance, the compliance officer verifies that sustainability risks have been identified and analyzed, but that it does not fall within the scope of the Risk management (ESMA should speak more in terms of compliance control than risk management).

Lastly we would recommend adding " ...sustainability **where relevant...**" to the amended Articles 38 and 40.

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.)?

No – see our response to previous question. The internal policy should be focused in terms of compliance control.

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)?

No

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?

AFG would not propose any other amendments to the provisions on risk management.

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.

It is difficult for AFG to precisely know how these matters materialize within our companies (a Member State like France has 633 companies of all sizes and strategies). In addition, there is to be noted some scarcity of reliable data and methodological knowledge. Knowing that asset management companies always act in the best interest of their unitholders, the reaffirming of the principle of proportionality is important.