FECIF response ESMA - CONSULTATION ON INTEGRATING SUSTAINABILITY RISKS AND FACTORS 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 agree with par. 17 of the Consultation Paper: ‘sustainability risk’ should be understood as the risk of fluctuation in the value of positions in the fund’s portfolio due to ESG factors. At the same time we believe that a common notion is necessary to create an effective level playing field, promote transparency and avoid regulatory arbitrage.

We also point out that specific attention shall be paid to the possibility that the choice of ESG considerations and objectives may affect the risk profile of the product, thereby modifying the attribution to a specific risk category; other factors being equal, the choice of ESG investment policies could in fact change the risk level of the investments with a possible reduction in the degree of risk (in this regard, it will be important to verify the evidence coming from empirical studies on the markets). For instance, this could be the case for a hedge fund with an ESG investment policy that, other factors being equal, lowers its risk profile as compared to another non-ESG hedge fund, with the resulting possibility to implement a higher financial leverage.

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 amendments. The proposed high-level and principles-based approach achieves the necessary balance between proportionality and the need to ensure that management companies take into account sustainability risks and factors when complying with general requirements on procedures, organisation and resources.

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 amendments. The proposed high-level and principles-based approach achieves the necessary balance between proportionality and the need to ensure that management companies take into account sustainability risks and factors when complying with the requirements on the identification of conflicts of interest, due diligence in the
selection and ongoing monitoring of investments, and adequate knowledge and understanding of the assets in which the UCITS/AIF is invested.

**Q6: Do you see merit in further elaborating on the provisions above on the identification and ongoing monitoring of sustainability risks, factors and indicators that are material for the financial return of investments?**

We believe that the mere criterion based on the financial return of investments does not correspond to the principles of sustainable finance. The example under par. 27 states: “For example, when analysing the investment in an industrial company, the social risks could be considered as material for the valuation of investments. One factor materialising this risk could be the security of the employees working on site. One indicator that could be used to monitor that factor is the number of accidents. An increase in the number of accidents should be monitored if it leads to a decrease in the valuation of the investments.”

If we consider the case of an investor with ESG preferences it is likely that he/she invests in the UCITS/AIF investing in the industrial company Alpha since such a company cares for the security of the employees working on site as a general principle. That is to say, the investment in company Alpha would cease to comply with the investor’s ESG preferences whenever an increase in the number of accidents takes place, the value of the investments being affected or not. We can also consider another example relating to social dumping, i.e. company Beta saves money, earns profits and increases its value by reducing labour and social standards: this is clearly a non-sustainable investment, although the indicator concerning the number of accidents might not affect the valuation of the investments.

More generally, we believe that sustainability finance should:

- Be interpreted as the need to couple the search for financial returns with the respect of ethical, social and environmental principles. That is to say, performance should not be the only result because ESG investors are developing an approach to investments that is different from the standards until today.
- Make a substantial contribution to a lifestyle and sensibility that is “sustainable as a whole”, i.e. considering all the aspect of a citizen’s life.

**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 amendments. The proposed high-level and principles-based approach achieves the necessary balance between proportionality and the need to ensure that
management companies assess for each UCITS/AIF they manage the exposure to all relevant risks, including sustainability risks.

About FECIF

The European Federation of Financial Advisers and Financial Intermediaries (FECIF) was chartered in June 1999 for the defence and promotion of the role of financial advisers and intermediaries in Europe.

FECIF is an independent and non-profit-making organisation exclusively at the service of its financial adviser and intermediary members, who are from the 28 European Union member states, plus Switzerland; it is the only European body representing European financial advisers and intermediaries. FECIF is based in Brussels, at the heart of Europe.

The European financial adviser and intermediary community is made up of approximately 500,000 private individuals exercising this profession as a main occupation (representing approximately 26,000 legal entities including 45 networks), about 280,000 are members of national professional associations (51 at today’s count).