

Regulatory News Alert

Sustainable Finance: ESMA publishes technical advice on the integration of sustainability risks and factors in MiFID II, AIFMD and UCITS Directive

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Context and objectives

Since the **Paris Climate Agreement**, concluded by the European Union (EU) in 2015 and formally adopted in 2016, sustainability forms an integral part of the European Commission (EC)'s work.

According to the **EU Action Plan on Financing Sustainable Growth** from May 2018, one of the major goals of the EC is to **clarify fiduciary duties** and to **increase transparency** on sustainability risks and investment opportunities. The purpose is to achieve sustainable and inclusive growth by reorienting capital flows towards sustainable investments, fostering long-termism in financial activity and actively managing the financial risks stemming from climate change.

Following a formal request by the EC, the **European Securities and Markets Authority (ESMA) has now provided technical advice** on how to integrate these sustainability risks and factors in key regulatory texts, more precisely:

- The Markets in Financial Instruments Directive II (MiFID II)
- The Alternative Investment Fund Managers Directive (AIFMD)
- The Undertakings in Collective Investment in Transferable Securities (UCITS) Directive

Amendments suggested by ESMA

To integrate the topic of sustainability in the European financial services regulations, ESMA considers **minor changes** to the regulation as sufficient. Yet, financial institutions and investment companies should not misinterpret this advice: the minor changes suggested by ESMA may have a **large impact** on their daily operations and organizational set-up.

Concerning **MiFID II**, the ESMA proposes to require investment firms to:



- Take into account Environmental, Social and Governance (ESG) considerations when complying with the existing **organizational requirements**
- Consider sustainability risks in their **risk management** policies and procedures
- Identify **conflicts of interest** that may stem from the distribution of sustainable investments
- Set-up appropriate arrangements to ensure that the inclusion of ESG considerations in the **advisory process and portfolio management** does not lead to misselling practices
- Ensure that their **compliance function, internal audit** function, **management** body and senior management consider aspects related to sustainability risk in their respective duties

In addition, in both the **AIFMD** and the **UCITS Directive**, amendments with regard to the following are proposed:

- **General requirements on procedures and organization**, i.e. management companies should take into account sustainability risks in their decision-making procedures and organizational structure
- **Resources**, i.e. management companies will need to consider the necessary resources and expertise for the effective integration of sustainability risks
- **Control by senior management**, i.e. the senior management should assume overall responsibility for the integration of sustainability risks

These might inevitably have an organizational impact on the fund management and governance structure.

As a next step, ESMA intends to cooperate closely with the EC to transform the technical advice into formal delegated acts. Given the forthcoming EU elections, this might take a bit more time than usual, but overall we can expect that the year 2021 will be the ESG year with the formal application of several regulatory requirements.

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