
ENVIRONMENTAL. SOCIAL. GOVERNANCE.

UCITS & AIFMD Revisions: *Draft Sustainability Directive and Regulation*

One of the aims of the EU Action Plan on Sustainable Finance is to reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth in line with UN sustainable development goals. Under the Action Plan, several measures are being introduced to encourage financial market participants to take into account ESG factors.

Among a flurry of EU legislative ESG proposals, the European Commission published a draft delegated UCITS directive and draft delegated AIFM regulation on the sustainability risks and sustainability factors to be taken into account for UCITS and AIFMs. A consultation period in respect of the drafts closed on 6 July 2020.

The drafts reflect ESMA's Final Report to the European Commission on 30 April 2019 on revisions to the UCITS and AIFM regimes for the integration of sustainability risks and sustainability factors.

Which entities will be impacted by these changes?

The proposed changes will apply to all UCITS management companies and AIFMs (referred to collectively here as management companies), regardless of whether or not they manage ESG funds. This includes investment companies or ICAVs that have not designated a management company, taking into account, where outlined below, the nature, scale and complexity of the business of the investment company or ICAV.

Where investment or portfolio management has been delegated by the management company, the changes will likely have an indirect impact on the delegate regardless of whether they are domiciled in the EU or not, for example, in relation to investment due diligence.

Proposed changes

Under the proposed UCITS and AIFM regimes, management companies will be required to expressly take into account sustainability risks as part of compliance with existing organisational and governance rules and to integrate the sustainability risks in the investment decision-making process.

A sustainability risk is 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.

A summary of some of the key changes to the UCITS and AIFM regimes is set out below:

ESG integration	<p>Senior management of the management company will be made responsible for integrating the consideration of sustainability risks into the management company's business.</p> <p>Management companies will be obliged to retain the necessary resources and expertise for the effective integration of sustainability risks into their governance structure. This requirement sits alongside the existing obligation on management companies to employ personnel with the skill, knowledge and expertise necessary for the discharge of their responsibilities. UCITS investment companies or ICAVs that have not designated a management company may take into account the nature, scale and complexity of their business when seeking to comply with this requirement.</p>
Organisation systems	<p>Documented decision-making procedures, organisational structures, reporting lines and control mechanisms will need to be updated to ensure that sustainability risks are taken into account.</p>
Conflict of interest	<p>Processes, policies and registers around conflicts of interest will need to be updated to include conflicts that may arise as a result of the integration of sustainability risks such as conflicts arising from the risk of greenwashing, mis-selling or misrepresentation of investment strategies.</p>
Due diligence	<p>Management companies are subject to existing due diligence requirements relating to the selection and ongoing monitoring of investments but will be required to update these due diligence processes to take account of sustainability risk.</p> <p>Larger management companies and entities which choose to voluntarily comply with the principal adverse impact reporting obligation under the EU Disclosure Regulation must take into account the principal adverse impact of investments on sustainability factors. Sustainability factors are environmental, social and employee matters as well as respect for human rights, anti-corruption and anti-bribery matters. There is some ambiguity on whether such management companies would be required to apply this requirement to all products and clarification has been sought in the responses to the consultation seeking to align this with the Sustainable Finance Disclosure Regulation, which provides for consideration of size, nature scale and the types of products being made available.</p>
Risk management	<p>The risk management policy will need to be updated to consider exposures of UCITS and AIFs to sustainability risks, in addition to market, liquidity and counterparty risks and all other relevant risks, including operational risks.</p>

When will the changes come into effect?

The changes are not expected to come into effect until Q3 2021 at the earliest. The delegated directive for UCITS and the delegated regulation for AIFMs shall apply from the first day of the twelfth month after publication in the Official Journal of the European Union. Because the UCITS draft delegated act is a delegated directive, rather than a regulation, before the date of application of the UCITS delegated act, member states will need to put in place appropriate local laws, regulations or administrative provisions to comply with the delegated directive.

Additional considerations for management companies

Organisational requirements

Relevant employees of management companies will need to have an understanding of sustainability risks and how they could apply in the context of the manager's business. Some management companies may already have the requisite level of skills, others may consider upskilling relevant employees through training or hiring in new personnel.

Larger management companies may consider the designation of a sustainability officer but this would not be appropriate for all.

Management companies should develop a policy in relation to sustainability issues which will be applied by its senior management.

Due diligence

As other ESG EU legislative initiatives come into force, it is hoped that the quality and availability of reliable ESG data will improve. This should assist management companies, and their delegates, with complying with their due diligence obligations.

What should management companies do now?

- Become familiar with the impact of the UCITS and AIFMD revisions as well as the other new EU ESG regulations and legislation
- Consider the management company's organisational structure to ensure it has the appropriate resources, expertise and governance to comply with the requirements when enacted
- Review relevant policies to disclose how sustainability risks are integrated into the decision making-process
- Put ESG on the strategy planning agenda
- Stay tuned to ESG-related industry work

You can contact a member of the A&L Goodbody [Asset Management & Investment Funds team](#) for further information.

Our team



Brian McDermott
Partner and Head of Asset Management & Investment Funds
+353 1 649 2307
bmcdermott@algoodbody.com



Michael Barr
Partner
+353 1 649 2327
mbarr@algoodbody.com



Stephen Carson
Partner
+44 20 7382 0820
scarson@algoodbody.com



Mary McKenna
Partner
+353 1 649 2344
mmckenna@algoodbody.com



Kerill O'Shaughnessy
Partner
+353 1 649 2422
koshaghnessy@algoodbody.com



Laura Butler
Partner
+353 1 649 2209
lbutler@algoodbody.com



Nollaig Greene
Associate & Knowledge Lawyer
+353 1 649 2359
ngreene@algoodbody.com



Ann Shiels
Associate & Knowledge Lawyer
+353 1 649 2396
ashiels@algoodbody.com



Chris Bergin
Associate
+44 207 382 0826
cbergin@algoodbody.com

Disclaimer: A&L Goodbody 2020. The contents of this document are limited to general information and not detailed analysis of law or legal advice and are not intended to address specific legal queries arising in any particular set of circumstances.