MACFARLANES

ESG in the UCITS, AIFMD and MiFID rules
Overview

What were the amendments?

In August 2021, a series of delegated acts were published in the Official Journal of the EU which consisted of a series of amendments to the existing AIFMD, UCITS and MiFID frameworks, which aim to integrate sustainability considerations into firms' day-to-day operations. The measures formed part of the EU's Sustainable Finance Action Plan.

Impact on the industry

At the heart of the amendments was a desire to mainstream the consideration of sustainability risks. Firms to whom these measures apply are required to incorporate the consideration of sustainability risks into their internal policies and procedures and ensure they have sufficient resources and expertise for the effective integration of sustainability risks. Firms also have to ensure that clients' sustainability preferences are taken into account as part of their target market assessments.

Application

The changes to AIFMD and UCITS applied from **1 August 2022**.

The changes to MiFID applied as follows:

- **2 August 2022** – in respect of the organisational requirements (including suitability assessments).
- **22 November 2022** – in respect of the product governance obligations.

ESMA produced guidelines on the implementation of the MiFID changes. The final report was published on 27 September 2022, after 2 August 2022 effective date for the implementation of the organisation requirements.

Scope

The changes amended existing EU directives and regulations governing the AIFMD, UCITS and MiFID frameworks. As such, the amendments, which are all now in force, will apply to AIFMs, UCITS mancos and MiFID investment firms that are currently in scope of those existing EU directives and regulations (broadly, EU-based AIFMs, UCITS Mancos and MiFID investment firms). However, there may also be implications for UK firms (see below).

What does this mean for UK firms?

These amendments do not directly apply to UK firms. However, it may be prudent for UK AIFMs and UK UCITS mancos that market their funds to EU investors (and are thus required under article 6 of the Sustainable Finance Disclosure Regulation (SFDR) to disclose the manner in which they integrate sustainability risks into their investment decision making), to align their internal policies and procedures with these requirements, thereby ensuring those policies and procedures support their public disclosures. UK MiFID investment firms using EU distributors to market their products to EU investors are often required by those distributors to provide information on any sustainability-related objectives and sustainability factors of those products, and therefore are often indirectly caught.

New concept

The amendments to MiFID build on concepts introduced by the SFDR and introduced a further new concept:

"Sustainability preference": a (potential) client's choice as to whether and, if so, to what extent, one or more of the following financial instruments should be integrated into his or her investment:

- a financial instrument for which the (potential) client determines that a minimum proportion should be invested in environmentally sustainable investments (as defined in the Taxonomy Regulation);
- a financial instrument for which the (potential) client determines that a minimum proportion should be invested in sustainable investments (as defined in SFDR); and
- a financial instrument that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the (potential) client.

Next steps

AIFMs, UCITS mancos, and MiFID investment firms that operate in the EU should have considered the requirements overleaf and should have updated their internal policies and procedures to incorporate the requirements. UK firms should also have considered whether there is commercial pressure to comply with the requirements, for example from EU distributors, and should continue to monitor closely any publications from HM Treasury and the Financial Conduct Authority (FCA) on this topic, in order to understand any potential domestic divergence.

Requirement		UCITS and AIF managers	MiFID investment firms
Due diligence	Take into account sustainability risks and, where applicable, principal adverse impacts of investment decisions on sustainability factors when carrying out investment due diligence	**Yes**	No
Resources	Retain the necessary resources and expertise for the effective integration of sustainability risks	**Yes**	No
Conflicts of interest: sustainability risks	Identify conflicts that may arise as a result of the integration of sustainability risks	**Yes**	No
Conflicts of interest: sustainability preferences	Consider a client's sustainability preferences as part of the identification of conflicts	No	**Yes**
Risk management	Assess sustainability risk as part of its risk management policies and procedures	**Yes**	**Yes**
Internal organisation	Take into account sustainability risks as part of the firm's organisational requirements	**Yes**	**Yes**
Senior management	Ensure a senior manager is responsible for the integration of sustainability risks	**Yes**	No
Suitability	▪ Consider a client's sustainability preferences and sustainability factors of a product when selecting financial instruments ▪ Describe the sustainability factors taken into consideration in the selection process of financial instruments	No	**Yes**
Product governance	▪ Include sustainability-related objectives as part of target market assessment ▪ Examine sustainability preferences as part of the target market assessment ▪ Disclose sustainability factors of a product to distributors/as part of an investment recommendation ▪ Ensure the sustainability factors of a product are consistent with the relevant target market's sustainability preferences	No	**Yes**

Contact details

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