MACFARLANES

Draft ESG measures to amend the UCITS, AIFMD and MiFID rules
Overview

What is it?

The suite of draft measures (the Draft Delegated Acts), which will affect UCITS and AIF managers and MiFID investment firms (collectively, managers). The Draft Delegated Acts are a further development of the European Commission's Sustainable Finance Action Plan.

The Draft Delegated Acts follow the Disclosure Regulation (Regulation (EU) 2019/2088) and the Framework Regulation (Regulation (EU) 2020/852) (together, the Regulations), both already published in the Official Journal, and which apply to managers, and which prescribe certain website and investor-reporting disclosures about the firm's approach to ESG.

Impact on the industry

If the Draft Delegated Acts are implemented in their current draft form, we would expect the following outcomes post-implementation:

- updated internal organisation and risk management policies;
- updated due diligence and conflicts of interest processes;
- new hires and/or training to ensure integration of sustainability risk;
- new senior management responsibility for sustainability risks;
- updated suitability processes to include sustainability preferences; and
- updated product governance procedures.

Application

The Draft Delegated Acts are still in draft and we are awaiting an update on the results of the consultation. Whilst the timetable is unclear, it is expected that Draft Delegated Acts will come into force later than the Regulations, likely in the latter part of 2021.

Scope

The Draft Delegated Acts amend existing directives and regulations:

- the UCITS Implementing Directive (2010/43/EU);
- the AIFMD Level 2 Regulation (231/2013/EU);
- the MiFID Organisational Regulation (2017/565/EU); and
- the MiFID Delegated Directive (2017/593/EU).

The changes will impact managers subject to those requirements, as applicable.

Brexit implications

It is possible that the UK may decide not to implement the Draft Delegated Acts as part of the post-Brexit onshoring of legislation, and there remains significant uncertainty in the UK about how firms will be expected to implement these and other EU legislative measures in practice.

New concepts

The Draft Delegated Acts build on concepts introduced by the Disclosure Regulation (which are explained in our article on the Disclosure Regulation) by adding a new concept:

- **sustainability preference:** a (potential) client's choice as to whether (i) financial instruments which have sustainable investment objectives, or (ii) financial instruments which promote environmental or social characteristics, and either pursue sustainable investments or consider principal adverse impacts on sustainability factors, should be integrated into their investment strategy.

Next steps

Consider the requirements set out overleaf and begin to plan accordingly, whilst monitoring 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?
Investment 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	Take into account sustainability when identifying conflicts of interest.	**Yes – UCITS and AIF managers would need to consider sustainability risk integration.**	**Yes – MiFID investment firms would need to consider sustainability preferences as a client interest.**
Risk management	Take into account sustainability risk in risk management policies and procedures.	**Yes**	**Yes**
Internal organisation	Take into account sustainability risk in internal organisational policies and procedures.	**Yes**	**Yes**
Senior management	Ensure a senior manager is responsible for integration of sustainability risks.	**Yes**	No
Suitability	Take into account sustainability preferences when selecting investments for clients.	No	**Yes**
Product governance	Specify any sustainability preferences for target markets. Ensure any financial instrument's sustainability factors, or any products or services offered or recommended, are consistent with any relevant target market's sustainability preferences.	Not directly, but the FCA has extended existing product governance requirements to UCITS and AIF managers as guidance in the UK.	**Yes**

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