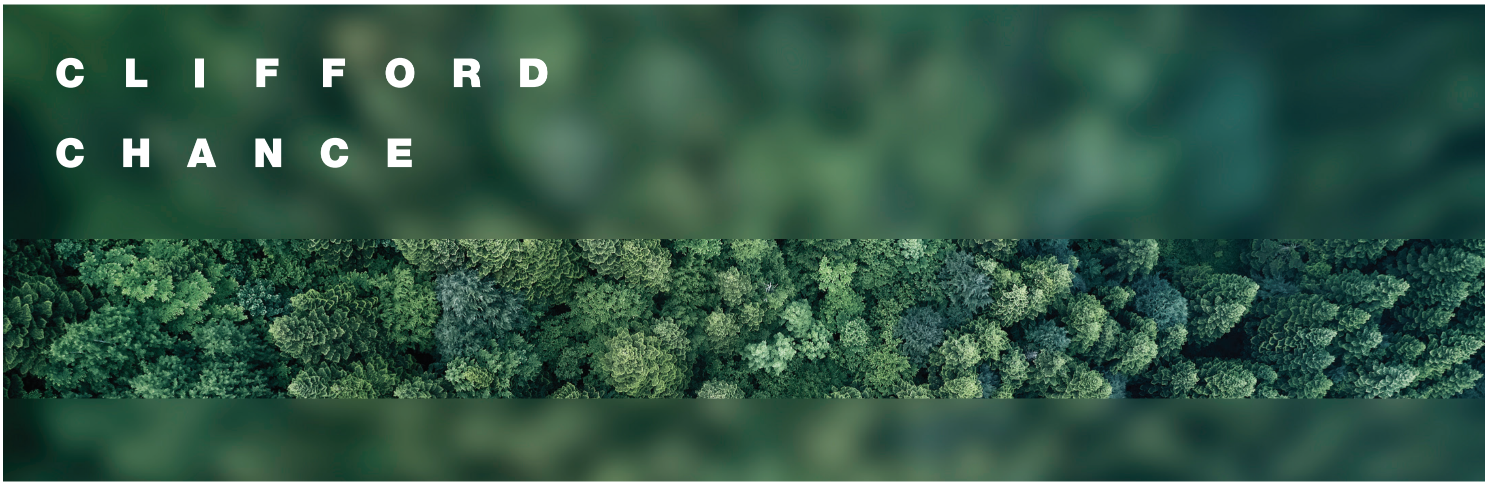


EUROPEAN COMMISSION ADOPTS LONG-AWAITED AMENDMENTS FOR ASSET MANAGERS, INSURERS AND INSURANCE DISTRIBUTORS ON ESG INTEGRATION

Introduction

On 21 April 2021 the European Commission adopted a package of measures to help improve the flow of money towards sustainable activities across the European Union. The package comprised:

- The **European Taxonomy Climate Delegated Act**;
- A proposal for a **Corporate Sustainability Reporting Directive** (you can read our briefing on this development **here**); and
- Six amending Delegated Acts (Delegated Acts) on fiduciary duties, investment and insurance advice covering amendments to the AIFMD, UCITS, MiFID II, IDD and Solvency II frameworks.

This briefing provides an overview of what the Delegated Acts entail, and their impact on UK-based asset managers, insurers and insurance distributors.

Background to the Delegated Acts

These Delegated Acts have been in the pipeline since as far back as May 2018. See the timeline below for an illustration of the various stages that the legislation has passed through between then and now.

What the Delegated Acts say

Integration of Sustainability Risks and Factors

The Delegated Acts amend the AIFMD, UCITS, MiFID II, IDD and Solvency II frameworks to specifically require asset managers, insurers and insurance distributors to:

- in the case of AIFMD and UCITS, integrate sustainability risks and factors into their processes, systems and internal controls, and ensure that they retain the necessary resources and expertise to effectively integrate sustainability risks;
- in the case of MiFID II and IDD, take into account sustainability factors and sustainability-related objectives in, and integrate sustainability risks into, the product oversight and governance process and the rules on conflicts of interest; and
- in the case of Solvency II, identify and take into account sustainability risks in both the assessment of the uncertainty associated with estimates made in the calculation of technical provisions and in the implementation of the prudent person principle.

The Commission has stated that these Delegated Acts are meant to clarify the obligations of asset managers, insurers and insurance distributors concerning the integration of sustainability in fiduciary duties, in accordance with the objectives set out in the Sustainable Finance Action Plan and the European Green Deal. However, the Commission has emphasised that this clarification does not seek to introduce ranking amongst different risks (presumably in answer to a concern raised during the consultation process that the highlighting of sustainability risks meant that other traditional investment risks were in danger of seeming less important).

ESG Preferences

Two of the Delegated Acts relating to MiFID II and IDD introduce a requirement to assess a client's sustainability preferences, effectively as a 'top up' to the suitability assessment that asset managers, insurers and insurance distributors are already required to conduct under each of those frameworks.

The Commission hopes that this will ensure that sustainability considerations are taken into account systematically by these advisers when assessing the range of products that they recommend to their clients, and also that providing clients with the opportunity to assert their sustainability preferences will increase demand for products with sustainable investment strategies and/or that consider adverse impact on sustainability. Moreover, the Commission intends that the new measures on sustainability preferences will help to reduce greenwashing.

Consultation Delegated Acts versus Adopted Delegated Acts

There are no changes between the versions of the Delegated Acts relating to AIFMD and UCITS that the Commission consulted on in June 2020 and the versions that the Commission has now adopted. You can read our briefing on the June 2020 consultation drafts **here**.

The most significant changes between the consultation and adopted versions of the Delegated Acts relating to MiFID II, IDD and Solvency II are to the definition and use of 'sustainability preferences'. Previously the definition covered financial instruments/ products that:

(i) had as their objective sustainable investment (as defined in SFDR); or

(ii) promoted environmental or social characteristics as per Article 8 SFDR and either (A) pursued sustainable investments; or (B) considered principal adverse impacts on sustainability factors.

Under the adopted Delegated Acts, the definition now refers to financial instruments/ insurance-based investment products:

(i) for which the client determines that a minimum proportion shall be invested in environmentally sustainable investments (as defined in the Taxonomy Regulation);

(ii) for which the client determines that a minimum proportion shall be invested in sustainable investments (as defined in SFDR); or

(iii) that consider principal adverse impacts on sustainability factors where elements demonstrating that consideration are determined by the client.

The rationale given for this change is that it avoids sustainability preferences being restricted to financial products within the meaning of the SFDR and the Taxonomy Regulation, and bases them instead on the Regulations' sustainability-related concepts.

The term 'sustainability preferences' has also been replaced with the un-defined term 'sustainability related objectives' when describing the new product governance requirements in the Delegated Acts relating to MiFID II and IDD.

Interaction with other sustainable finance measures

The Delegated Acts relating to AIFMD and UCITS purport to clarify some of the implications of the SFDR, particularly where asset managers disclose information concerning the consideration of adverse sustainability impacts. More generally, the Delegated Acts are also intended to reinforce and ensure consistency with both the SFDR and the Taxonomy Regulation in that, taken together, these measures all seek to consistently integrate sustainability considerations into the investment, advisory and disclosure process.

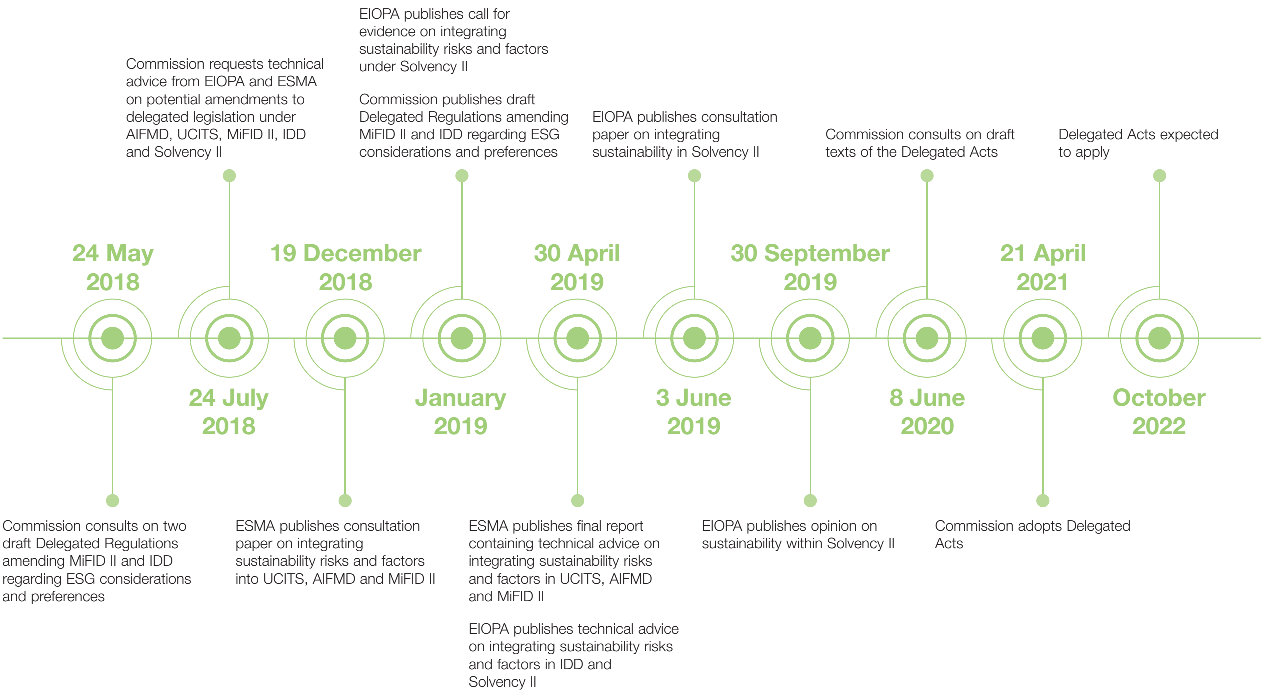
Impact for UK entities

These amendments will not apply to the AIFMD, UCITS, MiFID II, IDD and Solvency II frameworks as they continue in the UK post-Brexit, and the UK Government has not as yet signalled any intention to make any equivalent changes to the UK regimes. However, the UK government announced in November 2020 that it is separately considering how to position the UK as a global leader in green finance so we may see similar sustainability proposals in the coming months.

Next Steps

The Delegated Acts will be scrutinised by the European Parliament and the Council (for a period of three months, extendable once by an additional three months), and are expected to apply as of October 2022.

Timeline for delegated acts



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