**Stand out for the right reasons**
Financial Services Risk and Regulation

# EC to bring sustainable finance into the mainstream

**AT A GLANCE**

June 2020

## What's new?

- The European Commission (EC) published six draft delegated acts on 8 June 2020 which amend existing EU regulation to incorporate sustainability concepts.
- It proposes changes to MiFID II, AIFMD, the UCITS Directive, Solvency II and the IDD, which will have implications for investment firms, fund managers and insurers.
- These proposals follow ESMA's advice to the EC from May 2019, and form part of the EU Sustainable Finance Action Plan.

## What does this mean?

- Under the proposed Delegated Acts, in-scope firms would have to consider sustainability factors across their organisations, including risk management, advice models and product governance processes.
- Firms will need to incorporate sustainability considerations within their governance frameworks, ensuring processes, systems and internal controls reflect sustainability risks.
- This will include identifying any conflicts of interest that may arise from the integration of sustainability considerations across an organisation.
- The EC is proposing to introduce an obligation on firms to explicitly identify and assess sustainability risks when establishing, implementing, and maintaining risk management policies and frameworks.
- Managers of UCITS and AIFs are being asked to consider sustainability factors in the context of market, liquidity, and counterparty risks.
- Managers of UCITs and AIFs will also need to disclose how their due diligence policies take account of any negative impacts their investment decisions may have on sustainability indicators.
- Insurers and reinsurers will need to consider sustainability risks when meeting various obligations under Solvency II, including the prudent person principle.
- The proposed changes to MiFID II and IDD would mean that investment firms, insurers and insurance intermediaries providing advice would need to carry out a mandatory assessment of their clients' sustainability preferences, taking these preferences into account as part of the product selection process.
- Under the MiFID II proposals, investment firms providing advice would also be required to produce a report setting out how the recommendation meets the client's sustainability preferences.
- The EC is also calling on those firms to consider sustainability factors in the product governance process, including in the context of their target market assessment and identifying appropriate distribution channels.


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### What do firms need to do?

- Firms should consider the EC's proposals in the context of the wider sustainable finance regulatory agenda to ensure a holistic response. They should consider their overall strategic approach to sustainability and the implications this agenda could have for their purpose.
- Approaches to suitability and product governance will be of critical importance. As part of the suitability assessments carried out when providing advice to clients, relevant firms will need to be proactive in collecting information on clients' ESG preferences, and be transparent on the ESG profile of products being offered.
- Product manufacturers and distributors will need to consider any ESG preferences of clients when identifying the target market for funds. They will need to determine the level of granularity at which to do this, which should be a commercial decision about how they want to embed sustainability considerations into their strategy.
- They will also need to determine whether the ESG characteristics of a product are consistent with the identified target market and ensure these factors are considered throughout the product life-cycle.
- Careful consideration should be given to the identification and management of any conflicts of interest stemming from the integration of ESG factors across their organisations. Any conflicts of interest should be clearly referenced in firms' conflict of interest policies.
- Firms providing advice to clients must ensure that the integration of ESG considerations in the advisory process does not lead to mis-selling practices or 'greenwashing'.
- Managers of AIFs and UCITS will need to ensure that due diligence policies address any negative impacts of their investments on sustainability metrics.They will need to determine the appropriate metrics to use.
- Firms will need to ensure that relevant staff have the appropriate skills, knowledge and expertise on sustainability issues to support the ESG integration process.
- Effective integration of sustainability considerations into organisational processes, products and advisory models will need to be supported by data. Firms should review their ESG data strategy, and consider the available ESG data sources and tools that can help identify and manage exposures to ESG risks.

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### Next steps

The EC is requesting feedback on the six draft delegated acts by 6 July 2020.

The Delegated Acts will enter into force **20 days** after being published in the Official Journal. Firms will then be given **12 months** to implement the changes.