

ESG: European Commission Opens New Consultation on Amendments to the AIFMD Delegated Regulation

17 June 2020

The European Union's 2018 action plan on sustainable finance set some ambitious goals for financial services regulation and the private equity industry will be among those who feel its effects. Significant progress has been made in recent months, including an important consultation by the European Supervisory Authorities ("ESAs") on the framework for firms that will disclose the principal adverse impacts of their investment decisions on sustainability factors.

Now the European Commission (the "Commission") has published a [draft delegated regulation](#)¹ (the "Draft Regulation") with proposals to amend the delegated regulation made under the Alternative Investment Fund Managers Directive² ("AIFMD"). The Commission's proposals go beyond the disclosure obligations of the Disclosure Regulation³ by also providing organisational and procedural requirements, although these are not unduly prescriptive. Unlike the Disclosure Regulation, which also seems to apply to non-EU managers if they market their funds in the EU, the Draft Regulation only applies to EU AIFMs.

The Draft Delegated Regulation: Background. From March next year, Alternative Investment Fund Managers ("AIFMs"), in common with many other EU financial firms, will be required to disclose their policy on sustainability risks and, as reported in a [recent client update](#), how they consider the material adverse impacts of investment decisions on sustainability factors. These obligations arise from the [Disclosure Regulation](#). Most AIFMs will be able to apply the material adverse impact disclosure on a "comply-or-explain" basis as it is only mandatory for firms with 500 or more employees or parents of large groups.

¹ Regulation amending Delegated Regulation (EU) No 231/2013 as regards the sustainability risks and sustainability factors to be taken into account by Alternative Investment Fund Managers.

² Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

³ Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

Alongside these new disclosure obligations, the Draft Regulation published by the Commission on 8 June would add an obligation for authorised EU AIFMs to integrate sustainability risks and, where applicable, adverse impacts on sustainability factors, in their policies and procedures. Other draft regulations were published at the same time, including similar amendments for Undertakings for Collective Investment in Transferable Securities (“UCITS”) managers and for firms regulated by the Markets in Financial Instruments Directive (“MiFID”).

The Commission’s consultation is open for one month.

General Principles. The Draft Regulation is largely in line with the recommendations made by the European Securities and Markets Authority (“ESMA”) in a [report](#) published last year.

As suggested by ESMA and welcomed by the industry, the Commission applies a principles-based approach, introducing the concept of sustainability risk as a further dimension to existing organisational and procedural requirements, but without setting out prescriptive obligations. Helpfully, in order to ensure consistency between the various EU sustainability laws, the Draft Regulation uses the same definition of “sustainability risk” as the Disclosure Regulation⁴ (i.e., risks that could affect the value of an investment) and requires these to be integrated into processes for all AIFMs. This recognises the principle of proportionality, meaning that smaller firms should be able to accommodate the provisions with fewer resources and processes than larger firms. On the other hand, a requirement to integrate the “adverse impacts of investment decisions on sustainability factors” (which may or may not affect value) only applies to the investment process and only for those AIFMs who choose to (or have to) make “material adverse impact” disclosures under the Disclosure Regulation.

The Draft Regulation sets out requirements in the following areas:

- **Organisational Requirements and Risk Management.** The Draft Regulation requires the AIFM to take sustainability risks into account when implementing its internal structures and decision-making procedures, task and responsibility allocation, reporting lines, internal control and compliance and documentation procedures. In particular, sustainability risks will need to be taken into account in the AIFM’s risk management policy.
- **Senior Management.** The governing body, senior management and, if applicable, the supervisory function are responsible for the integration of

⁴ Article 2; point 22 “sustainability risk means 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”.

sustainability risks in any function for which they are responsible (including valuation, oversight of investment strategy approval, compliance function, monitoring of the risk policy, and the remuneration policy). It is important to note that the way in which sustainability risks are reflected in the remuneration policy will also be a disclosure item under the Disclosure Regulation.

- **Investment Due Diligence.** AIFMs are obliged to apply high standards to the selection and monitoring of their investments. To that end, the AIFM has to establish, implement and apply a written due diligence policy and retain sufficient knowledge and understanding of the assets in which it invests. The Draft Regulation now emphasises that sustainability risks and, where applicable, the principal adverse impacts of an investment decision on sustainability factors are integrated in these due diligence policies and procedures.
- **Conflicts of Interest.** Conflicts of interest that may arise as a result of the integration of sustainability risks in the processes, systems and internal controls of the AIFM must be identified and included in the conflict of interest policy if they could damage the interests of the AIF.
- **Resources.** AIFMs will be required to employ sufficient personnel with the skills, knowledge and expertise necessary for the effective integration of sustainability risks. This provision will not necessarily require firms to employ a dedicated ESG person, although of course some firms will choose to do so.

Next Steps. Stakeholders have until 6 July 2020 to comment on the Draft Regulation.

The Commission plans to adopt the Regulation by the end of 2020, and the expedited legislative process means that it will not require the agreement of the European Parliament or the Council of the European Union. It is intended that the Regulation will apply from the end of 2021.

* * *

Please do not hesitate to contact us with any questions.



Patricia Volhard
Partner, London
+44 20 7786 5505
pvolhard@debevoise.com



Jin-Hyuk Jang
International Counsel, Frankfurt
+49 69 2097 5115
jhjang@debevoise.com



Simon Witney
Special Counsel, London
+44 20 7786 5511
switney@debevoise.com



John Young
International Counsel, London
+44 20 7786 5459
jyoung@debevoise.com



Clarisse Hannotin
Associate, Frankfurt
+49 69 2097 5220
channotin@debevoise.com



Eric Olmesdahl
Associate, London
+44 20 7786 5502
eolmesdahl@debevoise.com



Philip Orange
Professional Support Lawyer,
London
+44 20 7786 5412
porange@debevoise.com



Johanna Waber
Associate, Frankfurt
+49 69 2097 5242
jwaber@debevoise.com