Finance Watch
Making finance serve society

Response to the Commission's on the review of the Alternative Investment Fund Managers Directive (AIFMD)

29 January 2021

SUMMARY

Sustainability/ESG

Rules governing Alternative Investment Fund Managers (AIFMs) need to be well aligned with the requirements stemming from the EU regulation on sustainability-related disclosures in the financial services sector (SFDR) and the EU Taxonomy Regulation as well as other pieces of the sustainable finance puzzle. We therefore suggest to 1) **reinforce the obligation introduced by SFDR by specifically requiring AIFMs to integrate sustainability risks in investment decision-making process**, and 2) to further **extend it to risk management and other relevant processes** in line with the forthcoming adjustments to the Delegated Acts on AIFMD.

Use of both qualitative and quantitative approaches to assess sustainability risks should be allowed. Quantitative methods for evaluation of sustainability risks and adverse impacts are still under development. A difference should be noted between considering environmental or social KPIs while assessing sustainability risks (which can be done in a qualitative way), and between including such indicators in a risk assessment model (quantitative method). Moreover, to enable a quantitative assessment of sustainability risks, corporate ESG disclosures need to be improved.

All AIFMs – regardless of their size - should consider potential adverse impacts of investment decisions on sustainability factors, meaning the environment and society. Fully integrating the "double materiality" assessment in investment decisions is needed to meet the EU's goal to be climate-neutral by 2050 and the revised 2030 Climate Target Plan. Therefore, we believe that the obligation stemming from SFDR to consider principal adverse impacts of investment decisions on sustainability factors, should be extended to cover all AIFs.

Financial stability & supervision

There is ample evidence that private corporate lending has grown substantially in recent years but the sector lacks transparency and supervisors are far from having at their disposal the data they need to monitor markets and the build-up of systemic risk. AIFMs that operate private debt funds are exposed to many of the same risk drivers as credit institutions and should be supervised accordingly. Adequate supervision of AIFs is essential to forestall regulatory arbitrage, which has been one of the main drivers behind the exorbitant growth of the private debt sector in recent years.

Concerns have also been growing over the significant growth in the investment management industry. Between 2008 and 2017, alternative investment funds (AIFs) have more than tripled in size, growing

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from €1.6trn to €5.8trn. As concluded by the ESRB in its report of 2017, "as the investment funds sector becomes a larger part of the total financial market, so managing systemic risk in that sector becomes more pertinent".

We therefore make several recommendations aimed at enhancing transparency, appropriate tools and improved supervision:

- The AIFMD framework should be adjusted to **address more effectively macroprudential concerns**. This should be done by 1) improving supervisory reporting requirements; 2) harmonising availability of liquidity risk management tools for AIFMs across the EU; 3) granting ESMA strong and binding coordination powers in market stress situations. If the work of supervisors leads to conclusions that there are systemically important AIFMs, there should be specific macroprudential requirements for such AIFMs.
- The **capital requirements** established for AIFMs carrying out ancillary services under Article 6 of the AIFMD should correspond to the capital requirements applicable to the investment firms carrying out identical services.
- We see value in **introducing in the AIFMD a Supervisory Review and Evaluation Process (SREP)** similar to that applicable to the credit institutions.
- We believe that **ESMA should be granted more competences and powers** beyond those already granted to them under the AIFMD. Having one authority with the complete picture in terms of volumes of investments as well as the risks incurred by the system would significantly contribute to financial stability. However, if ESMA is to be entrusted with such powers, its resources must be increased accordingly.

Investor protection

We believe that the AIFMD should cross-refer to the **client categories** as defined in **the MIFID II**. There is no inherent rationale for categorising investors differently according to the type of investment. Enhanced regulatory consistency would also benefit investors and companies by reducing regulatory complexity and would contribute to the objective of creating a Capital Market Union.

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RESPONSES TO SPECIFIC QUESTIONS

I. FUNCTIONING OF THE AIFMD REGULATORY FRAMEWORK, SCOPE AND AUTHORISATION REQUIREMENTS

The central pillar of the AIFMD regulatory regime is a European licence or a so-called AIFM passport. EU AIFMs are able to manage and market EU AIFs to professional investors across the Union with a single authorisation. This section seeks to gather views on potential improvements to the AIFMD legal framework to facilitate further integration of the EU AIF market. The objective is to look at the specific regulatory aspects where their potential refining could enhance utility of the AIFM passport, gathering data on concrete costs and benefits of the suggested improvements, at the same time ensuring that the investor and financial stability interests are served in the best way. A number of questions focus on the level playing field between AIFMs and other financial intermediaries.

Question 5. Should AIFMs be permitted to invest on own account?

Yes

No

Don't know / no opinion / not relevant

Question 5.1 Please explain your answer to question 5:

While we appreciate that this would be a way, in theory, for AIFMs to align their interest with clients by investing alongside them, this would likely open the door to a regulatory arbitrage opportunity for regulated (CRR/CRD) investment firms to run their in-house principal investment operations as AIFs, leveraged by the funds of a number of friendly co-investors. It would not prevent the same firms, e.g., from running market-making and/or prime brokerage businesses and/or managing purely third-party AIFs, which could give rise to potentially significant conflicts of interest, as it has already in the past.

Question 12. Should the capital requirements established for AIFMs carrying out ancillary services under Article 6 of the AIFMD correspond to the capital requirements applicable to the investment firms carrying out identical services?

Yes

No

Don't know / no opinion / not relevant

Question 12.1 Please explain your answer to question 12, presenting benefits and disadvantages of your suggested approach as well as potential costs of the change, where possible:

Yes, this would be necessary to establish/maintain a level playing field and protect the business model of smaller, 'boutique' investment firms, which specialise in these ancillary services. AIFMD should be required to conduct these services through separate, dedicated entities, which should also be capitalised separately.

Question 14. Would you see value in introducing in the AIFMD a Supervisory Review and

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Evaluation Process (SREP) similar to that applicable to the credit institutions?

Yes

No

Don't know / no opinion / not relevant

Question 14.1 Please explain your answer to question 14, presenting benefits and disadvantages of your suggested approach as well as potential costs of the change, where possible:

AIFMs that operate private debt funds are exposed to many of the same risk drivers as credit institutions and should be supervised accordingly. Adequate supervision of AIFs is essential to forestall regulatory arbitrage, which has been one of the main drivers behind the exorbitant growth of the private debt sector in recent years.

Moreover, certain institutions including ESRB have been concerned over possible systemic risks posed by the asset management industry. In its report of 2017, ESRB notes that "there are concerns that increased financial intermediation by investment funds may result in the amplification of any future financial crisis. Mismatches between the liquidity of open-ended investment funds' assets and their redemption profiles may result in fire sales in order to meet redemption requests in times of market stress. Such fire sales could adversely affect other financial market participants that own the same or closely correlated assets. Furthermore, leverage can amplify the impact of negative market movements as it creates exposure in excess of the assets of an investment fund. In addition to such channels of indirect contagion, an investment fund can spread risk through interconnectedness, e.g. interconnections with its investors, which is a direct channel through which shocks can be transmitted to other financial institutions." ESRB also highlight that while there is evidence that the current regulatory framework provides for effective risk management by investment funds at the microprudential level, its efficacy from a macroprudential perspective is largely untested.

The concerns have been exacerbated by the fact that the sector has grown significantly in the years after the crisis. ESRB reports that since 2008 total net assets of EU-domiciled investment funds have more than doubled, growing from €6.2trn to €15.3trn in the third quarter of 2017. Moreover, **alternative investment funds (AIFs) have more than tripled in size, growing from €1.6trn to €5.8trn over the same period**. The ESRB concludes that "as the investment funds sector becomes a larger part of the total financial market, so managing systemic risk in that sector becomes more pertinent".

II. Investor protection

The AIFMD aims to protect investors by requiring AIFMs to act with the requisite transparency before and after investors commit capital to a particular AIF. Conflicts of interest must be managed in the best interest of the investors in the AIF. AIFMs must also ensure that the AIF's assets are valued in accordance with appropriate and consistent valuation procedures established for an each AIF. The AIF assets are then placed in safekeeping with an appointed depositary that also oversees AIF's cash flows and ensures regulatory compliance.

Questions in this section cover the topic of investor categorisation referencing to MiFID II, stopping short of repeating the same questions that have been raised in its recent public consultation on MiFID II, rather inviting comments on the most appropriate way forward. Views are also sought on the conditions that would make it possible to open up the AIF universe to a larger pool

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of investors while considering their varying degrees of financial literacy and risk awareness. Examples of redundant or insufficient investor disclosures are invited.

Greater clarity on stakeholders' views of the AIFMD rules on depositaries is sought in particular where such rules may require clarification or amending. The introduction of the depositary passport is desirable from an internal market point of view, but stakeholders are invited to propose other potential legal solutions, if any, that could address the issue of the short supply and concentration of depository services in smaller markets.

a) Investor classification and investor access

Question 21. Do you agree that the AIFMD should cross-refer to the client categories as defined in the MIFID II (Article 4(1)(ag) of the AIFMD)?

Yes

No

Don't know / no opinion / not relevant

Question 21.1 Please explain your answer to question 21:

A uniform categorisation of investors would be highly desirable. There is no inherent rationale for categorising investors differently according to the type of investment. Enhanced regulatory consistency would also benefit investors and companies by reducing regulatory complexity and would contribute to the objective of creating a Capital Market Union.

III. International relations

Considering the global nature of financial services, the AIFMD interacts with the third country regulatory regimes. By adopting the AIFMD the EU co-legislators sought to put in place a legal framework for tackling risks emanating from AIF activities that may impact the EU financial stability, market integrity and investor protection. The questions below are seeking views on where to strike the balance of having a functioning, efficient AIF market and ensuring that it operates under the conditions of a fair competition without undermining financial stability. Besides posing general questions on the competitiveness of the EU AIF market, this section seeks views on how the EU market could interact with international partners in the area governed by the AIFMD. The focus is on the appropriateness of the AIFMD third country passport regime and delegation rules.

Question 53. Should the AIFMD standards apply regardless of the location of a third party, to which AIFM has delegated the collective portfolio management functions, in order to ensure investor protection and to prevent regulatory arbitrage?

Yes

No

Don't know / no opinion / not relevant

IV. Financial stability

One of the main objectives of the AIFMD is to enable supervisors to appreciate and mitigate systemic risks building up in financial markets from different sources. To this end, AIFMs are subject to periodic reporting obligations and supervisors are equipped with certain market intervention powers to mitigate negative effects to the financial stability that may arise from the activities on the AIF market.

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The section below invites opinions whether the intervention powers and a tool-kit available to the relevant supervisors are sufficient in times of severe market disruptions. Shared views on the adequacy of the AIFMR supervisory reporting template will be important in rethinking the AIFM supervisory reporting obligations. According to the FSB report, markets for leveraged loans and CLOs have grown significantly in recent years exceeding pre-crisis levels (FSB, Vulnerabilities associated with leveraged loans and collateralised loan obligations (CLOs), PLEN/2019/91-REV, 22 November 2019). While most leveraged loans are originated and held by banks, investment funds are also exposed to the leveraged loan and CLO markets. In order to assess risks to the financial stability and regulatory implications associated with leveraged loans and CLOs it would be commendable to continue collecting the relevant data and monitoring the market. The stakeholders are invited to cast their views on the matter.

With particular regard to the loan originating AIFs, suggestions on the optimal harmonisation of the rules that could apply to these collective investment vehicles are welcome. Finally, questions are raised whether leverage calculation methods could benefit from further standardisation of metrics across the AIF market and potentially also across the UCITS for the supervisors to have a complete picture of the level of leverage engaged by the collective investment funds.

a) macroprudential tools

Question 56. Should the AIFMD framework be further enhanced for more effectively addressing macroprudential concerns?

Yes

No

Don't know / no opinion / not relevant

Question 56.1 If yes, which of the following amendments to the AIFMD legal framework would you suggest?

- improving supervisory reporting requirements
- harmonising availability of liquidity risk management tools for AIFMs across the EU
- further detailing cooperation of the NCAs in case of activating liquidity risk management tools, in particular in situations with cross-border implications further clarifying grounds for supervisory intervention when applying macroprudential tools
- defining an inherently liquid/illiquid asset
- granting ESMA strong and binding coordination powers in market stress situations
- other

Please explain what other amendments to the AIFMD legal framework you would suggest.

If the work of supervisors leads to conclusions that there are systemically important AIFMs, there should be specific macroprudential requirements for such AIFMs.

Question 57. Is there a need to clarify in the AIFMD that the NCAs' right to require the suspension of the issue, repurchase or redemption of units in the public interest includes financial stability reasons?

Yes

No

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Don’t know / no opinion / not relevant

Question 57.1 Please explain your answer to question 57, presenting benefits and disadvantages of the potential changes to the existing rules and processes as well as costs:

Legislation needs to take into account "inaction bias", encourage proactive supervision in times of an emerging crisis. The power of supervisors to intervene to require the suspension of the issue, repurchase or redemption of units for financial stability reasons must be recognised by legislation.

Question 59. Should AIFMs be required to report to the relevant supervisory authorities when they activate liquidity risk management tools?

Yes

No

Don’t know / no opinion / not relevant

Question 64. Should the identification of an AIFM with a LEI identifier be mandatory?

Yes

No

Don’t know / no opinion / not relevant

Question 64.1 Please explain your answer to question 64, presenting benefits and disadvantages as well as costs associated with introducing such a requirement:

LEI have been developed in the wake of the financial crisis of 2007 – 2008 to help supervisors understand the build-up of risk and interconnections in financial markets. They are an essential tool for supervisors to follow market trends, prevent systemic crises and manage them if they happen. Their logic is to apply to all financial institutions and funds, and it is now required for listed companies and entities conducting financial transactions in the European Union. Requiring the identification of AIFMs with an LEI is all the more important for institutions managing alternative investments given that those institutions are particularly likely to be involved in situations that can lead to a financial crisis. In the guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD ESMA recommends use of LEI for the purpose of reporting information on the main instruments in which they are trading and on the principal exposures and most important concentrations of the AIFs that they manage.

Given the cost to society associated with financial crises and the benefit associated with avoiding them, the cost consideration of introducing such a requirement is not relevant: it has to be done, absent which supervisors will be flying blind when it comes to estimating the risks linked to alternative investments.

Question 65. Should the use of an LEI identifier for the purposes of identifying the counterparties and issuers of securities in an AIF’s portfolio be mandatory for the Annex IV

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reporting of AIFMR?

Yes

No

Don't know / no opinion / not relevant

Question 65.1 Please explain your answer to question 65, presenting benefits and disadvantages as well as costs associated with introducing such a requirement:

Please refer to our explanation in box 64. The same reasons apply.

Question 66. Does the reporting data adequately cover activities of loan originating AIFs?

Yes

No

Don't know / no opinion / not relevant

Question 66.1. If not, what data fields should be added to the supervisory reporting template:

- loans originated by AIFs
- leveraged loans originated by AIFs
- other

Please explain why you think loans originated by AIFs should be added as a data fields to the supervisory reporting template, providing information on the benefits, disadvantages and costs of implementation:

There is ample evidence that private corporate lending has grown substantially in recent years but the sector lacks transparency and supervisors are far from having at their disposal the data they need to monitor markets and the build-up of systemic risk.

Data for loan origination emanating from AIFs is, at best, very partial despite the fact that it is indispensable for supervisors to monitor the market. It is critical for the stability of credit markets that credit quality and risk management standards are applied consistently, regardless of whether loans are originated by credit institutions or AIFMs.

Please explain why you think leveraged loans originated by AIFs should be added as a data fields to the supervisory reporting template, providing information on the benefits, disadvantages and costs of implementation:

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There is ample evidence that private corporate lending has grown substantially in recent years but the sector lacks transparency and supervisors are far from having at their disposal the data they need to monitor markets and the build-up of systemic risk.

Question 67. Should the supervisory reporting by AIFMs be submitted to a single central authority?

Yes

No

Don't know / no opinion / not relevant

Question 67.1 If yes, which one:

ESMA

other options

Please explain your choice, particularly substantiating 'other options', and provide information, where available, on the benefits, disadvantages and costs of implementing each proposition:

This is needed to produce aggregated figures of AIFM-originated loan exposures so that ESAs can properly assess total leverage in the EU financial system.

Question 68. Should access to the AIFMD supervisory reporting data be granted to other relevant national and/or EU institutions with responsibilities in the area of financial stability?

Yes

No

Don't know / no opinion / not relevant

Question 68.1 If yes, please specify which one:

ESRB
ECB
NCBs
National macro-prudential authorities
Other

Please specify to which other relevant national and/or EU institutions the access to the AIFMD supervisory reporting data should be granted:

5000 character(s) maximum

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including spaces and line breaks, i.e. stricter than the MS Word characters counting method.

We believe that all of the above mentioned authorities (ESRB, ECB, NCBs and National macro-prudential authorities) as well as all three European Supervisory Authorities (ESMA, EBA and EIOPA) should be given access to the AIFMD supervisory reporting data.
Regarding the reason for granting the access to the ESAs, this is coherent with our responses to the questions in section VI where we advocate that more supervisory powers should be transferred from the National Competent Authorities to the ESAs with the aim to create a Capital Markets Union.

It is self explanatory why ESMA should have access to the AIFMD supervisory reporting data, being financial market's supervisor. Regarding EBA, many AIFs are highly interconnected with the banking sector, which may affect financial stability. Insurance companies are asset owners who often invest in AIFs and hence such data is also of interest to EIOPA.

Question 71. What additional data fields should be added to the AIFMR supervisory reporting template to improve capturing risks to financial stability:

Please select as many answers as you like

- value at Risk (VaR)
- additional details used for calculating leverage
- additional details on the liquidity profile of the fund's
- portfolio
- details on initial margin and variation margin
- the geographical focus expressed in monetary values
- the extent of hedging through long/short positions by an AIFM/AIF expressed as a percentage
- liquidity risk management tools that are available to AIFMs
- data on non-EU master AIFs that are not marketed into the EU, but which have an EU feeder AIF or a non-EU feeder marketed into the EU if managed by the same AIFM
- the role of external credit ratings in investment mandates
- LEIs of all counterparties to provide detail on exposures
- sustainability-related data, in particular on exposure to climate and environmental risks, including physical and transition risks (e.g. shares of assets for which sustainability risks are assessed; types and magnitudes of risks; forward-looking, scenario-based data)
- other

Please explain what other data fields should be added to the AIFMR supervisory reporting template, providing as much detail as possible and relevant examples as well as the costs, benefits and disadvantages of this option:

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VaR is not an appropriate metric as it gives a false sense of security and, as such, is a dangerous tool when it comes to monitoring systemic risk. It can lead supervisors to making the wrong decisions. It is a good approximation of what happens on the market in normal circumstances. But it is not an appropriate metric for the times of crisis.
For instance, VaR will tell you that 99% of events will be within mean plus or minus 3% standard deviation. During the global financial crisis 12 years ago, we had 20 standard deviation events five times a day.
Instead, we would suggest to use 'expected shortfall' metric which is intended to address 'tail risks' of sustaining major losses, which is a much more meaningful measure of extreme risk.

Question 77. Should the supervisory reporting requirements for UCITS and AIFs be harmonised?

Yes

No

Don't know / no opinion / not relevant

Question 82. Should the leverage calculation metrics be harmonised at EU level?

Yes

No

Don't know / no opinion / not relevant

Question 82.1 Please explain your answer to question 82, presenting the costs, benefits and disadvantages of your chosen approach:

The leverage calculation metrics for funds should be harmonised at EU level. Leverage calculation aims to measure risk at micro and macro levels. From an economic standpoint this risk is the same notwithstanding the products' wrapper.
Therefore, whether it is a UCITS or AIF fund, the leverage calculation metrics should be measured in the same way (this is obviously different in the case of banking which has entirely different specificities and for which leverage calculation metrics can legitimately be different).

Question 85. Should the requirements for loan originating AIFs be harmonised at EU level?

Yes

No

Don't know / no opinion / not relevant

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Question 85.1 If yes, which of the following options would support this harmonisation:

- limit interconnectedness with other financial intermediaries
- impose leverage limits
- impose additional organisational requirements for AIFMs
- allow only closed-ended AIFs to originate loans
- provide for certain safeguards to borrowers
- permit marketing only to professional investors
- impose diversification requirements
- impose concentration requirements
- other

VI. Sustainability/ESG

Integrating sustainability factors in the portfolio selection and management has a double materiality perspective, in line with the non-financial reporting directive (2014/95) and the European Commission's 2017 non-binding guidelines on non-financial. Financial materiality refers in a broad sense to the financial value and performance of an investment. In this context, sustainability risks refer to potential environmental, social or governance events or conditions that if occurring could cause a negative material impact on the value of the investment. For example, physical risks from the

consequences of climate change may concern a single investment/company, e.g. due to potential supply chain disruptions or scarcity of raw materials, and may concern welfare losses for the economy as a whole. Non-financial materiality, also known as environmental and social materiality, refers to the impacts of an investment/corporate activity on the environment and society (i.e. negative externalities). Still, there is also a financial dimension to non-financial materiality. Notably, so-called transition risks arise from an insufficient consideration for environmental materiality, for instance due to potential policy changes for mitigating climate change (e.g. to regulatory frameworks, incentive structures, carbon pricing), shifts of supply chains and end-demand, as well as stakeholder actions for mitigating climate change.

The disclosure regulation 2019/2088 requires a significant part of the financial services market, including AIFMs, to integrate in their processes, including in their due diligence processes, assessment of all relevant sustainability risks that might have a material negative impact on the financial return of an investment or advice. However, at the moment AIFMs are not required to integrate the quantification of sustainability risks. Regulatory technical standards under the disclosure regulation 2019/2088 will specify principal adverse impacts to be quantified or described. This section seeks to gather input permitting better understand and assess the appropriateness of the AIFMD rules in assessing the sustainability risks.

Question 90. The disclosure regulation 2019/2088 defines sustainability risks, and allows their disclosures either in quantitative or qualitative terms.

Should AIFMs only quantify such risks?

Yes

No

Don't know / no opinion / not relevant

Question 90.1 Please substantiate your answer to question 90, also in terms of benefits, disadvantages and costs as well as in terms of available data:

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At this point in time, AIFMs should be allowed to use both qualitative and quantitative approaches while assessing sustainability risks. Quantitative methods for evaluation of sustainability risks and adverse impacts are still under development. One thing is to consider an environmental or social KPI disclosed by a company and take it into account while making an investment decision, another thing is to include such an indicator or multiple indicators in a risk assessment model. Moreover, corporate sustainability disclosures need to be improved to enable quantitative sustainability risks and adverse impacts assessment.

In 2019, the Alliance for Corporate Transparency performed a thorough analysis of the non-financial reports of 1000 companies from main industrial sectors and EU countries. The conclusion of the report is that while there is a minority of companies providing comprehensive and reliable sustainability-related information, by and large the quality and comparability of companies' sustainability reporting is not sufficient to understand their impacts, risks, or even their plans.

Another issue is the technical possibility to make a quantitative assessment of social factors. Checking the application of norms and analysing information (including considering quantitative KPIs) is feasible but this remains, and will remain for the foreseeable future, a fundamentally qualitative process.

AIFMs must be required to integrate sustainability risks in their investment decision-making process, risk management and other relevant processes, assessment of all relevant sustainability risks that might have a material negative impact on the financial return of an investment or advice. Moreover, AIFMs that are required or choose to disclose a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors should be specifically required to consider principal adverse sustainability impacts of their investment on sustainability factors. Otherwise, some may interpret requirements within SFDR as a pure disclosure obligation that could be complied with by following a 'comply or explain' approach.

In view of the above, we strongly believe that AIFMs should be required to consider sustainability risks on their investment and principal adverse impacts of their investment on sustainability factors using both a qualitative, and – where possible – a quantitative approach.

Question 91. Should investment decision processes of any AIFM integrate the assessment of non-financial materiality, i.e. potential principal adverse sustainability impacts?

Yes

No

Don't know / no opinion / not relevant

Question 91.1 Please substantiate your answer to question 91, also in terms of benefits, disadvantages and costs. Please make a distinction between adverse impacts and principal adverse impacts and consider those types of adverse impacts for which data and methodologies are available as well as those where the competence is nascent or evolving:

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SFDR requires financial market participants (FMPs) with more than 500 employees to identify and consider principal adverse impacts of investment decisions on sustainability factors and to disclose a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors. For smaller FMPs this obligation is on a comply or explain basis.

Fully integrating the "double materiality" assessment in investment decisions is of paramount importance. To meet the EU's goal to be climate-neutral by 2050 and the revised 2030 Climate Target Plan, all FMPs – regardless of their size - should consider not only sustainability risks (meaning environmental, social or governance events or conditions that, if they occur, could cause an actual or a potential material negative impact on the value of the investment) but also potential adverse impacts of investment decisions on sustainability factors, meaning the environment and society. This is key to fully mainstream sustainability considerations into investments and understand and communicate their impact. Such information should be also disclosed to end-investors who should fully understand the impact of their investment, notwithstanding whether their investment manager is large or small.

Regarding the distinction between adverse impacts and principal adverse impacts, we believe that the thinking reflected in SFDR should be followed, where AIFMs should first identify all potential adverse impacts and have policies on their prioritisation which should be public. Then, they should consider those that are considered most material ('principal'). It would be useful to align this with the development of the double materiality assessment in the forthcoming NFRD review.

Last but not least, we would like to point out that adverse impacts on the environment and society, when material, can become sustainability risks with a material financial impact, creating a self-reinforcing doom loop.

Question 92. Should the adverse impacts on sustainability factors be integrated in the quantification of sustainability risks (see the example in the introduction)?

Fully agree

Somewhat agree

Neutral

Somewhat disagree

Fully disagree

Don't know / no opinion / not relevant

Question 92.1 If you agree, please explain how and at which level the adverse impacts on sustainability factors should be integrated in the quantification of sustainability risks (AIFM or financial product level etc.).

Please explain your answer including concrete proposals, if any, and costs, advantages and disadvantages associated therewith. Please make a distinction between adverse impacts and principal adverse impacts and consider those types of adverse impacts for which data and methodologies are available as well as those where the competence is nascent or evolving

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We are concerned about the formulation of this question. In SFDR, which introduced the notion of sustainability risks and principal adverse impacts, those two notions are distinguished from each other and are considered as requiring different treatment. Disclosures prescribed for sustainability risks and adverse impact consideration are also diverging. We are not convinced that the assessment of principal adverse impacts should be integrated in the sustainability risks assessment as these are two quite different processes. We fear it could lead to an undue complexity of rules.

As explained in our response to Q 90.1, quantitative methods for evaluation of sustainability risks and adverse impacts are either still under development or, depending on the issues considered, will never be available, and corporate sustainability disclosures, needed for a quantitative assessment, remain largely unsatisfactory. Therefore, to start with, AIFMs should be allowed to use both qualitative and quantitative approaches while assessing sustainability risks and adverse impacts. However, use of KPIs and quantitative-based assessment methods should be encouraged and will be surely supported by the ESAs forthcoming final draft RTS on SFDR level II measures.
When it comes to social factors, quantification of the sustainability risks they pose, it is and will remain to a large extent a challenge. Social factors, (e.g. human rights, labour rights, etc...) in a given company can comply with principles (in particular internationally agreed principles emanating from the UN, ILO, OECD, EU...). It may be possible to come up with KPIs on a number of social aspects, but their quantitative assessment is not possible for the moment.
Overall, corporate disclosures on social aspects remain less developed than climate-related and environmental data.

In terms of nascent and evolving methodologies for quantification of adverse impacts on sustainability factors, we are aware (however have not scrutinized) of some initiatives in the market:

- I360X venture created an investor-oriented platform that calculates monetary values for companies' non-financial externalities. It uses data-gathering technologies such as "cognitive" search engines that can use artificial intelligence to tag data sets.
- The Impact Weighted Accounts Initiative led by George Serafeim, a professor at Harvard Business School, is developing a valuation methodology building on work by organisations such as the Sustainability Accounting Standards Board and the UN-backed Global Reporting Initiative.

Question 93. Should AIFMs, when considering investment decisions, be required to take account of sustainability-related impacts beyond what is currently required by the EU law (such as environmental pollution and degradation, climate change, social impacts, human rights violations) alongside the interests and preferences of investors?

Yes

No

No, ESMA's current competences and powers are sufficient

Don't know / no opinion / not relevant

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Question 93.1 If so, how should AIFMs be required to take account of the long-term sustainability and social impacts of their investment decisions? Please explain.

This question is formulated in an ambiguous way. Our positive response is mainly directed by the use of the word 'currently'. We believe that overall, EU law is a sufficiently good enough benchmark for consideration of sustainability-related impacts. However, in light of the EU Green Deal and the recently revised EU ambition regarding climate-neutrality objectives, the EU environmental and climate laws are about to change. Similarly, we are expecting an Action Plan for the implementation of the European Pillar of Social Rights. Therefore, the EU law should be a reference benchmark but not a static one, referring to a regulatory state of play in a given moment.
Moreover, sustainable investing goes beyond complying with the law, as complying with the law is everybody's obligations and sustainable investing should be about developing an impact.

Question 94. The provides EU Taxonomy Regulation 2020/852 a framework for identifying economic activities that are in fact sustainable in order to establish a common understanding for market participants and prevent green-washing. To qualify as sustainable, an activity needs to make a substantial contribution to one of six environmental objectives, do no significant harm to any of the other five, and meet certain social minimum standards. In your view, should the EU Taxonomy play a role when AIFMs are making investment decisions, in particular regarding sustainability factors?

Yes
No
Don't know / no opinion / not relevant

Question 94.1 Please explain your answer to question 94:

Yes, we strongly believe that the EU Taxonomy should play a role when AIFMs are making investment decisions, in particular regarding sustainability factors.

Since it's inception, the EU Taxonomy has been designed to evaluate the level of environmental sustainability of a financial product based on the assessment of the economic activities the fund invests in against the EU Taxonomy screening criteria.

Currently the EU Taxonomy covers only environmental aspects, however it is expected that as part of the renewed Sustainable Finance Strategy the Commission will put forward a proposal for a social taxonomy, including governance aspects.
It would be only be coherent that **AIFMs consider the EU Taxonomy alignment of the potential investee companies while making investment decisions**.

Question 95. Should other sustainability-related requirements or international principles beyond those laid down in Regulation (EU) 2020/852 be considered by AIFMs when making investment decisions?

Yes
No
Don't know / no opinion / not relevant

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VII. Miscellaneous

This section contains a few questions on the competences and powers of supervisory authorities. It also opens up the floor for any other comments of the stakeholders on the AIFMD related regulatory issues that are raised in the preceding sections. Respondents are invited to provide relevant data to support their remarks/proposals.

Question 96. Should ESMA be granted additional competences and powers beyond those already granted to them under the AIFMD?

- entrusting ESMA with authorisation and supervision of all AIFMs
- entrusting ESMA with authorisation and supervision of non-EU AIFMs and
- AIFs
- enhancing ESMA's powers in taking action against individual AIMFs and
- AIFs where their activities threaten integrity of the EU financial market or
- stability the financial system
- enhance ESMA's powers in getting information about national supervisory
- practices, including in relation to individual AIMF and AIFs
- no, there is no need to change competences and powers of ESMA
- other

Please explain why you think ESMA should be entrusted with authorisation and supervision of all AIFMs. Please present costs, advantages and disadvantages associated with the chosen option. Concrete examples substantiating your answer are welcome:

We believe that in line with the objective of creating a Capital Markets Union, it would be beneficial that more supervisory powers are transferred from the NCAs to the European Supervisory Authorities. ESMA's oversight would be particularly beneficial given: 1) the large number of AIFMs which are domiciled outside the EU; 2) the important amount of AIFMs cross-border activity, and 3) the potential systemic risk that investment management activity may present. Having one authority with the complete picture in terms of volumes of investments as well as the risks incurred by the system would significantly contribute to financial stability.

Importantly, if ESMA is to be entrusted with such powers, its resources must be increased accordingly.

Please explain why you think ESMA should be entrusted with authorisation and supervision of non-EU AIFMs and AIFs. Please present costs, advantages and disadvantages associated with the chosen option. Concrete examples substantiating your answer are welcome:

ESMA, in its capacity as a European supervisory authority, is naturally well placed to supervise non-EU AIFMs and AIFs. It is in line with the objective to create a Capital Markets Union and would lead to a more harmonised approach and an equal treatment of non-EU AIFMs and AIFs, preventing regulatory arbitrage. If ESMA is not entrusted with this responsibility, no authority will have a full picture about the non-EU AIFMs and AIFs activity in the EU. Moreover, such a situation opens the door to regulatory arbitrage and an unhealthy competition between the Member States.

Please explain why you think ESMA's powers should be enhanced in taking action against individual AIMFs and AIFs where their activities threaten integrity of the EU financial market or stability the financial system. Please present costs, advantages and disadvantages associated with the chosen option. Concrete examples substantiating your answer are welcome:

Stability of the financial system should be maintained at all cost. Therefore, we strongly believe that ESMA's powers should be enhanced to intervene when AIMFs and AIFs activities put the

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integrity of the EU financial market or its stability at risk. ESMA, as the European financial markets supervisory authority, is best placed for this role.

Please explain why you think ESMA's powers should be enhanced in getting information about national supervisory practices, including in relation to individual AIMFs and AIFs. Please present costs, advantages and disadvantages associated with the chosen option. Concrete examples substantiating your answer are welcome:

With the objective to enhance supervisory convergence in the EU, at the very minimum, ESMA's powers should be enhanced in getting information about national supervisory practices, including in relation to individual AIMFs and AIFs.

Currently, ESMA depends on the good will of NCAs to receive market information and is in the awkward position of ensuring supervisory convergence of NCAs in a context where it Supervisory Board, which has a mission "to make all policy decisions at ESMA", is composed of the Chairs of the various EU NCAs. For obvious reasons, this situation makes ESMA depend on the willingness of NCAs to provide information about national supervisory practices. Absent this willingness, ESMA is deprived of powers to force the process. This should definitely be changed and ESMA's powers enhanced.

Question 97. Should NCAs be granted additional powers and competences beyond those already granted to them under the AIFMD?

Yes
No
Don't know / no opinion / not relevant

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