

BlueBay Asset Management LLP: Response to the ESMA Consultation Paper on Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD

February 2019

Introduction

BlueBay Asset Management LLP is one of Europe's largest specialist active fixed income managers, entrusted by clients with over US\$60.1 billion in assets under management (as of 31st December 2018) in corporate and sovereign debt, rates and FX. Our investment philosophy and approach is focused on delivering absolute-style returns, with an emphasis on capital preservation. We have an established track record of innovation and performance, providing a broad range of relative return, total return and alternative investment portfolios in both public and private debt markets.

We welcome the opportunity to respond to this ESMA public consultation. Investment analysis of non-financial factors – commonly referred to as ESG (environmental, social and governance)* factors – encompasses those aspects of an issuer's practices that influence its ability to meet its financial obligations. BlueBay believes that ESG factors can potentially have a material impact on an issuer's long-term financial performance. Given the limited upside (and potentially significant downside) of fixed income investments, the focus of our ESG analysis is on understanding downside risks. Poorly-managed ESG risks can lead to inefficiencies, operational disruption, litigation and reputational damage, which may ultimately impact an issuer's ability to meet their financial responsibilities. Supplementing traditional financial analysis by reviewing ESG-related management practices and performance is, therefore, not only prudent but also in line with BlueBay's fiduciary duty to optimise investor returns. There is also increasing recognition that as some ESG factors can potentially represent systematic financial risks, ensuring a sustainable financial market is critical to avoid potential financial crises.

Whilst consideration of such factors has always been a feature of BlueBay's investment activities, since 2013, we have been conducting this in a more strategic and systematic way. We recognise investors and other key stakeholders are increasingly requiring managers such as BlueBay to demonstrate to what extent ESG factors are relevant to, and an important feature of, our investment process, and we are committed to being open and transparent about our position and efforts in this regard. We believe this is critical to facilitating informed choice for investors as to how they wish to invest their assets, including directing capital towards strategies which more proactively and explicitly factor in ESG issues.

As such we are supportive of initiatives which promote transparency as a core principle. We believe a high-level, principles-based approach is most appropriate. Whilst it may be helpful to provide suggestions on what good/best practice looks like on incorporating ESG factors into investment activities, these should be applied with the proportionality principle in mind as there may be circumstances where this may not be relevant or appropriate the proportionality principle e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ. The field of ESG investing (which can encompass responsible investing, and sustainability investing) is broad ranging and rapidly evolving given it is still in its infancy. An approach to regulation which is principles-based in such a dynamic field can avoid stifling innovation or being too onerous, whilst delivering effective and efficient outcomes.

** BlueBay considers, and uses, 'ESG' as a term that is synonymous with 'sustainability' which is used in this consultation. For us, both refer to non-financial (or extra financial) factors.*

Responses to questions

Q1: How do you understand or how would you define the notion of “sustainability risks” for the purposes of the delegated acts adopted under the UCITS Directive and AIFMD?

BlueBay prefers to use the term ‘ESG’ rather than ‘sustainability’ to refer to non-financial factors which relate to those aspects of an issuer’s practices that influence its ability to meet its financial obligations and ensure long-term financial sustainability. The extent to which such issues may be financially material may vary, as well as the extent to which they are considered more ethically/morally orientated. Different managers and investors may have different priorities and objectives for wanting to incorporate ESG factors into their investment strategies. Given the spectrum of potential ESG investment strategies that reflect these different drivers, transparency is critical to ensure managers explain the specific ESG philosophy of their investment strategy (e.g. the extent to which the focus is on investment material ESG factors rather than emphasizing an ethical mandate). For instance, BlueBay has a primary focus on ESG investment material risk factors so our emphasis is on ESG integration for the majority of our assets. To a lesser extent, we also offer other strategies, which go beyond ESG integration to be more ethically orientated.

We would be supportive of a revision in the use of ‘sustainability’ in the amendments to the regulation, and would suggest this be replaced with ‘ESG’ as we believe this to better represent the factors referred to and is more consistent with the terminology used in the marketplace.

Q2: Do you agree with the proposed amendments relating to organisational requirements included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.

Yes, we are supportive of a high-level, principles-based approach relating to organisational requirements. However, whilst it may be helpful to provide suggestions of what good/best practice looks like regarding organisational requirements, we would recommend that these be applied with the proportionality principle in mind as there may be circumstances where the suggestions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager’s activities and the investment strategies they employ.

Q3: Do you see merit in expressly requiring or elaborating on the designation of a qualified person within the authorised entity responsible for the integration of sustainability risks and factors (e.g. under Article 5 of the Commission Directive 2010/43/EU and Article 22 of the Commission Delegated Regulation (EU) 231/2013)?

Whilst we recognise the underlying rationale for this, in practice, we would argue that it is not required given the existing regulatory requirements around ensuring a designated individual for risk management can already capture this. More generally managers should be clear in signposting explicitly the individual(s) with responsibility for integrating ESG factors into their investment activities.

Q4: Would you propose any other amendments to the provisions on organisational requirements in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risks and factors?

Not at this time.

Q5: Do you agree with the proposed amendments to provisions relating to due diligence included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.

Yes. We are supportive of the high-level principles-based approach as set out by ESMA. Whilst it may be helpful to provide suggestions of what good/best practice looks like regarding due diligence activities, given how dynamic the field of ESG investing is, we would recommend these to be applied with the proportionality principle in mind as there may be circumstances where the suggestions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ.

Q6: Do you see merit in further elaborating in the provisions above on the identification and ongoing monitoring of sustainability risks, factors and indicators that are material for the financial return of investments?

It could potentially be helpful if these were provided under the context of 'suggestions' rather than being prescriptive given how dynamic the field of ESG investing is. It is important to allow flexibility as there may be circumstances where such suggestions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ.

Q7: Do you agree with the proposed inclusion of recitals relating to conflicts of interest? Should the technical advice cover specific examples? If so, what would be specific examples of conflicts of interests that might arise in relation to the integration of sustainability risks and factors and should be covered in the advice?

These could potentially be useful to draw attention to potential conflicts of interests, which can then be managed to ensure appropriate checks and balances.

Q8: Would you propose any other amendment to the provisions on operating conditions in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risks and factors?

Not at this time. We believe a high level, principles-based approach to regulation is the most appropriate approach given how dynamic the field of ESG investing is. It is important to allow flexibility as there may be circumstances where such provisions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ.

Q9: Do you agree with the proposed amendments to provisions relating to the risk management included above following a high-level and principles-based approach? If not, please elaborate on the reasons for preferring a more granular approach and describe how you would incorporate such view in the aforementioned provisions.

Yes we would support high level, principle-based approach taken by ESMA. It is important to allow flexibility as there may be circumstances where such provisions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ.

Q10: Do you see merit in further specifying the content of the risk management policy by expressly listing key elements for the effective integration of sustainability risks (e.g. techniques, tools and arrangements enabling the assessment of sustainability risks, probability of occurrence and time horizon of sustainability risks with regard to the expected time of holding of the positions bearing the risks, quality of underlying data and methodologies etc.)?

No. We are supportive the high-level, principles-based approach as set out by ESMA. Whilst it may be helpful to provide suggestions of what good/best practice looks like on due diligence activities, given how dynamic the field of ESG investing is, we would recommend these be applied with the proportionality principle in mind as there may be circumstances where the suggestions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ. In this particular case there are many data challenges to consider (e.g. availability, quality, and consistency), lack of understanding and knowledge, as well as limited availability of tools and techniques that means such guidance may not be that useful.

Q11: Do you see merit in amending risk management provisions relating to regular review of risk management policies and systems in order to more specifically refer to elements related to sustainability risks (e.g. quality of the arrangements, processes, techniques and data used, need for authorised entities to highlight the limitations, and demonstrate the absence of available alternatives)?

No. We are supportive of the high-level principles-based approach as set out by ESMA. Whilst it may be helpful to provide suggestions on what good/best practice looks like on due diligence activities, given how dynamic the field of ESG investing is, these should be applied with the proportionality principle in mind as there may be circumstances where the suggestions may not be relevant or appropriate e.g. to account for the size, nature, scope and complexity of a manager's activities and the investment strategies they employ. We believe investment managers are best placed to know what should be included in risk reviews. Furthermore, existing content around the review of risk management in present regulation has the potential to allow for this to be taken into account currently.

Q12: Would you propose any other amendment to the provisions on risk management in the Commission Directive 2010/43/EU or Commission Delegated Regulation (EU) 231/2013 as set out in Annex III to ensure the effective and adequate integration of sustainability risk and factors?

Not at this time.

Q13: What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size,

internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.

It is difficult to generalise on this as the answer will vary from manager to manager depending on their unique situation and circumstances (i.e. size, nature, scope and complexity of manager's activities and the investment strategies they employ). We are not able to provide a detailed breakdown of BlueBay's financial resourcing as we do not disaggregate this; however, we have provided an overview below.

Information requested	Firm response
Firm size (annual turnover)	US\$60.1 billion (31 st Dec 2018)
Number of employees	Approx. 378 employees and partners in offices in the UK, US, Japan, Luxembourg, Switzerland, Germany and Australia (as of 31 st Dec 2018)
Firm complexity	We are a specialist fixed income manager, managing both private and public debt (corporates and sovereigns) in long only, total and absolute return strategies (spanning investment grade, leveraged finance, emerging market, convertibles debt, multi-asset and private debt)
Expected costs for market research related to ESG factors	<ul style="list-style-type: none"> • Difficult to isolate the full amount as other research resources may also encompass ESG factors even where it is not the primary focus for the subscriptions (also we do not track and monitor this explicitly) • As the nature of the ESG related funds have evolved, our costs associated with market research has increased • Overall, costs associated with market research of ESG factors can be financially meaningful
Expected IT costs related to ESG factors	<ul style="list-style-type: none"> • Difficult to isolate the full amount as it is included within broader IT projects where ESG factors are incorporated alongside others (also we do not track and monitor this explicitly). Costs associated with IT also tend to fluctuate to some extent over time depending on priorities • As the nature of how we seek to leverage ESG data has evolved, this has increased • Overall, costs associated with IT activities related to ESG factors can be financially meaningful
Expected training costs related to ESG factors	<ul style="list-style-type: none"> • Difficult to isolate the full amount, as we do not track and monitor this explicitly. Costs associated with training also tend to fluctuate to some extent over time depending on priorities • As the nature of how we seek to incorporate ESG into our investment processes has evolved, this amount has increased • Overall, costs associated with training can be financially meaningful
Other expected organisational costs related to ESG factors	<p>e.g.</p> <ul style="list-style-type: none"> • ESG dedicated staff (e.g. we currently have a team of four, having started with one person in 2013) • Cost of ESG related industry memberships • Cost for producing / maintaining ESG public reporting (e.g.

Information requested	Firm response
	annual ESG reports) Overall these can be financially meaningful.