Triodos' non-paper as to retail investors' access to sustainable investments

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UCITS – UCISS: Undertaking in Collective Investments in Sustainable Securities: the European framework covering simple sustainable collective investment schemes for retail investors in Europe under UCITS.

Why do we need this?

1. The Capital Markets Union aims to connect "saver Paul" with "entrepreneur Anna", but if Anna is not listed, or if Paul regards crowd-funding too risky, they cannot find each other across the Union. Some member states do allow for AIFs investing in non-listed companies to be sold to retail investors, but only within their jurisdiction. For example, funds that invest directly in renewable energy initiatives, or funds that invest directly in organic farms. There is no harmonized set of rules regulating the connection of saver Paul and entrepreneur Anna across national borders if Anna is not listed and if Paul regards crowd-funding too risky, while there is demand, especially for funds that invest in sustainable firms like renewable energy initiatives and organic agriculture.
2. More and more entrepreneurs choose a sustainable business model, which includes staying away from transferable securities and thus the short-termism of public exchanges. So especially if entrepreneur Anna is a sustainable entrepreneur and chooses to stay away from short-termism, funding by a collective of retail investors through the current UCITS[1] framework is no option for her.
3. Traditionally, the availability of UCITS for retail investors is based on the transferability and, with that, suggested liquidity of the underlying assets, in combination with the open-end status. From a retail investor protection point of view, this is a ('the') key point: retail investors should be able to exit a fund at their request and the fund should have sufficient liquidity. However, recent events have shown that the key-concept of UCITS on the underlying assets (transferability of its securities), does not per se guarantee sufficient liquidity of the fund. A revised concept for the liquidity of funds may be called for.
4. This leads to the conclusion that the focus of a CMU-inspired concept of retail investors' access to sustainable funds should be on liquidity in relation to retail investors protection. Simple investments in sustainable type assets, with sufficient liquidity, should also be fitting and thus available to retail investors across national borders.
5. The Taxonomy framework is now allowing a definition of (environmentally) 'sustainable' in a clear and concise manner, and can empower citizens to make their own informed choices as to investment funds, but these citizens don't have the choice of investing in simple, sustainable funds across the border of their own jurisdiction. A Unit for

[1] undertakings for collective investment in transferable securities (UCITS) as in article 1 (2) UCITS Directive 2009/65/EC (UCITS IV) as amended 2014/91/EC (UCITS V)

Collective Investments in Sustainable Securities – UCISS - could provide them this simple and sustainable choice, safer than crowd-funding, across the Union: combining sustainable assets with adequate liquidity and investor protection measures under UCITS.

What kind of set up for a UCITS- UCISS would be required?
A UCISS would be a special UCITS: a simple, sustainable fund offered to retail investors across the Union, allowing them to invest in non-listed, sustainable firms, to know where their money goes, and to be assured of a diversified portfolio and a certain degree of liquidity.

Today, this fund would be an AIF, subject to national rules if a member state allows it offered to retail investors following AIFMD Article 43. This fund may get an eco-label, but it could still not be marketed across the Union to retail investors. A different concept is needed: a fund meeting very strict investor protection rules.

The UCITS- UCISS concept would provide this:

- Allowing for non-complex ESG assets that are not ‘transferable’
- which meet strict liquidity and diversification rules that ensure investor protection,
- and meet (retail) investors requests for redemption in a clear & set framework for redemptions (including rules for frequency of redemption, notice periods, gates)
- under the UCITS directive.

As such it would provide a harmonized concept that could be offered to all retail investors across the Union under the normal UCITS framework.

This could be done by drafting a new Chapter VIIa & article 57a onwards in the UCITS Directive, by way of derogation of Chapter VII (for ‘ normal’ UCITS)

The Chapter must include:

1) a clear concept of and focus on the necessary liquidity,
2) risk management processes as imposed by UCITS, so with high investor protection (by reference);
3) diversification as imposed by UCITS (by reference);
4) obligation for sustainable assets as defined in the Taxonomy;
5) full ESG disclosure as meant in DSR, and
6) conditions for use of the name UCITS-UCISS

1. Liquidity:

   The belief that only listing or transferable securities provides sufficient liquidity, and as such investor protection, as in UCITS is not always justified and might need fundamental revision. Moreover, transferability on a stock exchange facilitates potentially non-sustainable short-term-ism. Liquidity for a retail fund is key from the viewpoint of investor protection. For UCITS-UCISS sufficient liquidity could be ensured by sound liquidity management and minimum of available cash or a credit facility, but also conditions to ensure redemption rights of (retail) investors in a clear framework, such as at least one redemption opportunity per month, longer notice periods and clear use of liquidity instruments such as gating.

2. Risk management processes:
   This is a key process from an investor protection point of view, and should be applied similarly as normal UCITS (as in art 51). UCISS include holistic risk management, including SDG-tracking as meant in DSR and application of the Taxonomy.
3. Diversification:
   The core of the success of UCITS must be kept and cherished: the diversification rules and concentration limits in articles 52 and onwards, as well as the strictly regulated use of derivatives for protection purposes only. This can possibly be done by referral.
4. Sustainable assets:
   A definition of eligible investments that meet enforceable sustainability criteria, must ensure the sustainability of the fund. UCITS-UCISS would apply the Taxonomy and exclusively (>80%) invest in sustainable, enabling or transition activities.
5. Full ESG disclosures:
   The highest category of disclosure in the DSR (2019/ 2088) must be applied.
6. Use of name UCITS-UCISS:
   In order to provide sufficient transparency to investors as to that the UCISS has sustainable assets, the use of the name UCISS should be restricted

What should a proposed regulatory text include?

The introduction of UCITS- UCISS could be done through amendments and complements of the UCITS Directive on (only) the assets that would be allowed in order to qualify as UCITS-UCISS. For all other aspects, a UCITS-UCISS would be a ‘normal’ UCITS:

- A management company licensed to manage UCITS would also be allowed to manage UCITS-UCISS and having to cope with the normal organizational requirements.
- Because the UCISS is a UCITS, the same high level of investor protection and guarantees would apply across Europe.
- From the (retail) investor point of view, a UCITS-UCISS would be available in the same manner as a normal UCITS, as there is similar investor protection.

New provisions could be inserted in the following manner:

- Recitals UCITS Directive

Recitals should acknowledge that simple and sustainable funds exist for which there’s high demand from retail investors. They should underline that management companies “… should hold a diversified buffer of liquid assets that they can use to cover short term liquidity needs.(…) It is appropriate to promote a diversified and high-quality liquidity buffer consisting of different asset categories. A concentration of assets and *overreliance on market* *liquidity creates systemic risk* to the financial sector and should be avoided." (quote from recital 100 CRR 575/2013, our cursive).

Recitals should acknowledge the popularity of crowdfunding, revealing a genuine interest of retail investors to be engaged in where their money goes, while there's no safe crowdfunding framework and investors should expect loosing 100% of their investment when participating in crowd-funding. Achieving positive social and environmental impact in a safer, diversified, and liquid way similar to the organization of the UCITS framework for transferable securities would meet this genuine interest as well as boost Europe's need for sustainable growth and jobs, and respect the EU's core value of social inclusion.

- Articles

UCITS-UCISS is a type of UCITS, but applies different requirements with respect to liquidity, and thus on type of assets and sustainability. The following text copies and revises and adds to the provisions in UCITS Article 2(1)(s) and the core of article 50 for UCISS purposes. New wording in bold.

(*NEW) Article 2(1)(si) 'Sustainable securities' means*
*1. '**sustainable** securities' means:*
*(i) shares in companies and other securities equivalent to shares in companies **that deliver positive social impact, and as such meet the criteria of Article 3(1)(d) of Regulation 346/2013 [EUSEFs]; or***
*(ii) shares in companies and other securities equivalent to shares in companies **that deliver positive environmental impact, and as such meet the criteria of Article 10 of Regulation 2015/760 [ELTIFs];***
*(iii) shares in companies and other securities equivalent to shares in companies **that contribute to sustainability objectives as meant in Regulation [Taxonomy].***
*(iv) bonds and **loans in companies as defined in the first three indents**;*
*(v) any other negotiable securities which carry the right to acquire any such **sustainable** securities by subscription or exchange;*

(NEW) CHAPTER VIIa

OBLIGATIONS CONCERNING THE INVESTMENT POLICIES OF UCITS – UCISS

Article 57a

1. ***As a derogation of Chapter VII, the investment policy of a UCITS-UCISS shall at all times ensure that the UCITS-UCISS:***
    a. ***has adequate liquidity, and***
    b. ***only comprises of assets allowed as further defined in this article.***
2. ***For adequate liquidity as in paragraph 1(a) of this article, a UCITS-UCISS shall:***
    a. ***hold at least [5%] of its assets in high quality liquid assets as defined in Article 416(1) of Regulation 2013/575,***
    b. ***offer at least one redemption opportunity per month,***

   c. **apply a notice period for redemption of at least one month**
   d. **clearly communicate the application of redemption gates if applicable.**

3. Following paragraph 1(b) of this article, a UCITS -UCISS shall comprise of one or more of the following assets:
   a) **sustainable** securities;
   b) units of UCITS-**UCISS** authorised according to this Directive or other collective investment undertakings within the meaning of Article 1(2)(a) and (b) of Directive 2009/65, whether or not established in a Member State, provided that:
      i. such other collective investment undertakings are authorised under laws which provide that they are subject to supervision considered by the competent authorities of the UCITS- **UCISS** home Member State to be equivalent to that laid down in Community law, and that cooperation between authorities is sufficiently ensured;
      ii. the level of protection for unit-holders in the other collective investment undertakings is equivalent to that provided for unit-holders in a UCITS-**UCISS**, and in particular that the rules on asset segregation, borrowing, lending, and uncovered sales of **sustainable** securities and money market instruments are equivalent to the requirements of this Directive;
      iii. the business of the other collective investment undertakings is reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period; and
   c) deposits with credit institutions which are repayable on demand or have the right to be withdrawn, and maturing in no more than 12 months, provided that the credit institution has its registered office in a Member State or, if the credit institution has its registered office in a third country, provided that it is subject to prudential rules considered by the competent authorities of the UCITS-**UCISS** home Member State as equivalent to those laid down in Community law;
   d) financial derivative instruments, including equivalent cash-settled instruments, dealt in on a regulated market referred to in points (a), (b) and (c) of Article 50(1) or financial derivative instruments dealt in over-the-counter (OTC) derivatives, provided that:
      (i) the underlying of the derivative consists of instruments covered by this paragraph, in which the **UCITS-UCISS** may invest **in order to protect** its investment objectives as stated in its fund rules or instruments of incorporation;
      (ii) the counterparties to OTC derivative transactions are institutions subject to prudential supervision, and belonging to the categories approved by the competent authorities of the UCITS home Member State; and
      (iii) the OTC derivatives are subject to reliable and verifiable valuation on a daily basis and can be sold, liquidated or closed by an offsetting transaction at any time at their fair value at the UCITS’ initiative;

e) *money market instruments other than those dealt on a regulated market, which fall under Article 2(1)(o), if the issue or issuer of such instruments is itself regulated for the purpose of protecting investors and savings, provided that they are:*
   i. *issued or guaranteed by a central, regional or local authority or central bank of a Member State, the European Central Bank, the Community or the European Investment Bank, a third country or, in the case of a Federal State, by one of the members making up the federation, or by a public international body to which one or more Member States belong;*
   ii. *issued by an undertaking any securities of which are dealt in on regulated markets referred to in points (a), (b) or (c);*
   iii. *issued or guaranteed by an establishment subject to prudential supervision, in accordance with criteria defined by Community law, or by an establishment which is subject to and complies with prudential rules considered by the competent authorities to be at least as stringent as those laid down by Community law; or*
   iv. *issued by other bodies belonging to the categories approved by the competent authorities of the UCITS-**UCISS** home Member State provided that investments in such instruments are subject to investor protection equivalent to that laid down in points (i), (ii) or (iii) and provided that the issuer is a company whose capital and reserves amount to at least EUR 10 000 000 and which presents and publishes its annual accounts in accordance with Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54(3)(g) of the Treaty on the annual accounts of certain types of companies (14), is an entity which, within a group of companies which includes one or several listed companies, is dedicated to the financing of the group or is an entity which is dedicated to the financing of securitisation vehicles which benefit from a banking liquidity line.*

4. For the purpose of paragraph 1 (b), a UCITS- ***UCISS*** *shall not:*
(a) invest more than 10 % of its assets in securities or money market instruments other than those referred to in paragraph 1; or
(b) acquire either precious metals or certificates representing them;
(c) invest in companies violating human rights and labour rights;
(d) invest in companies or projects engaged in irresponsible alcohol sales, gambling, pornography, tobacco, weapons, conflict minerals;
(e) invest in companies or projects engaged in animal testing, factory farming, unsustainable fisheries, and fur and specialty leather;
(f) invest in companies or projects engaged in fossil fuel, nuclear power, deforestation, genetic engineering, hazardous substances, unsustainable mining, contamination, and water-waste;
(g) invest in companies or projects engaged in corruption, evasive tax-structures, and violation of legislation.

5. A UCITS- ***UCISS*** *may acquire* ***sustainable*** *movable or immovable property that is essential for the direct pursuit of its business.*

Article 57b
Managers of qualifying UCISS-UCITS that comply with the requirements set out in this Chapter shall be entitled to use the designation ‘UCISS-UCITS in relation to the marketing of this type of funds across the Union.