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NON-FINANCIAL APPROACHES IN COLLECTIVE INVESTMENT SCHEMES

THIRD REPORT

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AUTORITÉ DES MARCHÉS FINANCIERS

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1. INTRODUCTION

Following the 2015 and 2017 reports, the AMF publishes its third report examining non-financial approaches in collective investment schemes. The report is being published at a time of increasingly numerous initiatives, on both the private and public levels: on the one hand, the roll-out of non-financial investment management schemes and ranges of funds incorporating environmental, social and governance criteria has gathered momentum, with announcements along these lines made by several asset management companies (**AMCs**); and, on the other hand, regulatory requirements on the subject are being specified on the European level.

This report supplements Position-Recommendation 2020-03, the first version of which was published on 11 March 2020, on *information to be provided by collective investment schemes incorporating non-financial approaches*, in particular with particular approaches adopted by fund managers. Following a description of the key market figures and various strategies developed by asset managers, the report outlines **particular approaches**, relating to certain asset classes (private equity, real estate, money market funds) or strategies (synthetic replication funds), for which a number of specific points for attention are also identified. Moreover, in line with the AMF's mission to supervise the quality of information relating to management of the effects of climate change,[1] it has endeavoured to assess the framework of AMCs' use of information relating to **greenhouse gas emissions**, and on this basis it specifies its requirements regarding the monitoring of data and information by fund managers. Finally, at a time when French and European market participants are going to have to prepare for the future implementation of European Regulation 2019/2088 (the Disclosure Regulation), a review is presented of the French market's compliance with the publication obligations concerning the consideration of environmental, social and governance criteria (**the "Article 173" framework**[2]), in order to note the progress made and the areas for improvement. This review is an extension of the observations made in a joint report by the authorities published in the summer of 2019.[3] It aims to ensure effective continuity with the future system, the details of which are not yet fully known.

For each theme studied, the AMF has endeavoured to identify practices and the related risks. It proposes several **changes to Position-Recommendation 2020-03** and identifies a number of good and poor practices, so as to better assist market participants looking to develop non-financial approaches and promote them to their clients. Regarding this, and in order to ensure equality of treatment between funds marketed in France, when foreign investment funds marketed in France do not comply with some of the positions appearing in this document, they shall provide a warning notice in their marketing materials.

The AMF's approach has been guided by the following principles:

- The development of responsible investment or thematic products, taking environmental, social and governance (ESG) aspects into consideration in their risk management or in their investment strategy, is underpinned by European regulatory initiatives and by increasing demand from investors, especially institutional investors;
- The AMF wants to **encourage and support** this trend, which contributes to mobilising the financial sector in favour of sustainable development, while taking care to **ensure the conditions for trust** and the emergence of best practices;
- The rapid changes in the industry are taking place in a context that is still not well defined, without real minimum standards and in which numerous strategies, with more or less significant ambitions, coexist; this variety of approaches may correspond to diverse expectations and needs on the part of investors but

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1 Cf. Article L. 621-1 of the Monetary and Financial Code: "[the AMF] *ensures the quality of information provided by asset management companies on their investment strategy and the way they manage risks related to the effects of climate change*" introduced by Act No. 2019-486 of 22 May 2019 on business growth and transformation (PACTE Law, Article 77 I 29°).
2 Framework introduced by article 173-VI of the law n° 2015-992 du 17 août 2015.
3 Cf . application review published in July 2019.

it could create confusion; to prevent **risks of *green/ESG washing***, a key issue is the information provided to the investor to evaluate the proposed approach, i.e. whether it is accurate, clear and not misleading;

- It is important to only allow collective investment schemes ("CIUs") offering guarantees that their non-financial approach is systematic and significant to centre their communication on the consideration of non-financial criteria in their investment policy as specified in Position-Recommendation 2020-03, and to provide **information for investors which is proportional** to the measures adopted;

- While the necessary data and methodologies to take ESG factors into consideration are still being established and are the subject of numerous reviews on the French and European levels, the AMF notes with interest the initiatives of market participants to develop innovative strategies, on climate issues in particular; however, it recalls the **necessary precautions regarding the use of data** (carbon data in particular) at the fund manager level and within the framework of the information provided for clients;

- Lastly, the work carried out by the AMF, notably within the framework of monitoring of the implementation of Article 173, is also designed to enrich the **research in progress on the European level**, whether it regardes corporate non-financial information (a subject addressed in the AMF's 2019 report on social, societal and environmental responsibility of listed companies) or new regulations concerning the investment management industry (the Disclosure Regulation in particular). Progress in discussions on the European level will also lead the AMF to reconsider the subject in the coming months and years.

To produce this report, the AMF processed a questionnaire sent to about fifty AMCs, supplemented by about ten interviews. Meetings were also held with a number of key actors: non-financial rating agencies, service providers specialised in the calculation of greenhouse gas emissions data, and listed companies. The availability of the contributors and the quality of the discussions contributed to the quality of this report.

Disclaimer: Positions and recommendations presented in this report will eventually be incorporated in Position-Recommendation 2020-03. They are quoted here for pedagogical purpose. Furthermore, « good » and « poor » practices are identified throughout this report. They highlight approaches identified during the investigations that may facilitate, or complicate, compliance with regulations.

Furthermore, as the majority of the investigations in this report were carried out during the first half of 2019, changes in practices and the progress of discussions at European level may lead the Authority to reconsider certain subjects in the months and years to come, by developing or supplementing some aspects of the report.

2. REVIEW OF THE CURRENT MARKET SITUATION

This section first summarises the origins and nature of the non-financial approaches of collective investment undertakings, and the AMF's role. It then describes the general "non-financial" market trends seen in France: assets under management, main strategies used, existing labels and means employed by AMCs to establish their framework.

2.1. PRINCIPLES OF NON-FINANCIAL APPROACHES

A growing number of investors pose questions concerning, not just the risks and expected returns of a financial investment, but also the consistency of those investments with their personal convictions, and the impact of those investments on aspects not directly related to the financial sphere: environment, working conditions, reputation, etc. Conversely, the faster materialisation of some of these risks over time has led market participants to take into consideration the impact that these non-financial aspects could have on the financial performance of their investment (destruction of means of production by a natural disaster, a business model that has become inappropriate in a low-carbon economy, impact of reputational risk on profitability, but also the link between ESG performance and financial performance, etc.).

The emergence of these approaches has led asset management companies, like all producers of financial investments, to propose offers adapted to these ideas (on one hand the financial impact of non-financial aspects, on the other hand the non-financial consequences of the assets held), without them necessarily being very clearly differentiated from one another. [4]

Accordingly, the "non-financial" concept is inherently plural: on the one hand, the consistency of the financial approach with an investor's convictions is a highly individual approach, while on the other hand the impacts of the financial sphere on aspects which are in principle in the general interest are complex; the perception of them may therefore vary from one actor to another. Thus, with regard to environmental aspects, the hierarchy of risks and the measurement of their impact are a subject of debate between experts, while the consideration of social aspects may depend on the cultural context in question, both that of the issuer (if it is the impact of social criteria on financial performance that is taken into consideration) and that of the investor (if it is the non-financial requirements of the investor that are taken into consideration).

This results in a multitude of solutions, which the urgency of certain issues (climate) and the growth in assets under management nevertheless give grounds for rationalising. For example, the concept of "Socially Responsible Investment" (**SRI**) has emerged on the French market and is structured on the one hand by a commitment of the Paris marketplace to produce Transparency Codes for funds claiming this approach, and on the other hand by a government "SRI" label. However, this process is still **far from complete.** Not only do the approaches differ, but the understanding of the terms and concepts used is not yet completely uniform (for example, the term "SRI" used by the government label is not reserved solely for SRI-labelled funds, and has various definitions, as seen in section 2.2.1). In this regard, the European regulatory efforts, and in particular the Disclosure Regulation (described in detail by the AMF publication of 25 July 2019) which defines certain expressions such as "sustainable investments", "sustainability risk" and "sustainability factors", should nevertheless permit progress, notably by increasing the information to be provided to explain the policies adopted.

As part of its missions, the AMF must be attentive to the quality of non-financial information for products which emphasise this type of characteristics. And yet, the AMF is agnostic regarding the non-financial approaches proposed by market participants. However, in order to guarantee the quality, clarity and comparability of offers, the AMF must monitor market developments and adapt its policy to the strategies proposed. It can thereby help to organise the universe of these funds and put them in order by providing guidelines. Lastly, it endeavours to

[4] Cf. the 2015 report for a summary of the development of responsible finance.

support the development of innovative solutions and promote the sharing of best practices. The AMF's overall approach is presented in its roadmap on sustainable finance, published in November 2018.

2.2. KEY FIGURES

2.2.1. ASSETS UNDER MANAGEMENT OF THE "NON-FINANCIAL" FUNDS MARKET

This section provides a brief quantitative overview of the universe of CIUs having non-financial characteristics. As outlined in section 2.1, the approaches adopted by the funds are very diverse, and it is not possible at present to provide an exhaustive identification or a standardised classification of all these approaches. As a consequence, the AMF has chosen to adopt as a basis the data produced on the one hand by the AFG,[5] which since 2018 has conducted an annual exercise of identification of "responsible investments", and data from Novethic,[6] which in the past several years has published a sustainable fund indicator. The figures, as at 31 December 2019, produced by these two sources based on different definitions and processes, are presented below.

	AFG (sample of 61 AMCs)	Novethic
Terms and definitions adopted by AFG and Novethic	**SRI investment**: "An investment which aims to reconcile economic performance with social and environmental impact by financing companies and public entities that contribute to sustainable development regardless of their sector of activity"	**Sustainable funds**: "Funds claiming to represent sustainable finance on the French market (SRI, Sustainable, Responsible, SDG, impact funds)"
AUM of open-ended SRI CIUs / sustainable CIUs	**€210 billion**	**€278 billion**
Number of SRI CIUs / sustainable CIUs	Not disclosed[7]	**704**
AUM of ESG CIUs	**€422[8] billion**	Not disclosed

Source: AMF consolidation based on figures published by the AFG and Novethic.

The observed divergences between the concepts, definitions and scopes of the two sources illustrate the diversity of the approaches adopted by AMCs and the difficulty of producing an exhaustive and precise description of this universe. For example, the AFG has made a distinction between "SRI" funds on the one hand, which take environmental, social and governance criteria into consideration simultaneously and are bound by disciplinary rules of information (Transparency Code, label), and "other ESG funds" on the other hand, which covers funds that, according to the AFG, include a non-financial aspect without complying with the SRI framework. Novethic, for its part, has published figures relating to so-called "sustainable" funds, the definition of which includes both "SRI" funds and "ESG" funds according to the AFG classification. The amounts of SRI and sustainable funds referred to

5 See AFG - Responsible Investment fund management - Survey data at end-2019

6 See Novethic - Sustainable Finance indicator (2019).

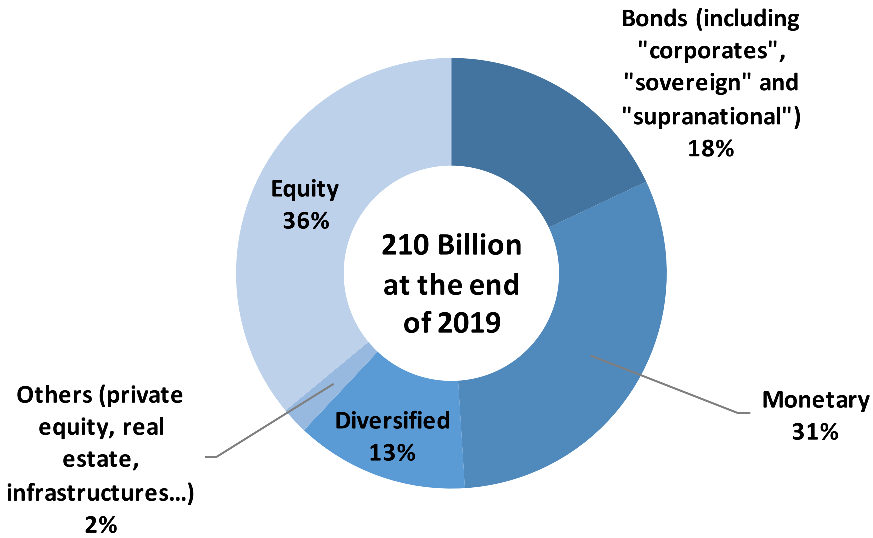
7 In practice, funds presenting themselves as SRI funds and managed by AMCs that are members of the AFG must produce a Transparency Code. In 2019 the AFG listed on its website some 300 funds publishing this Transparency Code (in June 2020, the AFG suspended the publication of this list on its website and indicated that it will be "available soon"). However, the scope is not necessarily the same as that of the AUM presented, because the results concerning AUM are based on the information collected from a limited number of AMCs.

8 Funds having other ESG approaches ("other ESG") include, in particular, thematic funds not presenting themselves as SRI, funds which include ESG criteria in a non-binding manner (ESG integration funds, see below), funds which apply approaches of normative exclusion or exclusion of certain limited sectors (coal, tobacco, etc.), solidarity funds and impact investing funds.

by the two sources are nevertheless of the same order of magnitude, standing at €210bn for AFG and €278bn for Novethic respectively. Note that the AFG also discloses figures for ESG CIUs, amounting to €422bn.
The following section describes the various strategies implemented by the funds termed "SRI" by the AFG based on the AFG publication, which describes the major market trends.

2.2.2. AUM BY ASSET CLASS AND CLIENTELE

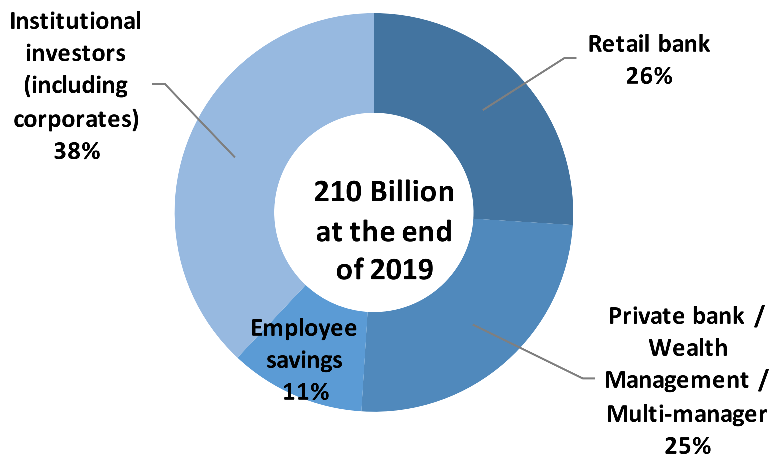
Regarding the asset class, it is **listed equities and money market funds** that account for the largest assets under management in SRI investments (about one-third each). Money market funds are covered by a dedicated study in section 3.3. Then come bond funds (18%) and diversified funds (13%). Funds excluding transferable securities represent a very small part of the AUM (private equity, real estate, etc.).



Source: AFG

Moreover, another feature highlighted by the AFG in its study is the type of clientele that invests in SRI funds. The first kind of investors for SRI funds are institutional clients, representing about €80bn in assets under management (38% of SRI AUM versus 57% in 2018). This can be explained mainly by the fact that these are the main actors investing in money market funds. This appetite of institutional investors for SRI is confirmed by the size of so-called "SRI" portfolios,[9] which represent €336bn in assets under management. Due to the obligation for company savings plans to offer at least one fund having a non-financial label (SRI, Greenfin or Finansol, cf. section 2.4), the proportion of employee savings is also significant (11%). The PACTE Law,[10] which since 1 January 2020 requires that a fund having an SRI, Greenfin or Finansol label be proposed as an investment vehicle for unit-linked policies, constitutes a potential source of additional growth for this market.

[9] The very great majority of portfolio assets are held on account of institutional clients.
[10] Cf. in particular Article 72 of the PACTE Law establishing Article L. 131-1-2 of the French Insurance Code.



Source: AFG

2.3. MAIN STRATEGIES OBSERVED

As mentioned in section 2.1, fund strategies emphasising a non-financial aspect are by definition extremely numerous, so any presentation will inevitably be non-exhaustive. Here the AMF has endeavoured to describe the main strategies observed, based on the work performed by the AFG. Certain particular strategies (real estate, private equity, money market) are described in greater detail. Strategies including a promise relating to greenhouse gas emissions ("low carbon" funds, carbon offset funds, etc.) are described more specifically in section 4.

The non-financial strategies implemented break down into two major families: on the one hand "relative" approaches (*best in class*, *best in universe*, etc.), and on the other hand "absolute" approaches, or impact strategies. Normative exclusion strategies and so-called "integration" strategies, which are tending to become systematic features of the products of major asset management companies, are described later.

2.3.1. IMPACT STRATEGIES OR STRATEGIES WITH A TANGIBLE OBJECTIVE

Impact approaches, or those with a tangible objective, aim to select investments based on the achievement of a tangible objective highlighted by the fund. For example, an investor sensitive to the issue of global warming might want to invest in a fund which invests only in companies compatible with or contributing to ecological and energy transition, or in a fund which undertakes to invest only in projects contributing to the production of renewable energies. The investor in such a fund thus receives the promise that, in the former case, the companies selected by the fund contribute to the ecological transition or are compatible with it, and in the latter case that the money invested will fund renewable energy development projects.
This approach, which promotes **a tangible objective** for the investor, nevertheless entails **problems of implementation**:

- The definition of the criteria entailed by the promise may be complicated: identifying an activity contributing to funding of the ecological transition or compatible with a low-carbon economy is a difficult task;
- A demonstration of fulfilment of the promise made to the investor may be difficult due to its nature: for example, alignment with a climate scenario would inevitably be related to assumptions concerning the company's future behaviour, which involves some unknowns, especially when the objectives are distant (objective of reductions by 2050 or even 2100);
- The number of companies meeting the criteria resulting from the promise made may still be too small to be able to produce a product considered financially appropriate for an investor prepared to take a

moderate risk: an investment in companies contributing actively to the energy transition may, for example, lead to the design of a financial product that is heavily exposed to a single sector (typically renewable energies) and is therefore highly dependent on that sector's financial health.

Impact strategies or strategies with a tangible objective, as is the case of certain private equity actors in particular, are therefore in practice **not very widespread** and are mostly reserved for institutional investors, who have sufficient financial clout to invest in this type of project without jeopardising the liquidity and overall diversification of their asset portfolio.

2.3.2. BEST-IN-CLASS AND BEST-IN-UNIVERSE STRATEGIES

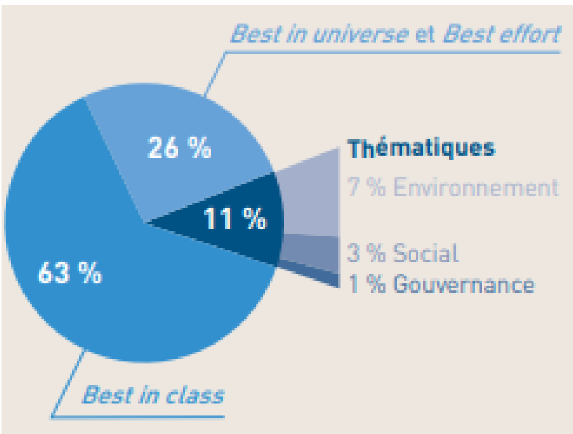
"Relative approaches", in contrast, aim to define one or more metrics for comparison between issuers, representing non-financial criteria, and, within the fund's investment universe, to only overweight or hold the best issuers (or to underweight or exclude the worst ones), without taking into account precise absolute objectives. This approach makes it easier to propose financial products:

- The AMC can select criteria which can be measured and monitored easily over time (for example, issuers' carbon footprint relating to their direct emissions and emissions resulting from the use of their energy – scopes 1 and 2, the rate of absenteeism in a company, the existence of anti-corruption policies or not, etc.);
- The product obtained can be easily diversified financially by means of rules for application of this selection at the level of each sector of activity (*best in class*) rather than at the level of the entire investment universe (*best in universe*).

Variants of these approaches may be developed. In particular, the "best effort" approach aims to select, not the issuers having the best scores, but those that have achieved the best improvement in their score over a given period.

The AMCs practising these "relative" approaches may sometimes emphasise a potential "cascade effect", encouraging non-selected issuers to improve their non-financial performance based on the selected criteria. For example, an issuer could be incentivised to reduce its carbon footprint if it observes that its financing is made more difficult by the fact that it is not selected by funds having a "climate" theme.

In its 2019 statistics the AFG produced a breakdown of the AUM of SRI funds based on their methodological approach. For example, the best-in-class approach accounts for a very great majority of assets under management (63%). As mentioned earlier, this approach has the advantage of keeping a sector diversity which makes it possible to obtain returns correlated to those of "conventional" financial investments that do not have a non-financial approach. Variants of the best-in-class approach, the best-in-universe and best-effort funds represent 26% of assets under management, according to the AFG figures. Lastly, thematic SRI funds represent 11% of assets under management. These are funds which take environmental, social and governance criteria into consideration simultaneously, but which are more especially oriented towards investment in a particular sector (e.g. activities related to water).



Source: AFG

2.3.3. EXCLUSION STRATEGIES

In addition to the approaches described above, many AMCs apply exclusion strategies, either alone or as a preliminary to the implementation of strategies described above. They consist of excluding issuers from the investment universe for various reasons:

- "Normative" exclusion, such as the AMC's compliance with international conventions, e.g. on the production of controversial arms (exclusions that are in principle mandatory and applicable to all AMCs), or issuers identified by a public or parapublic reference document as not complying with fundamental principles: respect for human rights, tax cooperation, etc.;
- Exclusion of sectors regarded as undermining health or morality: tobacco, pornography, etc.;
- Or else exclusion of sectors regarded as harming the environment: companies having significant operations in the coal sector, etc.

In general, the actual rate of exclusion is **relatively insignificant**, either because these exclusions are legally applicable universally even though not all market participants consider it necessary to communicate on this issue (Oslo and Ottawa conventions), or because some exclusions in practice concern a very restricted universe by comparison with the investment universe of CIUs (e.g. exclusions concerning tobacco). These factors must therefore be presented appropriately in the information provided to the potential investor.

2.3.4. ESG "INTEGRATION"

As specified in section 2.1, a growing number of investors consider that the integration of environmental, social and governance criteria contributes to the appropriateness of investment decisions. At the same time, asset management companies are increasingly sensitive to the potential impact on their investors of holding controversial assets in their funds (e.g. securities issued by a company exposed to a scandal). As a consequence, several asset management companies, especially the biggest ones, have established or are in the process of establishing a system for "integration" of ESG aspects which involves compiling ESG information on issuers (ratings, scores, analyses, controversy watches, etc.) and making it available to the fund managers alongside financial information. The fund manager is then **free to incorporate this information in his investment decision or not**. This approach is **non-binding and non-significant**. It therefore does not really constitute a non-financial approach as such, but rather a consolidation of the financial approach by additional factors of analysis. In this respect, it should be covered by an appropriate description in the information provided, to avoid any ambiguity with regard to the fundholder**Erreur ! Source du renvoi introuvable.**.

2.4. OVERVIEW OF THE LABELS

2.4.1. CONTEXT

On [26 September 2019](), the AMF published the results of a survey carried out on a sample of more than a thousand people representative of the French population,[11] which showed potential investors' interest for the responsible investment theme in financial products. For example, whereas 87% of those surveyed said they assigned importance to sustainable development issues, only 5% of the respondents stated that they knew precisely the various collective investment products that have responsible investment characteristics. This disconnect between knowledge of the product offering having responsible investment characteristics and the supposed interest of the population for this theme can partly be explained by the recent development of products intended more specifically for retail clients. Previously, the market for fund management with responsible investment characteristics was developed in response to the demand from institutional investors. SRI and its historically mostly *best-in-class* approach is now accompanied by other approaches more in line with the demand from a less

[11] Survey performed from 7 to 20 June 2019 on a nation-wide sample of 1078 persons representative of the French population, including 50 persons declaring that they owned responsible investments.

sophisticated clientele. Moreover, in order to make up for this shortfall in recognition and attract a growing number of investors, more and more asset management companies are also turning to the various labels existing on the market, which attest compliance with a list of criteria presented in each of the relevant reference documents. Moreover, the importance of these labels will increase with the application of Article L. 131-1-2 of the French Insurance Code as introduced by the PACTE Law, because since 1 January 2020 unit-linked insurance policies must propose units of account including at least one CIU labelled for or investing in solidarity companies.[12] This obligation will be stepped up from 1 January 2022. This section therefore presents an overview of the various French and foreign labels used by asset management companies.

2.4.2. THE VARIOUS ACTORS INITIATING THE CREATION OF LABELS

Sustainable finance in collective investment management is still even now marked by the variety of its approaches and strategies. The establishment of labels is designed to regulate this diversity, offering a guarantee of quality demanded by investors. However, these labels themselves remain very heterogeneous in their governance, their positioning and their requirements.

2.4.2.1. Government labels

France is the only country to have developed **two** marketplace labels initiated by the authorities. The Greenfin label (formerly called TEEC label) and the "Socially Responsible Investment" label (SRI label) were created by the Ministry for the Ecological and Solidarity Transition and the Ministry for the Economy and Finance. Both provide guarantees for the investor regarding the effective implementation of a strategy complying with guidelines defined by the label's governance and audited by a certifying organisation.

2.4.2.2. Labels of non-profit organisations or initiated by trade union organisations

Until the recent creation of the two government labels, two other French labels initiated by the non-profit organisation Finansol and the Comité Intersyndical de l'Epargne Salariale (CIES) became established in the market as models in each of their fields. These two labels were created in 1997 and 2002 respectively, and even today are still benchmarks for guiding investors towards collective investment products with solidarity characteristics.

The Finansol label attests the solidarity nature of various savings products, including Collective Investment Undertakings. It thus serves as a showcase for the Finansol non-profit organisation whose primary mission is to develop solidarity in savings and finance. This label is awarded by a committee of experts and is based chiefly on transparency criteria making it possible to assure investors that part of their investment will contribute to the financing of solidarity activities or projects. In practice, CIUs having a Finansol label include so-called "fonds 90/10" solidarity funds and shared return funds:

- Solidarity funds are characterised by holding between 5% and 10% of their net assets in solidarity assets (hence the name "90/10", expressing the breakdown between "conventional" assets and "solidarity"

[12] "*The policy containing guarantees expressed in units of account mentioned in the second paragraph of Article L. 131-1 shall refer to at least one unit of account consisting of transferable securities, collective investment undertakings or assets appearing on the list mentioned in the same Article L. 131-1 and which meet at least one of the following conditions: 1° They consist, for a proportion ranging between 5% and 10%, of securities issued by social-utility companies (ESUS) accredited pursuant to Article L. 3332-17-1 of the French Labour Code or by venture capital companies mentioned in I of Article 1 of Act No. 85-695 of 11 July 1985 containing various provisions of an economic and financial nature, or by venture capital funds referred to in Article L. 214-28 of the Monetary and Financial Code, provided that the assets of these funds consist for at least 40% of securities issued by solidarity companies mentioned in Article L. 3332-17-1 of the French Labour Code; 2° They have obtained a label recognised by the state and meeting energy and ecological transition financing criteria in accordance with conditions defined by decree; 3° They have obtained a label recognised by the state and meeting socially responsible investment criteria in accordance with conditions defined by decree. This article applies to policies signed and subscriptions performed from 1 January 2020. Policies signed and subscriptions performed after 1 January 2022 shall refer to units of account complying with the conditions mentioned in 1° to 3° of this article. As of 1 January 2022, the proportion of units of account in the policy meeting the conditions mentioned under said points 1° to 3° shall be disclosed to subscribers before signature of or subscription to these policies. This article does not apply to policies whose execution is related to retirement.*"

assets). These solidarity securities are issued by unlisted companies involved in projects of great social and/or environmental utility.
- Shared return funds are characterised by the payment of part of the CIU's returns in the form of a donation to one or more entities in accordance with conditions defined by its regulatory documents. They are the subject of a specific AMF instruction[13].

At the end of 2019, 159 savings products had a Finansol label.

The CIES label certifies that the ranges of funds proposed by asset management companies in the various employee savings schemes take environmental, social and governance criteria into consideration. The main objective of this label, created on the initiative of four trade union organisations (CFDT, CGT, CFTC, CFE-CGC), is to "*guide employees' funds in a direction consistent with their interests* [...] *and influence companies' behaviour by using a leverage effect due to the amounts collected*". This label is awarded at the request of asset management companies which, in order to obtain it, must comply with specifications detailing in particular the number of funds having responsible investment characteristics to be included in their product range intended for savings schemes, or else the resources devoted by the asset management company to the consideration of non-financial criteria. So far, about fifteen product ranges have received the CIES label.

Most of the other European labels used by asset management companies for marketing their CIUs were created on the initiative of non-governmental organisations or other types of non-profit organisations, sometimes backed by governments. For example, of the European labels described in the remainder of this report, the LuxFLAG label (for Luxembourg Finance Labelling Agency) was created in 2006 by seven private and public founding partners including the government of Luxembourg, the Association of the Luxembourg Fund Industry (ALFI), the European Investment Bank (EIB) and the Luxembourg Stock Exchange (LSE). Another example is the FNG label of the German Forum for Responsible Investment, intended for the main German-speaking countries (Germany, Switzerland, Austria and Liechtenstein). The German Forum for Responsible Investment brings together 175 members who work to promote sustainable development in the financial sector. Finally, the Belgian label *Towards sustainability* was launched in 2019 on the initiative of the Belgian financial sector federation, Febelfin. It underwent rapid expansion during its first round of labelling at the end of 2019.

The following illustration provides an overview of the labels used by asset management companies according to their country of origin.

[13] AMF Position DOC-2012-15 on the criteria applicable to shared return funds, in accordance with Articles 319-16 and 321-120 of the AMF General Regulation

2.4.3. FOCUS ON THE FRENCH SRI LABEL

Decree 2016-10 of 8 January 2016 supplemented by the order of the Minister for the Economy and Finance of 14 December 2018 describes the rules governing the functioning of the SRI label.

It was amended by the decree of 8 July 2020, published in the Official Journal of 23 July. This new standard, which came into force on 23 October 2020, includes collective real estate investments and management mandates within the scope of eligible products. It also reinforces the information requirements for investors.

- Objective

This label, created in 2016, aims to guide the savings of retail investors towards the collective investment products of asset management companies which take environmental, social and governance criteria into consideration It is therefore more specifically aimed at Undertakings for Collective Investment in Transferable Securities (UCITS), General Purpose Investment Funds (FIVG funds), Employee Savings Funds (FESs), Alternative Investment Funds (AIF) in real estate (SCPI and OPCI/OPPCI) and management mandates. All have the possibility of being individually labelled SRI by a certifying organization.[14]

Each fund can be labelled if it complies with a list of criteria set out in the SRI label reference framework annexed to the decree of 8 July 2020.

[14] At present, EY and AFNOR are certifiers of the SRI label.

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- Eligibility criteria

Eligibility for the SRI label involves, in particular, taking non-financial criteria into consideration in a binding and significant manner. Hence, a fund is eligible for the label if at least 90% of its portfolio is analysed based on ESG criteria[15] and if it is capable of reducing its investment universe by at least 20% after taking these criteria into consideration or of complying with a criterion of significant improvement in the average non-financial score of its portfolio. This must be significantly higher than the average score of the initial universe (i.e. better after eliminating 20% of the worst securities from a non-financial viewpoint).

In addition to these criteria, which constitute the main difference between funds having an SRI label and other funds, the SRI label also requires a presentation of ESG objectives in the CIU's documentation, or else membership of a label promotion organisation which aims to enhance its recognition through communication campaigns. The method developed by the label aims therefore to distinguish between funds according to their capacity for differentiation from other CIUs with regard to the selection or weighting of securities in the portfolio on the basis of non-financial criteria. It is agnostic regarding the non-financial criteria to be taken into consideration and imposes no method concerning stock picking. It limits or regulates the selection of certain asset classes or financial instruments. As an example, at present, the use of derivatives is limited to techniques allowing efficient portfolio management and the selection of debt securities issued by central and local governments, apart from "green" bonds, is capped at 70% of the CIU's assets.[16]

- Governance

Governance of the SRI label is performed by a label committee formed of leading figures from the world of finance and responsible investment appointed "intuitu personae" (in consideration of the person) which is tasked with proposing the major guidelines for the SRI label.[17] The label committee sends to the Ministry for the Economy and Finance proposals for action which will then be implemented by the Treasury Department. This label committee, established for a period of three years, is supplemented by a scientific committee formed mainly of academics, and by a promotion committee consisting of the Treasury Department, the Association Française de la Gestion Financière (French Asset Management Association AFG) and the Forum for Responsible Investment (FIR).

- Award process and conditions of inspection

The SRI label is awarded for a period of three years by a certifier, itself accredited for a period of three years by the French accreditation committee COFRAC, Comité français d'accréditation, a parapublic organisation which checks the quality of the organisations responsible for awarding labels. To be able to ensure the consistency and appropriateness of the label, the certifier makes sure to comply with an inspection plan appended to the label order. Supplementing the initial audit carried out during the examination of a fund's application for labelling, interim audits are performed every year, supplemented by a renewal audit in greater depth at the end of the first three years of labelling.
In addition, measures ensuring the consistency of the certifiers' interpretation of the reference document are provided for by the inspection plan. It stipulates that each certifier shall produce overall activity reports to be fed back to the Ministry listing problems of interpretation, problem cases which could lead to withdrawal of the label and any changes to be made to the functioning of the label.

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[15] According to the reference document for the SRI label, this percentage may be understood "*in terms of either the number of issuers or the market capitalisation*" (criterion 3.1).
[16] Criterion III – i): "*Debt securities issued by states, local authorities or government or international public agencies, apart from "green" bonds, are outside the scope of the SRI assets eligible for the label. The portfolio must consist of at least 30% of assets other than the debt securities mentioned above when the latter are the subject of an ESG assessment, and at least 50% otherwise.* "
[17] Members of non-financial rating agencies, issuers, asset management companies, academics, institutional investors and employee trade unions.

The SRI label in figures

At 31 January 2020, 362 funds were labelled, representing €140bn in assets under management.

Of the 65 asset management companies having at least one SRI label for their funds, 48 are French and 17 of foreign origin.

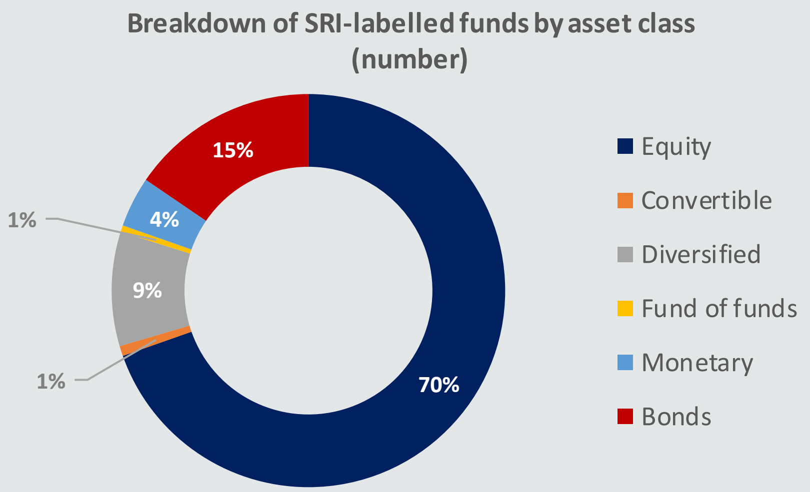
55% of the labelled funds are domiciled in France, 32% in Luxembourg and 3% in Ireland.

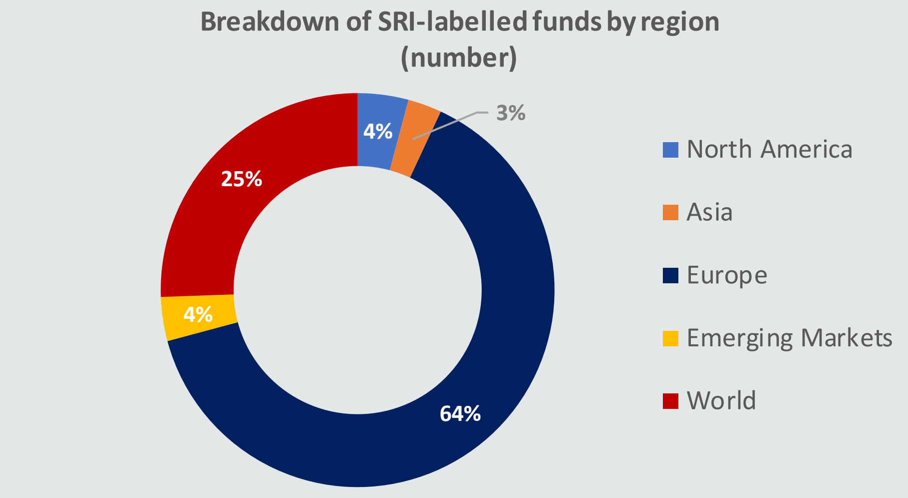
Funds having an SRI label are mostly equity funds (70%), while bond funds and money market funds appear less numerous, with 15% and 4% respectively of funds having an SRI label at 31 January 2020.

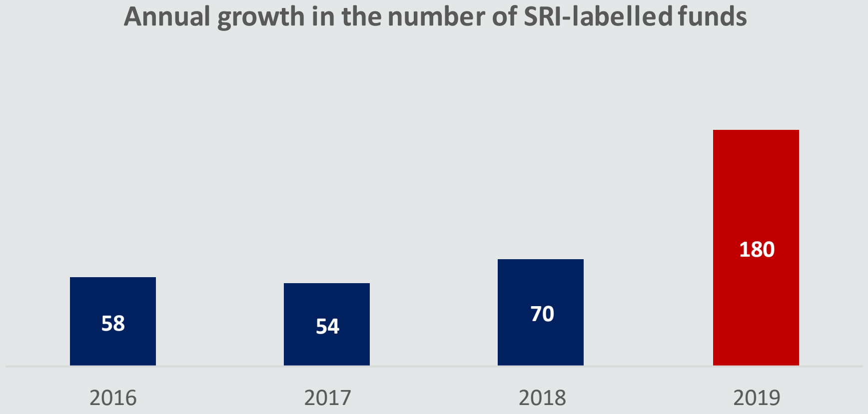
Moreover, most SRI assets are invested in Europe (64%), whereas few funds having an SRI label seem to invest in various other regions (emerging markets, Asia, North America, etc.). One-quarter of labelled funds are invested throughout the world.

Finally, as regards the annual labelling rate, the trend reveals a very sharp increase in the number of funds labelled SRI in 2019. 70 funds were labelled in 2018, versus 58 in the year of the label's launch (2016) and 180 in 2019. This growing "flow" of funds labelled SRI has the consequence of significantly increasing the "stock" of labelled funds from year to year. For example, at the start of 2020, 362 funds had an SRI label for €140bn in assets under management, versus 228 funds representing €58bn in assets under management at 30 June 2019, i.e. more than 50% growth in the number of funds having an SRI label in the last six months of 2019.

The entry into force of Article L. 131-1-2 of the French Insurance Code on 1 January 2020 is likely to further accelerate this growth.







Source: AMF based on SRI Label figures

2.4.4. FOCUS ON THE GREENFIN LABEL

Decree 2015-1615 of 10 December 2015 supplemented by the order of the Minister for the Environment, Energy and the Sea (since replaced by the Ministry for the Ecological and Solidarity Transition) of 10 March 2016 describes the rules governing the functioning of the Greenfin label (formerly called label of the "Energy and Ecological Transition for the Climate", the former TEEC label became the Greenfin label in June 2019).

- Objective

The Greenfin label, established in 2015 on the occasion of the COP 21 on climate, aims to provide guarantees to investors concerning consideration of the environmental criterion by collective investment products. It is thus distinguished from the SRI label by having the objective of guiding and deploying available savings for the benefit of companies engaged in the energy and ecological transition. It is intended for all UCITS and AIFs belonging to the categories of listed funds, unlisted funds (private equity and infrastructure AIFs in particular), bond funds and corporate debt funds, and since March 2018 SCPI and OPCI real estate funds. All these funds can be individually labelled Greenfin by a certifying organisation[18] which is tasked with performing an audit of the candidate funds in order to check whether they meet the label criteria.

- Eligibility criteria

The reference document for the Greenfin label lists all the criteria allowing CIUs to consider labelling.
It is based on the compliance of the candidate fund(s) with four categories of criteria defined directly by an official decision. Hence, to be labelled Greenfin, a CIU must have an investment policy incorporating:

1. a "green share" invested in green activities listed by the label's reference document;
2. exclusions;
3. ESG controversy management;
4. a metric of its environmental impact.

To ensure compliance with these criteria, the certifying organisation performs a review of the characteristics of the candidate funds by comparison with the label specifications.

The "green fraction" is determined on the basis of a list of activities eligible for labelled financing. The label reference document lists eight categories of "eco-activities"[19] coming within the scope of the energy and ecological transition and efforts to prevent climate change, and specifies, for each of the funds coming within the labelling scope, the percentage of net assets that must be invested in this "green fraction".

The exclusions to be observed on a long-term basis mainly concern certain economic activities contrary to the energy and ecological transition, or currently controversial. The special feature of the Greenfin label is therefore that it excludes companies operating in the nuclear sector and in fossil-fuel energies, and companies which are the subject of environmental or social controversies. The label reference document also excludes from its scope funds invested in companies which generate part of their revenues from certain controversial activities (storage and landfill centres, incineration, non-sustainable forestry production, etc.).

The funds that are candidates for labelling must also ensure an active watch on **controversies** on environmental, social and governance matters, and demonstrate their **impact** during portfolio building and throughout the portfolio's life cycle. They shall describe their process of ESG controversy monitoring and management, and the corresponding resources deployed.

Impact metric - The candidate fund must have established a mechanism for measuring the effective contribution of its investments to the energy and ecological transition. It shall provide information on the organisation set up for this purpose, in particular the human resources, the impact assessment method and the impact indicators adopted.
Where applicable, it shall provide insurance certificates or certificates of verification, by an outside third-party organisation, of the indicators produced, and a comparison of the adopted indicators with any benchmarks, where applicable.
Reporting - The fund shall measure the effective contribution of its investments to the energy and ecological transition, in at least one of the following four fields:

- Climate change
- Water
- Natural resources
- Biodiversity

[18] At present, EY France, Novethic and Afnor Certifications are the certifying organisations for the Greenfin label.
[19] Energy, Building, Waste Management and Pollution Control, Industry, Clean Transport, Information and Communication Technologies, Agriculture and Forestry, and Adaptation to Climate Change

For funds in course of creation, the fund shall indicate the environmental impact indicators that it plans to employ and monitor in at least one of these four fields.

- Governance

The Greenfin Label committee defines the main guidelines regarding coordination of the entire system and proposes to the authorities changes in the label specifications. Its members are appointed "intuitu personae" (in consideration of the person)[20] by order of the Minister for the Ecological and Solidarity Transition. The committee ensures the orderly functioning and upgrading of the labelling process. The present committee was set up by the ministerial order dated 4 October 2018. The Ministry for the Ecological and Solidarity Transition chairs the label committee whose internal rules were laid down by the order of 5 October 2017.

- Label award process and conditions of inspection

The Greenfin label is awarded by organisations chosen by the Ministry for the Ecological and Solidarity Transition via an invitation to tender or accredited by the COFRAC. They perform a fund labelling audit on the basis of the label specifications by analysing the regulatory and commercial documentation and the management reports of the candidate funds. They also hold discussions with the asset management company in order to clarify points of dispute if necessary, thus making it possible to determine whether the candidate fund meets the label criteria. Following the completion of this audit, the labelling organisation draws up an audit report presenting its conclusions and any comments, which will lead to a decision concerning the award of the label. If there is no non-compliance during the initial audit, a renewal audit is scheduled one year later. Details concerning the candidate fund labelling process are presented in the Inspection and Monitoring Plan for the Greenfin label.

The certifiers also produce a periodic review of labelling and suggest to the label committee any technical changes to be made.

The Greenfin label in figures

At 31 December 2019, 42 funds had a Greenfin label, for a total of €12 bn in assets under management.

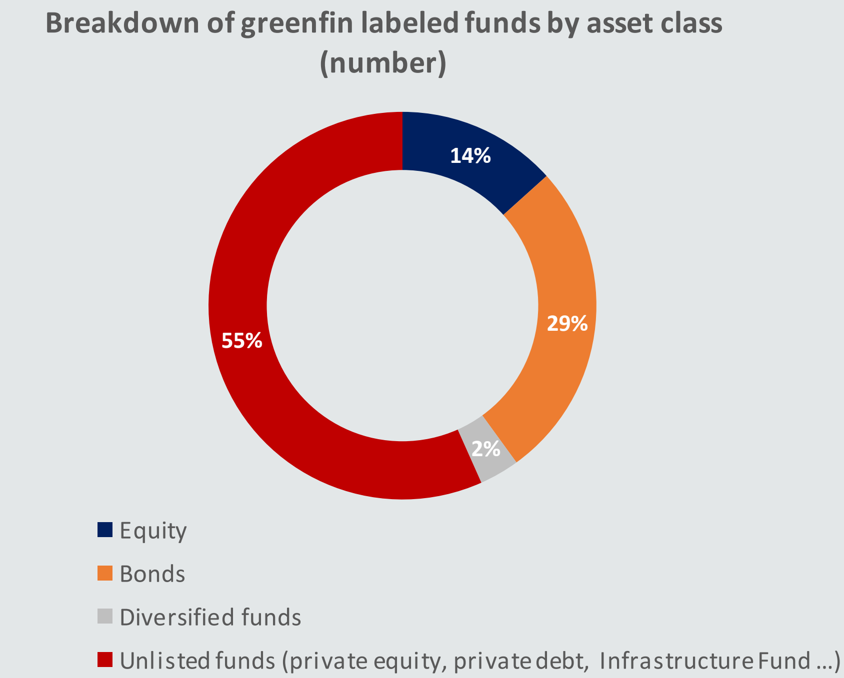
Of the 31 asset management companies having at least one Greenfin label for their funds, 27 are French and 4 of foreign origin.

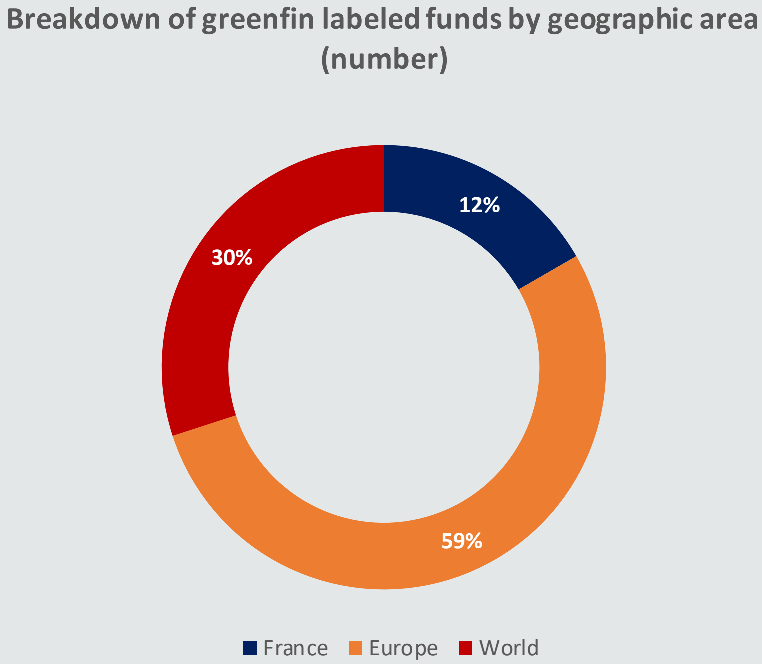
Of the labelled funds (and those for which data are available), 69% are domiciled in France and 26% in Luxembourg.

With regard to the asset classes preferred by funds having a Greenfin label, funds of unlisted assets are in the majority, notably because of infrastructure funds. By nature, these funds have a specific positioning in certain sectors[21] which correspond to the thematic sectors included in the list of "eco-activities" in accordance with the Greenfin Label reference document. Then come bond funds, heavily represented because they contain thematic funds investing in green bonds.

Finally, funds having a Greenfin label mostly prefer the Europe region to invest their assets. Funds which invest, in principle, exclusively in France, are fairly numerous in relative terms (5).

[20] In three boards: representatives of the state and its public establishments; professional or non-professional investors and asset management companies; representatives of civil society.
[21] Energy, social infrastructure, transport, utilities, telecoms.





Source: AMF

2.4.5. OTHER EUROPEAN LABELS USED BY ASSET MANAGEMENT COMPANIES

For the production of this report, the AMF questioned some fifty asset management companies concerning the use of French or European labels in the management of their CIUs in France and abroad. In addition to the French labels mentioned above, four other labels attesting to the consideration of non-financial characteristics in their management were mentioned. These four labels are therefore presented according to the frequency of their use observed during the survey of asset management companies.

2.4.5.1. The Towards Sustainability label

[The *Towards Sustainability*](#) label was created in February 2019 on the initiative of Febelfin, the Belgian financial sector federation. Febelfin groups together five non-profit organisations representative of the Belgian financial sector with the exception of insurance companies (Association belge des Banques et des Sociétés de Bourse ("ABB"), Union professionnelle du Crédit ("UPC"), Association belge des Asset Managers ("BEAMA"), Association belge des Membres de la Bourse ("ABMB"), and Association belge de Leasing ("ABL"). This label was placed under the governance of a Belgian non-profit organisation: the *Central Labelling Agency* ("CLA") whose governance in its various bodies (management committee, product eligibility committee, etc.) stipulates that at most half of the members are representatives of the financial sector.

By developing a quality standard for financial market participants, this label addresses all Belgian and foreign financial products having responsible investment characteristics marketed in Belgium to a client base of retail or professional investors[22] (savings products, collective investment products, life insurance: "euro funds" and unit-linked life assurance policies, structured EMTNs, discretionary portfolios,[23] etc.). This standard applies to products marketed as "sustainable", "socially responsible" or containing equivalent notions in their name ("ethical", "SRI", etc.). The label signatories undertake to market products containing these indications to retail clients only if they have first obtained the label (however, there is no obligation to be a label signatory in order to obtain the label).

The "quality standard" or reference document of the Towards Sustainability label is based on five key principles:

i. A multi-dimensional approach to responsible investment strategies. In practice, approaches taking non-financial criteria into consideration that could apply to obtain the label must have at least:
    a. a non-financial analysis covering the E, S and G pillars. The label does not specify a minimum coverage rate for this non-financial analysis but outlines several principles in this respect. To summarise, an asset should not be structurally held for investment purposes without having a non-financial analysis[24] (e.g. liquidity which is not "produced for investment purposes" does not require non-financial analysis). The label's reference document also describes in detail guidelines regarding non-financial analysis by asset class (treatment of derivatives, fixed-income instruments, funds of funds, etc.), although without stating any ban on them;
    b. a method for consideration of non-financial criteria such as best-in-class, thematic investment, normative analysis, etc. Note that the mere establishment of shareholder engagement is not considered a sufficient method of consideration of non-financial criteria to obtain the label.

ii. Anticipation of controversies by prohibiting investment in certain issuers considered as non-eligible for a responsible investment portfolio. These are, for example, issuers violating the United Nations Global Compact or firms that derive more than 10% of their revenues from the production of arms, tobacco, or else from thermal generation based on coal, oil or non-conventional gas. This exclusion list constitutes the main investment management constraint of the Febelfin label and is deployed in various sectors (energy, etc.);

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[22] February 2019 reference document of the Towards Sustainability label: "*The main scope of the quality standard is all standardised products that are actively marketed as being socially responsible or sustainable, towards primarily retail, but also private and institutional clients in Belgium*."

[23] February 2019 reference document of the Towards Sustainability label: "*While tailor-made and discretionary portfolios are not strictly speaking in scope, they could obtain the label if compliant with the standard*"

[24] February 2019 reference document of the Towards Sustainability label: "*A socially responsible portfolio shall not systematically (structurally and permanently) contain assets that cannot be evaluated on their sustainability in any way, i.e. not by any possible internal or external methodology. Temporary derogations for technical reasons are allowed[31]. In general, assets in a portfolio do not have to be evaluated if their only purpose is purely technical or for the temporary hedging of risks. When assets are structurally held with an investment purpose, they should be evaluated on their sustainability. As a guideline, when evaluating a more complex portfolio, one should look through the intermediate structures until the entities in the real economy that are being financed by the investment are reached, i.e. corporates and/or governments.*"

iii. Transparency, by incentivising fund managers to explain what is taken into consideration in their responsible investment process and what is their position regarding practices considered unsustainable such as risks of harming biodiversity, tax evasion, etc.;
iv. Transmission of useful and comparable information for clients concerning the way in which non-financial analysis is taken into consideration. This information is expressed formally on the label's website and compares the exclusions made for each product; and
v. Independent supervision which provides for obtainment of the label following an audit by an inspection body formed of the Ethibel Forum and academic institutions (ICHEC and UAntwerpen). They are then assessed by the CLA's labelling committee.

With 410 funds for €175 billion in assets under management at the start of March 2020, this label excludes no asset class, and funds investing mostly in government securities, for example, are eligible.

2.4.5.2. The Luxflag ESG label

The LuxFLAG ESG label was created in 2014 by the Luxembourg labelling agency, LuxFLAG. It is available to UCITS and AIFs domiciled anywhere in Europe or in equivalent jurisdictions.

The LuxFLAG agency is an independent international non-profit organisation, which aims to promote the deployment of capital for sustainable investment. The LuxFLAG ESG label is awarded to CIUs which take environmental, social and governance criteria into consideration in their investment process. To be eligible for this label, funds must:
- demonstrate how they take ESG criteria into consideration in their strategy;
- analyse 100% of their invested portfolio based on ESG criteria;
- have an exclusion policy;
- publish their portfolio at least once a year and report transparently on their investments.

The LuxFLAG ESG label is awarded by the LuxFLAG Board of Directors for a renewable one-year period. After presenting a candidacy, CIUs are audited by an outside auditor who makes a recommendation to the LuxFLAG eligibility committee.

At the end of 2019, 101 funds had a LuxLFlag ESG label, representing €40 billion in assets under management.

In addition to the LuxFlag ESG label, the LuxFlag agency proposes three other specialised labels dedicated to microfinance funds (Luxflag Microfinance), efforts to prevent climate change (Luxflag Climate Finance) and funds investing in sectors related to environmental protection (Luxflag Environment).

2.4.5.3. The FNG-Siegel label

The German label FNG-Siegel was created in 2015 by Forum Nachhaltige Geldanlagen (FNG), the German equivalent of the Forum pour l'Investissement responsable (French Forum for Responsible Investment). The organisation, founded in 2001, promotes responsible investment in Germany, Austria, Liechtenstein and Switzerland. The FNG is therefore intended for all UCITS or equivalents distributed in one of these German-speaking countries. Its aim is to ensure the quality of responsible investment in the region by contributing to the improvement of fund managers' practices.

The FNG label is awarded to funds having a strategy clearly identified by the asset management company as SRI and whose investment processes comply with transparency and quality criteria. Accordingly, in order to be eligible for it, funds must:
- Make public an FNG "sustainability profile" that is less than one year old. This profile offers an overall view of the responsible investment strategy based on environmental, social and governance criteria;
- Have a certificate of Eurosif Transparency Code compliance that is less than one year old;

- Analyse at least 100% of the issuers in the portfolio based on ESG criteria.

In addition to exclusions concerning the arms sector and companies violating one of the ten key principles of the United Nations Global Compact, this label requires that market participants have a policy excluding any company generating more than 5% of its revenues in the nuclear industry, and in the mining of coal and oil sands or else employing hydraulic fracturing (fracking) techniques. Regarding the production of electricity in coal-fired plants, a 25% threshold is applied.

The FNG label also has three levels of responsible investment quality materialised by three stars. Funds which meet these minimum requirements are therefore scored out of 100 following an overall analysis of the fund's entire infrastructure, i.e. institutional credibility, product standards (robustness of the investment process, in-depth analyses, non-financial reporting, etc.) and the potential impact related to the selectivity of securities, the exercise of voting rights or other engagement activities. This score awarded by the certifier determines the quality of the label, awarding candidate CIUs a "basic" label or a 1-, 2- or 3-star label.

The FNG label comprises 104 labelled funds for €30 billion in assets under management at the end of 2019. Auditing is now performed by the University of Hamburg, after having been historically performed by Novethic.

2.4.5.4. The Nordic Swan Ecolabel

The Nordic Swan Ecolabel, created in 1989 by the Nordic Council of Ministers which wanted to introduce an ecological label common to all the Nordic countries (Sweden, Denmark, Finland, Iceland and Norway), applies to about sixty consumer product groups. The "Financial products" category, introduced in 2017, establishes exclusion, inclusion and transparency criteria for all UCITS registered for distribution in one or more Nordic countries and whose assets comprise at least 50% of equities and corporate bonds or green bonds.

The objective of the label is to increase the visibility and commitment of the financial sector with regard to sustainable development, and encourage increased traceability between investors' capital and investments made in sustainable projects.

To determine whether a fund is eligible for labelling, the label defines in particular exclusion criteria covering, inter alia, companies contributing to the extraction and refining of fossil fuels or to arms production, or issuers that do not comply with certain international standards or conventions.[25] The label also defines exclusion thresholds for specific economic sectors or activities (natural gas, oil, uranium, etc.), above which an asset management company cannot make an investment if it wants to have its fund labelled.

The label also comprises inclusion criteria, which should be complied with and recorded in a dedicated report:
- At least 90% of portfolio securities have been analysed based on ESG criteria;
- More than 50% of the fund must be invested in companies applying good practice rules;
- The fund gives priority to companies transitioning towards a more sustainable activity.

Lastly, transparency criteria are imposed on asset management companies, notably via a quarterly report on the securities making up the portfolio of the CIU that is a candidate for labelling.

Other non-mandatory criteria are presented in the label specifications. They each offer points making it possible to achieve a minimum number of points needed to envisage labelling.

In practice, the NMN (Nordiska Miljömärkningsnämnden - Nordic Eco-labelling Council) determines the criteria to be met to be able to enjoy the label. Assisted by a group of experts, it consults representatives of the various governments, environmental protection organisations, commerce and industry to amend the specifications for the labels of each sector of activity covered by the Nordic label.

[25] ILO Declaration on Fundamental Principles and Rights at Work adopted in 1998, Human Rights, companies having caused serious environmental damage or involved in cases of corruption.

An asset management company that wishes to have its product labelled has a third-party organisation certify its compliance with the criteria adopted by the NMN. An application for certification accompanied by supporting documents is then sent to the Nordic Swan which takes charge of auditing and monitoring the asset management company by means of inspections. In order to verify a CIU's compliance with the label, an annual ESG report is therefore required, and random checks are performed, including on-the-spot inspections. The validity of the labelling is thus subject to compliance with criteria that are generally laid down for a period of three years. After these three years, new criteria are laid down and the firms must make a new application for labelling. The current criteria of the Nordic Swan Ecolabel for financial products are valid until 2022.

In 2019, 32 funds were labelled, for €11 billion in assets under management.

2.4.5.5. The Austrian ecolabel (Österreichisches Umweltzeichen)

The Austrian ecolabel, created in 1990 at the instigation of the Ministry for Agriculture and the Environment, also has the specific feature of labelling all general consumer goods (paper, shoes, buildings, etc.).

The financial part of the Austrian ecolabel, intended for financial products having responsible investment characteristics, was created in 2004. It is intended more specifically for those funds which have the most robust environmental approaches. It is now awarded by the Austrian Ministry for Sustainable Development and Tourism, supported by a consumer association in charge of working out and monitoring the labelling process.

This label is intended for all Austrian or foreign financial products wanting to be labelled for their policy of taking into consideration responsible investment issues. Funds developing a responsible investment approach and thematic funds are specifically concerned by this label. It is also the first label to specifically address firms in real estate.

Among the criteria adopted to benefit from labelling, the exclusion of certain sectors of activity (coal, nuclear power, the arms trade and production of arms, extraction of natural gas and crude oil, etc.) is explicitly required. Other exclusions applicable to companies and states which contravene international standards and conventions are imposed (systematic violations of human rights or labour law in particular). This is also the case for states without a target or measure for reducing greenhouse gases, or having an expansionary policy concerning the future development of nuclear power.

The specifications then establish a list of themes to be adopted for the selection of companies eligible for investment. These selection criteria must make it possible to identify companies or issuers which supply goods and services that are positive for society and the environment. The investment policy is assessed according to a scale which determines whether it takes each of the themes sufficiently into consideration. The label also incentivises market participants wanting to be labelled to adopt a high rate of selectivity after taking non-financial criteria into consideration. The consideration of ESG criteria should lead to a reduction in the investment universe by at least 50% in terms of the number of issuers for the fund to be entitled to labelling. If these criteria result in a selection covering 25% of its initial universe, it has three additional points enabling it to envisage labelling of its CIU (see below).

The third pillar on which the Austrian ecolabel is based is transparency. Information concerning the consideration of environmental and social issues must be disclosed in accordance with the principles established by EUROSIF in its Transparency Code. A policy of engagement with issuers and voting in general meetings must also be published.

Following an analysis of the fund's compliance with the label, the sum of the points weighted by each criterion results in a percentage score which determines whether the fund can be labelled. If it has a number of points less than 65% of the maximum number of points, it cannot be labelled.

Specialised auditors are tasked with assessing compliance with the label, which is then issued to the fund for a period of four years. The follow-up procedure examines any changes in the investment strategy. The fund must also inform the label of any major change in its strategy in order to confirm its eligibility for the label.

In 2019, 116 funds were labelled by the Austrian ecolabel, for €15 billion in assets under management.

2.4.6. SUMMARY OF THE MAIN CHARACTERISTICS OF FRENCH AND EUROPEAN LABELS (END-2019)

The following table summarises the key figures and the main characteristics of the different European labels at the end of 2019. Novethic's half-yearly reports[26] also provide a detailed overview of the trends in terms of outstandings and the differences in approach of each label.

	Label ISR	Label Greenfin	LuxFLAG ESG	Label FNG Siegel	Nordic Swan Ecolabel	Austrian Ecolabel	Towards Sustainability
Creation	2016	2015	2014	2015	1989 (2017*)	1990 (2004*)	2019
Initiator	Ministry of Economy and Finance	Ministry of Transition Ecological and Solidarity	Luxembourg Finance Labelling Agency	Forum Nachhaltige Geldanlagen	Nordic Council of Ministers	Ministry of Agriculture and Environment	Febelfin
Number of funds labelled	362**	42	101	104	32	116	410***
AUM (in Mds€)	140**	12	40	30	11	15	175***
Perimeter	European UCITS, RIF, PIF and SCPIs / OPCIs	European UCITS and AIFs	European UCITS and AIFs	UCITS distributed in Germany, Austria, Liechtenstein and Switzerland	UCITS distributed in a Nordic Country	Austrian or foreign UCITS and AIFs	European UCITS and AIFs
Selectivity rate	20%	« Green » share	-	-	50%	50%	-
ESG coverage rate	90%	100%	100%	100%	90%	100%	100%
Exclusion	NO	YES	YES	YES	YES	YES	YES
Points scale	NO	NO	NO	YES	YES	YES	NO

**Creation of the financial products category*
*** Figures as at 31 January 2020*
**** Figures as at 2 March 2020*

[26] Overview of European sustainable finance labels

2.4.7. GENERAL OBSERVATION

The labelling trend seen on the sustainable finance market in collective investment management has accelerated significantly in recent years. The planned creation of a real estate label in France and the recent launch of the Febelfin QS label in Belgium reflect the enthusiasm of asset management companies for these labels which offer the promise of greater visibility in a market which is still little-known by the general public.
However, the diversity of the criteria adopted, with "green" labels which exclude sectors considered as harmful to the environment, such as coal and oil and gas operations, and those based on screening of ESG criteria with minimum thresholds to be reached in order to be certified, contribute to the lack of clarity in the market. The same holds for considerations related to nuclear power ore gas, which are subject to different types of treatment. In this regard, the European classification documents could constitute a starting point for a possible convergence on these issues.

The heterogeneous nature of the characteristics of these various labels means it is not possible to have a clear view of the European offering regarding consideration of non-financial criteria by CIUs. In a market where the boundaries between the various countries are diminishing, the initial objective of clarity sought by asset management companies and their investors could be jeopardised by the lack of comparability of the various products available.

So discussions on the European level for the production of an ecolabel dedicated to sustainable finance will probably provide some clarity. The objective is to attract a large fraction of savings to green products, the supply of which is currently expanding rapidly. Shorter-term, the measures introduced by the PACTE Law in unit-linked life insurance policies should serve as a growth driver for labelled funds with retail clients.

2.5. ORGANISATION OF AMCS

Like for its previous reports, the AMF conducted investigations concerning the means deployed by AMCs to organise their system for taking into consideration environmental, social and governance criteria (ESG framework). These investigations consisted in a new survey of AMCs, supplemented by interviews. Thus, about fifty AMCs were selected by the AMF to reply to the survey on the basis of criteria such as size, the sector of activity, and the proposal of a specific offer (range of SRI funds, thematic funds, etc.). In addition, about ten AMCs were contacted for interviews in greater depth concerning, in particular, their resources.

Nearly all of the AMCs within the scope replied to the survey, namely 51 French AMCs, managing slightly more than €1,428 billion in assets at end-2018, and thus representing, in terms of AUM, around 65% of the collective investment management market in France. These AMCs had a cumulative total of 8,264 full-time personnel at end-2018 (or more than 45% of the total personnel of French AMCs).

The response rate shows **an increased involvement of AMCs in this field since the last survey**. The sample used in the 2017 report represented about one-third of those surveyed (16 AMCs). Therefore, the data submitted by this enlarged population are not directly comparable to the 2017 data to assess changes.

2.5.1. OVERALL ESG FRAMEWORK

Due to the diversity of non-financial issues (ethics, consideration of the financial risk entailed by non-financial criteria, consideration of the negative externalities of investments, etc.), AMCs must devote special resources, outsourced or not, to the consideration of non-financial aspects (and in particular ESG criteria) in managing their CIUs. For this analysis it is necessary to have methodologies, tools and above all persons involved in the process. Without claiming to cover all the existing issues and systems, several phases of the process can be distinguished:

- Data collection (carbon footprint, rate of absenteeism, existence of governance procedures, proportion of revenues from controversial activities, etc.), which will generally be supported, as described in particular for carbon data in section 4, by the services of service providers providing aggregated databases;

- Analysis of issuers/investments, which can be performed both quantitatively (building of metrics based on the collected data) and qualitatively (provision of advice according to predetermined non-financial lines of thought), and which could lead to the production of non-financial scores or classifications assigned to the issuers or investments;
- The supply of non-financial information to fund managers, through the combination of this information with "conventional" financial information, or to establish, where applicable, policies on issuer dialogue and voting in general meetings;
- Non-financial reporting, whether it be internal, designed for fund managers, risk managers, company officers, or external, designed for institutional investors or retail investors, the public or the supervisory authorities.

The following sections describe the human resources of AMCs, then their technical resources, before focusing on service providers. The organisations managing specific asset classes (real estate, private equity) are taken into consideration generally in the statistics here, and described in greater detail in the dedicated sections (cf. 3.1 and 3.2).

2.5.2. HUMAN RESOURCES: VARIED ORGANISATIONS WITH MORE NUMEROUS ACTORS

The ESG framework covers various tasks: data collection, analysis of issuers, fund management, reporting, non-financial risks, relations with issuers, etc. In practice, very few AMCs perform the collection of non-financial data themselves, preferring to use service providers. Moreover, although around 75% of AMCs state that they factor ESG risks into their risk management[27] system, the AMF has not identified any organisation in which the Risk Department is involved in the ESG framework, despite the establishment of several projects.[28] Finally, although more than 80% of the AMCs surveyed state that they have established a policy of dialogue with issuers or of voting formally taking into account ESG aspects, most will in practice use the service provided by a proxy recommending votes on resolutions according to a profile defined as "ESG". The teams allocated to the framework and analysed in the present section are therefore mostly ESG research teams, management teams or marketing teams. The AMCs were questioned concerning the number of people assigned to ESG in these various functions.

Overall, 92% of the AMCs responding state that they have at least one person dedicated to ESG in their organisation (whether it be a fund manager, an analyst, an expert in marketing or communication, or any other function).[29] Of the dedicated resources, the fund manager and analyst functions head the list (44% and 38% of the number of dedicated people respectively), with the marketing function accounting for 6% on average. "Other" functions (12%) in practice cover cross-functional positions for small organisations (teams in charge of development of tools and methodologies, research and dissemination in the organisation, and reporting), management and company officer positions, coordinators (notably for entities forming part of a group), and all the employees of subsidiaries dedicated to non-financial research where applicable.

In 60% of cases, the AMCs state that they have dedicated ESG analysts, and in 55% of cases dedicated ESG managers. In terms of the trend, the latter figure may appear lower than that of 2017 (63%), although, as already mentioned, since the population examined has been significantly enlarged, it would be mistaken to conclude that the trend is negative.

The organisations examined differ, and two main types of model can be found there: on the one hand, a model focused on management, in which certain managers develop non-financial expertise and are assigned to the

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[27] In practice by an investment policy excluding the most controversial issuers beforehand, on a systematic or else discretionary basis, in that case relying entirely on the expertise of the fund managers (first line of defence without a second line).

[28] Regarding this, the AMCs and professional associations met expressed on several occasions their misgivings faced with regulators' requirements in this area, notably in light of the principal-cause approach proposed by ESMA in its response in April 2019 to the Call for Advice sent by the European Commission on the allowance for ESG risks in AMCs' system in UCITS and AIFM regulations. For example, the AMF has not identified any AMC which might by itself have identified risk indicators and appropriate processes for taking ESG aspects into consideration in risk management.

[29] Of the AMCs which report no resources dedicated to ESG, two outsource their system within a group, while the other two, small in size, state that they implement an ESG approach by integration involving the fund managers and all the personnel, without any resources specifically dedicated to ESG.

management of funds highlighting non-financial aspects (SRI funds, thematic funds, etc.) and on the other hand a model focused on analysis, in which a team of analysts (often grouped together in a responsible investment or ESG department or division) collects (often by means of service providers selected following due diligence), analyses and disseminates the ESG information then used on various levels by the fund managers (in a binding or even industrialised manner for the management of funds highlighting a non-financial aspect, and in a more discretionary manner (by "integration") for the other funds). The bigger AMCs generally give priority to the second model, and the first is applied mostly by smaller AMCs that are ESG specialists. However, a trend to convergence between the two models has started, partly with the aim of developing fund managers' awareness or ESG so that they may more often take into consideration the non-financial information made available to them, and partly to bring the analysts closer to the fund managers so that they may produce information more appropriate to the specific needs of each manager.

2.5.3. WIDESPREAD INVESTMENT IN PROPRIETARY TOOLS, DIVERSE REALITIES

79% of the AMCs surveyed state that they have proprietary non-financial analysis tools (system for non-financial rating, assessment of the carbon footprint, etc.). This figure may appear lower than in 2017 (87.5%), but it remains high considering that, as mentioned above, the population examined has been significantly enlarged, and now comprises both mature actors and also new actors which have developed this expertise more recently, and therefore have fewer dedicated resources. Moreover, the same "proprietary tool" concept covers very different realities: certain AMCs that are highly developed in this area or large in size have tools capable of aggregating various sources of data in order to automate the production of scores, enhance qualitative analyses, and make data available to the fund managers automatically. Other tools consist in practice of tracing the qualitative ESG analysis performed on an issuer by aggregating it with financial analysis, or developing a reference database of non-financial data used for the purpose of implementing exclusion policies or monitoring particular constraints entailed by SRI management.

Regarding discretionary portfolios, 32% of the respondent AMCs stated that they have an ESG offering, but this seems generally to be a "default" offering, because a very small minority (15%) of these AMCs have formal tools (statistics, questionnaires, client profile) capable of guiding the proposal of a discretionary portfolio incorporating ESG or SRI characteristics.

2.5.4. USE OF SERVICE PROVIDERS

The AMF survey questioned the AMCs concerning the identity of service providers and the tasks entrusted to them. The survey was able to confirm that, as mentioned above and illustrated more specifically in section 4, AMCs make extensive use of non-financial service providers, not only for the collection of non-financial data, but also for the construction of specific metrics (calculation of a portfolio's carbon footprint, SDG alignment score, etc.), the production of analyses (an ESG score is often accompanied by a report detailing the opinion of a non-financial rating agency), controversy watch on issuers (specific event affecting the "virtuous" aspect of the investment, for example by failure by the issuer or its supply chain to comply with environmental, social and governance standards), production of reports, assistance in establishing ESG frameworks (e.g. development of a "sustainable" product offering, establishment of an engagement policy), etc.

It can therefore be observed that certain service providers, combining several services (aid with voting policy, ESG analysis, databases, etc.), are used extensively by the market. The survey questioned AMCs freely concerning their service provider selection criteria. The replies were analysed from the viewpoint of the most widely used criteria. The criteria most frequently mentioned are the coverage rate of the investment portfolio (slightly more than 60% of respondents), cost (40% of respondents), quality of analysis (38%) and the availability and quality of data (34%). Aspects such as the transparency of the methodology and the independence of the service provider are found less often, with 15% and 9% respectively of mentions by AMCs. This dispersion can also be explained by diverse needs: some AMCs need only raw data to enrich their internal models and their own work, whereas others want in-depth analyses.

Hence, the data quality and independence criteria are not mentioned in first position by the AMCs. Various service providers surveyed stated that they provided services both to issuer companies (production of the company's carbon balance, strategic counselling) and to asset management companies (provision of carbon databases, analyses, establishment of carbon metrics/reports). The combination of the two activities could result in conflicts of interest (e.g. favouring a client company in the analysis provided to asset management companies). In practice, the service providers surveyed indicated that they separated the two activities (Chinese wall) in order to prevent such conflicts of interest. Of the AMCs surveyed, some indicated that they considered this aspect important, while another judged it secondary.

Moreover, the AMCs interviewed (mostly of large size) stated that they conduct due diligence in advance to assess the quality of the data modelling methodologies and, where appropriate, the suitability of the methodology for the use that will be made of it. Regarding this, several AMCs reported that the service providers' methodologies were liable to change. Where applicable, they expect systematic notification from their service providers, even if this practice is not covered by a contractual arrangement between the AMC and the service provider. Generally, as illustrated in particular in section 4, the inspections conducted by AMCs on their service providers **are not systematic and seem limited**.

Given their significant dependence on service providers, which are unregulated, the AMF questioned the AMCs concerning the difficulties identified in organising inspections of ESG service providers. Around 60% of the AMCs questioned identified obstacles to the implementation of inspections, of which the most frequently mentioned are the divergence between the firms' methodologies (43% of AMCs identifying obstacles), the lack of technical and human resources or the costs created for the AMC (23%), and the lack of transparency of the service providers themselves (20%). Two AMCs called for regulation of these firms, while two others requested a certification. Certain AMC replies may appear contradictory: for example, one AMC says that the service providers are trusted third parties while stressing the existence of difficulties in being able to control them because they are not regulated and their methodologies are proprietary and not public.

2.5.5. CONCLUSIONS RELATING TO AMC ORGANISATION

The investigations conducted by the AMF were able to highlight **a growing interest in the subject of ESG among AMCs**, demonstrated notably by the response rate to the AMF survey, far higher than for the previous survey (close to 100% versus a rate of scarcely one-third for the previous survey). The AMCs' system remains primarily focused on the processes of analysis and consideration of ESG criteria in fund management. Data collection is still left up to service providers, except for a few AMCs, and the Risk Department is not yet involved in the process. However, this paradigm could change, notably with the implementation of the Disclosure Regulation which requires that AMCs report on the consideration of sustainability risks in their investments (cf. 5.1.2).

The method of organisation of the AMCs differs depending on their resources and their product offering. For example, some AMCs have established an "ESG" division for concentrating initiatives in this area and to provide the fund managers with non-financial information, while others have chosen to specialise fund managers directly in the sector. However, the need for better communication between the two pleads in favour of a convergence between these models. The tools on which the systems are based are of varied complexity, ranging from an aggregation of data, metrics and product analyses by several service providers, allowing the development of a proprietary rating methodology, to a support tool formalising the qualitative approach of the AMCs. Service providers have an essential role in this framework for all the AMCs, even though the inspections performed are not necessarily adequate, as illustrated in section 4. The AMF therefore reiterates **the obligation for AMCs** which emphasise non-financial characteristics to **establish data quality and consistency control systems**, including for non-financial data.[30]

[30] Obligation to provide the investor with information that is clear, accurate and not misleading (Article L. 533-22-2-1 of the Monetary and Financial Code) and obligations to have robust and credible data for risk management (Article 321-81 of the AMF General Regulation for UCITS and Article 45 of Delegated Regulation (EU) 231/2013 for AIFs).

3. SPECIAL CASES OF IMPLEMENTATION OF NON-FINANCIAL APPROACHES

3.1. PRIVATE EQUITY FUNDS

3.1.1. INITIATIVES OF THE PROFESSIONAL ASSOCIATION AND STUDY CONTEXT

Non-financial aspects, and in particular environmental, social and governance (ESG) issues, are increasingly addressed by certain private equity fund managers for the selection, monitoring and disposal of their equity stakes. The professional association of private equity fund managers, France Invest, has in the past few years performed much work and taken numerous initiatives in this area.

In 2010, for example, France Invest published a first ESG Guide. Updated in 2018, this Guide, prepared by the ESG Commission of the professional association with the support of PwC, was produced in partnership with about fifteen asset management companies. Illustrated by numerous case studies, it outlines the major principles of integration of ESG issues into all the phases in the life of an AMC (from fundraising to the disposal of an equity stake).

The sector is also organised around several initiatives and actions designed to encourage consideration of non-financial characteristics in their work.

For example, many French asset management companies operating in the private equity sector are signatories to the United Nations Principles for Responsible Investment (PRI) which generally constitute a first step for AMCs formalising their commitment to take ESG criteria into consideration in their fund management. At the end of 2017, for example, of the 213 private equity companies having subscribed to the UNPRI worldwide, one-quarter of them were French asset management companies. Furthermore, every year France Invest produces an annual report on ESG.

With a view to improving ESG dialogue between institutional investors and AMCs and limiting the workload for all, France Invest has published a number of recommendations designed to standardise the ESG questionnaires based on a number of principles established, inter alia, by the UNPRI and the TCFD. These recommendations were updated in October 2019. Accordingly, a joint reference framework (Due Diligence Definitions and Questionnaire - DDQ, see below) was adopted and made available to all institutional investors and investment managers.

Finally, the organisation is also behind the publication of a Gender Equality Charter in early 2020 and has an Impact Committee whose members must adhere to the France Invest Impact Charter.

Regarding the specific climate theme, France Invest has established an "Initiative Climat" task force. This initiative notably develops guidelines to assist investment managers and raise their awareness of climate-related issues. The initiative now has 36 signatories and was adopted by the UNPRI at the end of 2018.

In 2019, France Invest published a Cleantech index which presents a ten-year review of French private equity funding for the energy and environmental transition.

Apart from these various initiatives, as in other fields of investment management, the consideration of non-financial characteristics in private equity corresponds to very different realities depending on the firm.

Accordingly, as part of the questionnaire carried out for this report, the AMF specifically analysed the replies received from several AMCs operating in private equity. Also, and especially in the context of the "Article 173" information review (cf. section 5), the AMF analysed the information available on the website of an AMC specialised in private equity, and the commercial and regulatory documentation of several funds. Finally, interviews were held with four AMCs identified as being particularly advanced in their ESG policy. This section of the report presents the approaches implemented by the leading AMCs.

It is specified that, in this section, "private equity fund" refers to FCPR venture capital funds, FCPI innovation venture capital funds and local investment funds (FIPs) designed for retail clients, and all professional funds (FPCI, FPS, OFS, SLP or SCR) whose corporate purpose is to acquire equity stakes in unlisted companies. This section does not cover approaches relating to infrastructure funds that could implement non-financial approaches (e.g. funding of "green" projects, wind-power farms, solar panels, etc.), which are in practice open mostly to professional clients.

For all useful purposes, it is specified that private equity funds designed for a retail investor clientele come within the scope of AMF Position-Recommendation 2020-03.

3.1.2. SPECIFIC FEATURES OF THE PRIVATE EQUITY MARKET REGARDING THE ISSUE OF CONSIDERATION OF NON-FINANCIAL CHARACTERISTICS

Private equity funds select the companies which form their portfolios following due diligence performed by the AMCs themselves or possibly with the help of service providers. This due diligence involves performing all the necessary verifications prior to investment in order to have reliable information with a view to the acquisition of a stake in the targeted company. Because they are not listed, of smaller size and often less organised, the companies targeted by private equity funds are subject to less stringent information reporting obligations than other companies. In particular, with regard to non-financial information, the target companies will usually not be subject to the obligation to publish a non-financial statement.[31] Thus, in order to collect this information, the AMCs will usually send out questionnaires and conduct interviews to carry out their due diligence on the subject. Given the diversity of sectors of activity, AMCs have in practice developed questionnaires that are differentiated according to the firms, so as to ensure the relevance of the non-financial issues depending on the profile of the target company.
Therefore, by comparison with the non-financial information available for large enterprises, the AMCs of private equity funds are potentially capable of demanding of target companies in-depth information more appropriate to their needs. However, the collection of this information requires, on the one hand, that the AMC have the resources to produce a questionnaire adapted to the issues of the target company, and also that the latter be capable of replying to the queries satisfactorily.

To avoid increasing the workload for target companies which have limited resources to reply to their queries, certain private equity firms have started work to standardise these questionnaires from one AMC to another. Also, the professional association of private equity firms contributes to the development of marketplace practices and initiatives through the publication of studies such as its annual ESG report[32] and the dissemination of an engagement charter[33] intended for all the firms in the sector. Finally, when several funds invest jointly in a target company, the due diligence will be usually performed by the AMC which plans to make the main investment, and shared with the other AMCs, which may possibly carry out their own additional due diligence in order to decide whether or not to join the shareholder base.
Accordingly, given the nature of the investment, the duration of the acquisition process and the time frame for holding their equity stakes when they are majority shareholders, private equity firms prefer to support companies in the consideration of non-financial issues over several years without abandoning the investment in a stake initially showing less satisfactory results from a non-financial viewpoint (except for the implementation of certain sector exclusions described below). One of the specific features of private equity is therefore its support for the company throughout the holding period, which is 5 to 7 years on average. It is generally during this holding period that ESG actions are conducted and monitored. Note that, in some cases, the fund may not be represented in the corporate

[31] Article R. 225-104 of the French Commercial Code, presented in greater detail in section 4 of this report, stipulates thresholds of activity to be subject to the obligation of publication of a non-financial statement: permanent workforce of more than 500 employees and revenue thresholds, or total assets of more than €100m.
[32] Sixth Annual ESG Report – Financial year 2018, by France Invest in cooperation with Deloitte, which documents, estimates and qualifies French private equity exposure to promote Environmental, Social and Governance (ESG) goals in investment firms and in the companies that they support.
[33] Charter of investor engagement for growth, updated in January 2018.

governance bodies or not be aligned with its co-shareholders on these non-financial themes. The majority nature of the equity stake may therefore prove decisive.

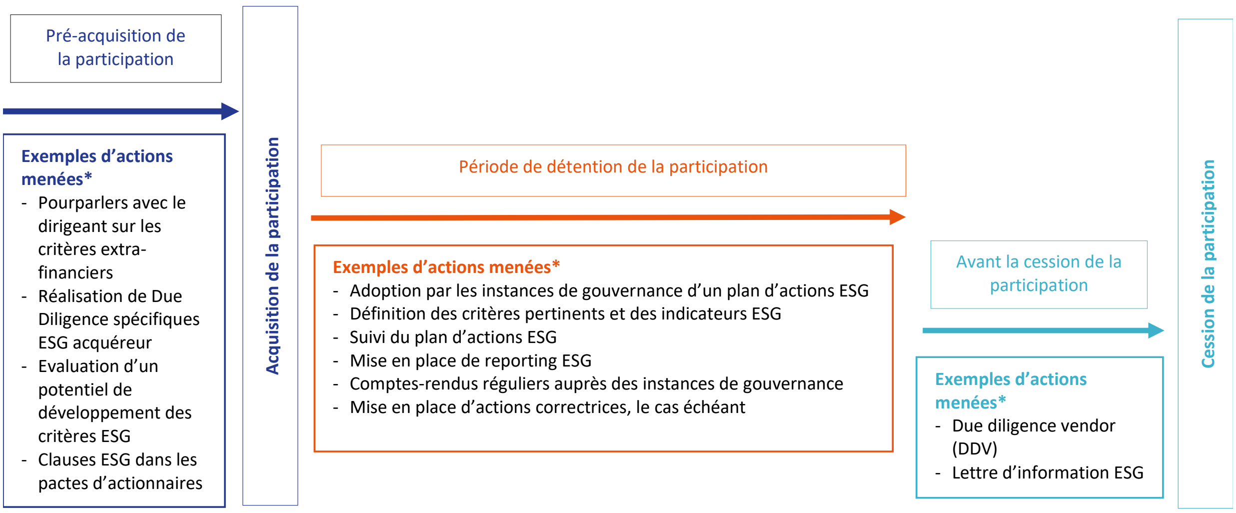
Finally, for certain growth capital funds such as venture capital funds, it is more difficult to assign a significant weight to the deployment of a non-financial system, to the extent that the main goals of these companies remain, from the perspective of both the asset management companies and the entrepreneurs, the company's growth and achievement of financial breakeven.

3.1.3. PRIVATE EQUITY FIRMS' FRAMEWORK FOR CONSIDERATION OF NON-FINANCIAL CHARACTERISTICS

The consideration of non-financial characteristics by the asset management companies that are most advanced in this respect usually concerns all their equity stakes irrespective of the type of fund or investment vehicle. This consideration is usually described in a document provided by the asset management companies on their website (ESG charter, responsible investment policy, engagement policy, "Article 173" information, etc.). As described in detail in the following sections, the ESG approach usually relates to approaches based on an engagement in investment management which cannot be considered significant.[34] Moreover, the commercial and regulatory documentation of the funds is generally not very expansive on the ESG framework, which is consistent with Position-Recommendation DOC 2020-03 on the information to be provided by collective investment schemes incorporating non-financial approaches.

Following the analysis of the available documents and various interviews conducted by the AMF, this section aims to describe the ESG framework deployed by asset management companies specialised in private equity that are most advanced in this respect, by breaking down each stage of the investment cycle.

As an illustration, the following diagram presents in French various initiatives regarding the consideration of ESG criteria by AMCs at the level of the target company and according to each stage in the investment process:



*Il s'agit d'exemples illustrant le panel des actions pouvant être mises en place par un fonds de capital-investissement au titre de la démarche ESG au niveau de la participation.

Source: France Invest

[34] As mentioned in the introduction, the AMF has also noted the existence of funds, notably with a Greenfin label, focused exclusively on "green" thematic investments (such as, for example, the renewable energies sector, with funds investing in ad hoc companies operating solar or wind-power farms). This approach is not investigated here.

3.1.3.1. Exclusions prior to investment

Several asset management companies that we met exclude from their investment universe beforehand companies performing part of their operations in sectors subject to controversy, including companies involved directly or indirectly in the production of arms (whether controversial or not), the tobacco industry, alcohol, coal, or else in the sectors of gambling, pornography, the processing of fur, oil and gas exploration, human cloning or tests performed on animals, etc. This broad range of exclusions reflects the diversity of approaches at the levels of both the asset management companies and the funds themselves. In practice, the AMF notes that AMCs define a common base of exclusions together with exclusions specific to certain funds at the request of their investor clients that can be set under the form of a contractual stipulation between the asset management company and its client. These exclusion policies have increased in recent years but do not yet constitute the approach mostly adopted by all private equity firms..

The operational deployment of these exclusions also covers **very diverse realities** from one asset management company or fund to another, in terms not only of philosophy but also of process. For example, certain AMCs investigate the indirect contribution of the target company's activity to an excluded sector, by evaluating, for example, the criticality of the target company's production of a sub-component of arms or electronic cigarettes with respect to their exclusion policy concerning the arms and tobacco sectors, where others will confine themselves to a policy of exclusion regarding direct activities. Regarding the process, certain AMCs set themselves no **binding** obligation concerning the exclusion of predefined sectors, relying on the expertise of the investment management teams and taking the investor's sensitivity into account in order to determine whether the investment in a company is acceptable or not. Other asset management companies have more formal tools and procedures enabling them to exclude certain investments following a thorough investigation based on objective data. For example, committee type decision making may be systematically adopted in case of doubt regarding the profile of a company, or else investment may be guided by the existence of a decision tree. Few normative approaches (e.g., definition of a maximum activity threshold in a controversial business) were noted.

Good practice 1:

The AMF considers as good practice the fact of having a decision aid procedure or tools capable of justifying the exclusion of certain issuers or sectors of activity.

3.1.3.2. Due diligence or pre-investment phase

During this phase, as described previously, AMCs perform an "ESG" analysis of the target company (ESG due diligence) generally by sending a questionnaire and/or by interviews, alongside conventional financial due diligence. This approach is applied systematically for certain AMCs, and in a more discretionary manner for others. On this occasion, several of the asset management companies we met indicated that they used service providers systematically or in order to examine more fully certain metrics that could have consequences for the valuation of the company analysed. The non-financial data extracted from this analysis is thus used as one measure of the risk involved in investment in the company.

In support of these initial results, a dialogue may be initiated with the company's managers in order to raise their awareness of non-financial issues. This phase thus makes it possible to identify or confirm material ESG issues, notably any involvement in controversial activities (cf. above), or to prepare the ground for the definition of non-financial improvement targets. Some AMCs rely on ESG databases to position the target company according to a sector benchmark to help them identify issues (for example, a history of occupational injury rates in all the companies in which the AMC has invested its funds). In practice, it is noted that nearly all the AMCs have a common base of criteria relating to good corporate governance and occupational health and safety. Moreover, the AMCs focus on a few criteria considered most important according to the target company's size and business. For example, depending on the target company's sector of activity, the analysis will be focused more on the environmental, social or governance aspect.

3.1.3.3. Investment decision phase

At the time of the investment decision, the non-financial aspects are incorporated in the decision generally as a tool for measuring the risk involved in the equity stake. However, for all the AMCs surveyed by the AMF, the fund managers remain free to select target companies irrespective of the result of the non-financial analysis performed during the ESG due diligence. The non-financial due diligence thus enriches the overall analysis performed on the target company during the investment decision phase, although, in the great majority of cases, these analyses are not by themselves decisive for excluding a target company.[35] They may nevertheless hold back the investment decision depending on the materiality of the issues (in particular for the sustainability and/or valuation of the company) and the company's capacity for transforming itself. Examples of investment opportunities excluded exceptionally because of non-financial considerations were nevertheless mentioned by certain firms. Moreover, it should be stressed that private equity firms have the ability to act to encourage companies whose ESG due diligence prior to the acquisition might be mediocre to transform themselves by raising their awareness of the potential implications of these non-financial issues. This capacity for action will be especially strong when the fund holds a majority stake in the company.

The asset management companies most active in this respect may, moreover, implement measures to assist the target company in improving issues considered major, e.g. by inserting specific requirements in the shareholder pact, or else through side letters. Depending on the AMC, these commitments may be more or less formal and quantified (for example the commitment may concern the implementation of means to combat absenteeism, or a quantified objective for reduction in the occupational injury rate). The approach is therefore specific to each investment case and cannot be easily compared.

Good practice 2:

The AMF considers that it is good practice for private equity firms to formalise their approach to taking ESG issues into account through specific clauses in shareholders' agreements or side letters.

3.1.3.4. Equity stake holding phase

The equity stake holding period is a crucial phase for transformation of the company and the operational integration of non-financial criteria. Following acquisition of the equity stake in the target company, most of the AMCs state, in their dedicated policy, that they perform monitoring of non-financial performance, which is materialised by continuing dialogue with the company, including the consideration of non-financial themes and the monitoring of any non-financial targets determined with the managers of the company at the time of the investment. The AMC can also, on this occasion, perform monitoring of controversies affecting the equity stake or develop monitoring tools such as, for example, the organisation of periodic reviews of the ESG KPI (Key Performance Indicators) by the governing bodies or else the setting up of collaborative tools between each equity stake and the AMC on some ESG criteria. In addition, certain AMCs send out a regular questionnaire to the equity stakes, notably based on the monitoring of indicators for measuring non-financial performance. The analysis of this questionnaire may take the form of a formal report containing, in particular, an identification of the leeway for improvement of the equity stake. In this respect, some AMCs have carried out work to develop a common base of relevant ESG indicators. However, this base is still small due to the diversity of the companies' sectors and situations. Accordingly, the tools made available to French private equity firms by France Invest and the UNPRI have allowed insourcing of the functions in charge of ESG for the firms that are most advanced in this respect. This trend has the effect of reducing the work performed by outside service providers, even though certain AMCs mentioned that during their lifetime they request third-party reviews of their equity stakes with regard to non-financial aspects.

[35] Except for involvement in the activities judged controversial that were identified during the exclusion phase. See above.

Most AMCs use all these factors in order to provide their investors with **ESG reporting** (usually in a dedicated report). Divergences are noted in the content of these reports: some reports present indicators aggregated at the portfolio level (e.g., the number of equity stakes in the portfolio having environmental certifications, the proportion of female employees in the equity stakes, etc.), while others, stressing the very great diversity of sectors of activity of the equity stakes, which would not permit the appropriate compilation of aggregated indicators, prefer to present individual examples of ESG changes (adoption of an ISO standard by an equity stake, monitoring of an indicator over time, etc.).

For all the AMCs surveyed, the AMF noted that a deterioration in the non-financial situation of the equity stake, or even the failure to achieve non-financial targets determined beforehand, **did not constitute**, by themselves, factors calling into question the investment or leading to the replacement of the equity stake's management team. The asset management companies specialised in private equity specify that they want to focus on supporting the companies in order to enable them to create value. Corrective measures may be taken in cases of inability to manage material issues, but the eviction of the management team or early disposal of the equity stake on non-financial grounds was very seldom noted. Note that the ousting of an equity stake's management team is subject to constraining rules which could have serious legal and financial consequences for the company. These legal and financial risks could partly explain the rareness of this type of measure. However, these factors could play a role, alongside financial factors, in the case, for example, of a second round of financing to increase the equity stake. Since the liquidity of the underlying assets leaves little potential for AMCs to reappraise their investment decisions during their life, policies of consideration of non-financial criteria in this asset class could mostly involve heightened due diligence ahead of the investment phase, even though the holding period remains a major lever of action for these actors.

Good practice 3:

In cases where the fund manager is the majority shareholder of a company for which an ESG approach has been put in place, the AMF considers that it is good practice to define the objectives to be achieved and to measure the results of this approach over time on the various ESG issues considered relevant.

3.1.3.5. Disposal phase

When selling the equity stake, the discussions held with the AMCs showed that the financial implications inherent in the disposal generally prevail over the non-financial targets determined beforehand and monitored during holding of the equity stake. Some non-financial information is made available to buyers. However, few asset management companies present all these non-financial analyses. Some actors nevertheless communicate in their investment policy on the occasional establishment of ESG Vendors Due Diligence performed by an outside service provider in order to give an independent viewpoint ("**ESG VDD**"), non-financial reporting or more generally CSR information shared directly by the equity stake and made available to the buyers at the time of the disposal. ESG VDD takes the form of an audit or a review on the initiative of the shareholders, which aims to present information on the non-financial performance of the target. It aims mainly to provide a "before and after" view of the non-financial situation in order to place a value on the efforts undertaken by the equity stake supported by the AMC, and potentially highlight any value creation generated by this approach. The potential buyers are thus informed of the target's progress with regard to consideration of environmental, social and governance issues.

Good practice 4:

The AMF considers that it is good practice to make information on the non-financial situation of a company in which a portfolio management company holds a stake at the time of its sale available to potential purchasers.

3.1.3.6. Specific case of funds of funds

In the case of funds of funds where the AMCs are indirectly exposed to the equity stakes by investing in other private equity funds, the ESG framework established by the fund's AMC relies on the manager of the target fund and not on the directly held equity stakes.

The AMC therefore first checks that the sector exclusion policy of the target fund is consistent with (i.e. at least as restrictive as) its own policy. The AMC then incorporates the ESG assessment of the target fund manager in its fund selection process. This ESG assessment can be determined by interviews and based on a questionnaire filled in by the manager of the target fund, which may concern both its own performance in terms of social and environmental responsibility and its responsible investment policy. During the fund unit holding phase, the AMC may, for example, perform monitoring[36] of the ESG indicators of its investments. These indicators, which may subsequently be disclosed to clients, measure the ESG practices of the managers of the target funds, and the non-financial performance of the underlying equity stakes.

Thus, just like for direct investments, the AMC of the fund of funds proceeds by a **non-binding integration** approach. An ESG approach that is considered mediocre or non-existent will generally not be a sufficient condition to rule out investing. However, it could be the starting point for a dialogue designed to assist the fund manager in improving his practices. The approach is therefore very similar to that of direct investments.

3.1.3.7. Overall view of AMCs' ESG frameworks

As noted throughout this section, the consideration of non-financial characteristics in the investigation of target companies implies resources and expertise (establishment of a dedicated ESG questionnaire adapted to each sector, collection and analysis of information, organisation of interviews, dissemination to fund managers and awareness raising, etc.). The AMF thus notes two main types of ESG frameworks in the AMCs:
- The largest or specialised asset management companies which establish a system such as that described above;
- Asset management companies, often of modest size, which do not study non-financial issues as such and which will sporadically analyse non-financial issues as a potential risk liable to impair the value of a company.

3.1.4. CONCLUSION

As shown throughout this section, the observed ESG framework of private equity funds, apart from thematic funds not covered by the investigations,[37] consists mainly of:
- an investment policy based on (i) sector or normative exclusions, according to conditions which may vary from one AMC to another and which in practice result in an expert qualitative approach, and (ii) an integration approach focused on dialogue and awareness raising for companies' management body throughout the life cycle of the investment (due diligence, monitoring, disposal);
- a policy of engagement by placing non-financial issues on the agenda with the equity stakes and where appropriate by putting in place improvement targets, whether quantified or not. However, notably because of the very low liquidity of the assets, a failure to achieve the targets entails no binding consequences for the fund's management in most of the cases reviewed.

As opposed to the responsible investment policies developed by funds comprising issuers of listed securities which consist in the selection, within an investment universe, of the companies that are most committed or best rated with regard to environmental, social and governance practices, the approach of AMCs in retail private equity is focused on supporting each equity stake and its managers and raising their awareness of non-financial issues.

[36] Also via a regular questionnaire or a data collection platform (case noted for one AMC, this type of tool can facilitate data collection) intended for managers of the target funds and underlying equity stakes.
[37] Funds intended mainly for professionals invested in infrastructure or thematic entities (e.g. specialised companies or projects dedicated to renewable energies).

Accordingly, apart from the thematic or infrastructure approaches (possibly labelled Greenfin in the environmental area), which are in practice still at present marketed mostly to professional clients, most of the ESG investment policies of the private equity funds reviewed **are not considered as approaches based on significant engagement in asset management at this stage within the meaning of AMF Position-Recommendation 2020-03.** This observation, moreover, is consistent with the AMF's observations, which show that the regulatory and commercial documents of the funds reviewed within the framework of this study do not excessively stress the consideration of non-financial criteria. However, some private equity firms develop **engaged ESG policies both at their own level and with respect to their equity stakes, in particular during the holding phase**. Their ability to upgrade and transform their equity stakes can therefore, if they allocate the requisite resources, significantly influence companies in a sustainable development policy. This is the case, in particular, of certain impact investing funds, a private equity segment that is expanding rapidly, generally dedicated to a clientele of professional investors (cf. 2.3.1).

Although most of these CIUs do not make their non-financial approach a central feature of their reports, the AMF reiterates that **AMF Position-Recommendation 2020-03** applies to these funds.

Ideas for work by market participants and the marketplace

In the context of growing interest among market participants in the issues involved in taking extra-financial characteristics into account, the AMF encourages managers of private equity funds for non-professional clients to develop approaches that provide objective and formalised evidence of the materiality and commitment of their extra-financial approaches, in accordance with the provisions of Position-Recommendation 2020-03. To this end, these players could take advantage of their specificities, and in particular their detailed knowledge of the companies invested and the influence they can exercise.

Lastly, the AMF emphasises that the frameworks established by the asset management companies such as those described above are not always described exhaustively in the "Article 173" information, which means the investor cannot always evaluate all the efforts deployed by the AMCs. Progress could be made in this area.

3.2. REAL ESTATE FUNDS

3.2.1. CONTEXT

Asset management companies specialised in the management of real estate CIUs do not escape the growing trend to take non-financial factors into consideration in their investment process. For example, an increasing number of asset management companies state that they use metrics translating the non-financial performance of a real estate asset to define its potential return. The energy efficiency of a building, its water consumption, or again its ability to offer comfort for the tenants are all factors contributing to the future profitability of a real estate asset.

This section therefore highlights the specific features of the French market for real estate CIU management regarding the issue of consideration of non-financial criteria.

By real estate CIUs are meant investment vehicles intended for retail clients, including real estate investment companies (SCPIs) and real estate collective investment undertakings (OPCIs) as well as "other AIFs".

For all useful purposes, remember that real estate CIUs intended for a clientele of retail investors and "other AIFs" come within the scope of AMF Position-Recommendation 2020-03.

3.2.2. THE FRENCH MARKET FOR MANAGEMENT OF REAL ESTATE AIFS

In November 2020, the AMF identified 135 asset management companies authorised to manage real estate assets, i.e. nearly 20% of French asset management companies authorised by the AMF for cumulative assets under management of around €70bn in SCPIs and OPCIs at end-2019.

The management of real estate CIUs brings together around AMCs the traditional actors of the real estate market (developers, solicitors, design offices, surveyors, architects, etc.). Accordingly, around the asset management company in charge of structuring and management of the portfolio of real estate assets built up in each of its CIUs, various stakeholders contribute to the orderly functioning of a system which the asset management company is in charge of on behalf of its investors. The property manager, for example, is responsible for day-to-day management of the real estate asset for its occupants and the facility manager takes care of building maintenance. All these service providers, to whom should be added real estate experts performing appraisal and valuation of real estate assets on behalf of the CIUs, contribute to the viability of this industry. These various service providers play a key role in the collection of non-financial data on real estate assets.

3.2.3. SPECIFICITY OF THE MARKET REGARDING CONSIDERATION OF NON-FINANCIAL CRITERIA

Real estate assets are regulated by a large number of standards, labels and certifications relating notably to environmental criteria and, to a lesser extent, social and governance criteria, mainly concerning new housing. However, most of the existing property stock still consists of old buildings which are not in line with these requirements. The non-financial qualities of new and existing real estate assets are therefore very diverse. In this context, a selection of the assets scoring best from a non-financial viewpoint, as is practised for SRI funds managing transferable securities, would have as a consequence the selection of only new real estate assets benefiting from the most recent standards and certifications. Such a selection would therefore redirect capital to buildings that are already efficient, whereas one of the major challenges identified by the sector, notably in relation to the energy transition, is an **improvement in the non-financial characteristics of existing buildings**.

Now, within the framework of their property management, asset management companies are capable, in particular, of performing renovation work to improve buildings' energy efficiency.[38] Thus, the AMF observes that

[38] Hence, the ASPIM proposes, via its charter, a list of good practices to be adapted to the asset management company's objective, aimed at selecting assets "for improvement", which will contribute to efforts to reduce the energy footprint of existing property stock.

real estate asset management companies have developed a specific type of approach known as *Best-in-progress*, which is capable of translating an asset improvement target from the non-financial viewpoint. This approach is thus opposed to the *Best-in-class* approach conventionally used in security investment management, which appears marginal in the field of real estate[39] (mainly the selection of new buildings…).

The environmental issue thus appears predominant for real estate funds including responsible investment characteristics. This mainly focuses on the energy efficiency of the assets or their greenhouse gas emissions resulting from their energy consumption (e.g. via the "**DPE**" energy efficiency diagnostic established in regulated conditions)[40] and their consumption of other resources (water consumption, waste treatment, etc.).

It is nevertheless followed by social and societal considerations (comfort, health and safety, revitalisation of city centres, etc.), which are increasingly taken into consideration by asset management companies in the sector. For example, the revitalisation of city centres seems to be a tangible lever for real estate investors, in order to make a positive contribution to the social issue of sustainable development. This approach also fits in with the state City Centre Action Programme[41] which aims to encourage real estate firms to invest in the city centres of medium-sized urban areas. However, the assessment and objective measurement of the social impact of a real estate investment in shops, restaurants, housing, cultural centres, etc. may prove complex. Finally, the governance issue remains the least obvious to grasp for asset management companies, which incorporate it through control of the ESG policy of the property service providers or else in some cases via their own CSR performance. The establishment of a CSR policy is a necessary prerequisite for good governance of a real estate asset by an AMC. However, the AMC's CSR performance could not be considered as the sole criterion for analysing the good governance of a real estate asset. Moreover, the consideration of this criterion poses a problem of conflict of interest, with the AMC being both judge and jury regarding the satisfactory governance of the property. Accordingly, it seems more objective to perform a non-financial analysis concerning the asset and its stakeholders (third parties participating in management of the CIU's assets) rather than the AMC itself.

Poor practice 1: Applicable to real estate funds

The AMF considers as poor practice the fact of presenting the CSR performance of an asset management company as one of the sole criteria of "good" governance of a real estate asset, unless this criterion is examined by a third-party organisation independently.

3.2.4. ORGANISATION OF ASSET MANAGEMENT COMPANIES FOR CONSIDERATION OF THE NON-FINANCIAL CHARACTERISTICS OF THEIR REAL ESTATE ASSETS

For the development of joint standards for the consideration of non-financial characteristics in the management of real estate CIUs, several marketplace initiatives have been launched. In 2016, for example, the members of the ASPIM adopted a responsible investment charter sharing principles and criteria which can be referred to by asset management companies whose ambition is to manage one or more funds "in accordance with an SRI policy".

Also, the Sustainable Real Estate Observatory (OID) is an independent non-profit organisation bringing together private and public firms in the real estate sector.[42] The OID's objective is to disseminate best practices regarding sustainable real estate by, for example, publishing barometers or guidelines. The OID also develops collaborative tools designed for real estate professionals, including, in particular, a platform for the collection of energy efficiency data on real estate assets.

[39] In this case it takes the form of the selection of buildings having the highest environmental or social properties.

[40] The DPE must be established for the construction of new buildings since 30 June 2007 (date of the building permit), for their sale since 1 September 2006, in the case of letting since 1 July 2007, and in real estate advertisements since 1 January 2011. See the website of the Ministry for the Ecological and Solidarity Transition

[41] Through this plan, the government will spend €5bn over five years to improve the living conditions of the inhabitants of medium-sized cities and consolidate these cities' role as a driving force for regional development.

[42] Including asset management companies, property companies, institutional insurers, industrial groups, service providers and public partners.

In parallel to these marketplace initiatives, several of the largest asset management companies in terms of assets under management commit themselves individually through the publication of charters listing "sustainability" targets such as the reduction of greenhouse gas (GHG) emissions, climate risk management, the "responsible" engagement of the stakeholders or the health and safety of tenants.

As part of this work concerning the consideration of non-financial characteristics by asset management companies specialised in real estate, the AMF has inventoried the resources devoted by asset management companies. This study covering a restricted scope of five of the largest firms in the sector and those most active on non-financial issues does not reflect the general approach adopted by all the asset management companies.

From the organisational viewpoint, the asset management companies put in place teams of two or three people in charge of organising the responsible investment policy and of non-financial analysis of the asset management company's real estate assets. Some of the asset management companies in the sample are developing proprietary tools for ESG analysis and rating. One AMC we met with, for example, has developed a specific audit tool making it possible to assign an ESG score to all the assets in its portfolios.

Moreover, data collection sometimes proves difficult, especially when it concerns tenants' consumption data (confidentiality, accessibility, reliability, etc.). As a result, it is often delegated to service providers such as technical assessors and property managers, notably by sending questionnaires. Other asset management companies state that they rely on a single service provider in charge of the non-financial analysis of real estate assets. The AMF notes that this use of service providers is becoming widespread for monitoring, data reporting (energy data in particular), energy audits and sometimes strategic support in the definition of non-financial criteria.

Recommendation 1: Applicable to real estate funds

When non-financial metrics (e.g., energy consumption, water consumption, greenhouse gas emissions, etc.) are incorporated in the fund's management objective or are the subject of commitments by the AMC concerning their improvement, their reliability is critical to ensure the clear, accurate and non-misleading nature of the information provided to investors. As a consequence, when the AMCs use service providers, the AMF recommends that they perform sampling inspections on the data provided by the service providers (e.g. once a year), the results of which could be taken into consideration at the time of their renewal. These inspections could take place within the framework of the AMC's more general inspection process and be adapted according to the nature of the various sources of data and the various levels of risk involved.

From an operational viewpoint, for their funds in a best-in-progress or best-in-class approach, the AMF noted from its discussions with the firms that the AMCs adopt an ESG analysis approach consisting, in most observed cases, of performing a pre-acquisition audit on buildings. A map of their total existing property stock may also be produced after each acquisition and/or regularly. With regard to new buildings already having good environmental and potentially social characteristics, which make them eligible for strategies of the best-in-class type, the AMCs must make sure to maintain these good characteristics. They also identify areas for improvement on existing real estate within the framework of their best-in-progress approach.

3.2.5. ASSET MANAGEMENT COMPANIES' OFFER REGARDING CONSIDERATION OF NON-FINANCIAL ISSUES

3.2.5.1. ESG integration strategy

Despite a shared desire to fit in with an improvement approach for most asset management companies, the AMF noted that the responsible investment strategies and policies of real estate firms remain very diverse.

For example, although these CIUs report on the consideration of non-financial criteria in their management, this **usually takes the form of a policy of non-binding and non-significant integration** for the fund management in that it does not generally oblige the fund managers to exclude all or part of real estate assets having the least satisfactory non-financial characteristics or, for example, to make improvements to the non-financial qualities of all or part of them.

And yet, **the AMF notes that several AMCs promote non-binding approaches in the KID/KIID and commercial documentation of the SCPIs and OPCIs that they manage**. In accordance with Position No. 2 mentioned in Position-Recommendation 2020-03, given the integration approach adopted, such a presentation could be considered as **disproportionate** in relation to the non-financial framework established.

This integration approach is itself variable. Some firms produce a map of each of their assets with the help of technical assessors in charge of gathering the necessary information to establish the non-financial description of the building (main emission items, carbon balance, etc.). Others take non-financial criteria into consideration only on part of their assets under management without a specific objective and without this being specified in their various documentation mentioning the consideration of these non-financial criteria.

3.2.5.2. Other main strategies for consideration of non-financial criteria within the framework of management of real estate CIUs

The approach most frequently used for binding and significant consideration of non-financial criteria is the best-in-progress approach reflecting a policy of improvement of the assets in the portfolio.

This is performed by the firms in various ways and covers various levels of ambition:

- Certain real estate funds may define quantitative targets for improvement of non-financial performance *ex ante* **on each real estate asset** (e.g. quantified reduction in the consumption of reference primary energy and/or water consumption);
- Other funds may define objectives for energy efficiency approaches or respect for tenants in the form of quantified targets for achievement of DPE scores and respect for tenants **on the scale** of the portfolio (method developed internally by the AMCs).

These approaches are therefore based on the definition of quantifiable indicators and a time frame. However, on the basis of the sample of funds that it examined, the AMF noted no CIU which:

- expresses quantified objectives in its regulatory documents. These objectives are in practice set out in ad hoc documents, which is contrary to Position No. 4 of Position-Recommendation 2020-03 which states that only clarifications of information already present in the legal documentation can be made in the commercial documentation in order to comply with the clear, accurate and non-misleading nature of the information;
- presents comparisons or illustrations making it possible to assess the significance of the objectives set. It is therefore difficult to assess the significance of the approach adopted by AMCs, which limits the assessment of this criterion mentioned in Position No. 2 of Position–Recommendation 2020-03.

Moreover, to ensure that the information provided is clear, accurate and not misleading, the AMF issues a recommendation.

Recommendation 2: Applicable to real estate funds

For funds developing a best-in-progress approach, the AMF recommends that a presentation of improvement objectives (quantified or objective) within a defined time frame be produced and monitored by the AMC via:

- an annual review of progress on the announced objectives;
- an explanation by the AMC of the achievement of the announced objective or not at the end of the predefined time frame.

If the objective were not achieved, it is recommended that the AMC explain the failure to achieve said objective. This annual review and the associated explanations concerning achievement of the set objectives or not may be disclosed to investors in a fund report (annual report, ESG report or other).

The best-in-class approach is generally used for thematic real estate funds. Accordingly, holdings of new real estate assets meeting the most recent environmental standards correspond to a significant proportion of the assets held by CIUs adopting this strategy. These are usually new property complying with current standards (e.g. low-energy housing label ("*Bâtiment Basse Consommation*"). Maintaining good non-financial performance of the assets in the portfolio is also one of the challenges for AMCs developing this approach. Lastly, depending on the type of real estate asset, these two approaches may be deployed in a single portfolio.

Conversely, a growing number of asset management companies specialised in real estate are developing a thematic offer by focusing in particular on assets in the healthcare sector or elderly care homes. However, these thematic investment products cannot be considered as developing a thematic approach having responsible investment characteristics insofar as, based solely on their investment universe, they embody no promise or commitment with regard to improvement or selection of the best assets in relation to environmental, social and governance issues. The AMF therefore calls for vigilance on the part of asset management companies to avoid any highlighting of non-financial characteristics of their thematic real estate funds which, apart from the selection of assets related to a sector (old people's homes, hospital or educational centres, student accommodation, etc.) provide investors with no guarantee concerning the consideration of non-financial criteria within the framework of management of these funds.

Poor practice 2: Applicable to real estate funds

The AMF considers it a poor practice to highlight non-financial characteristics in the management of a CIU which cannot provide evidence of a binding and significant consideration of environmental, social and/or governance criteria. It therefore invites firms whose approach consists merely in selecting thematic real estate assets related to a sector which intrinsically has no non-financial characteristics to restrict their communication to the mere selection of assets related to that sector or sub-sector without promoting non-financial criteria (e.g. related to health or educational aspects).

Moreover, one of the difficulties involved in the establishment of binding and significant approaches at present is the absence of guidelines regarding significance, because the quantified objectives may be variable and based on diverse market references.

In France at present, for example, no real estate fund has obtained the Greenfin label attesting consideration of non-financial factors in its management.[43] In order to promote and lend credibility to the measures undertaken by asset management companies in this area, the most advanced firms are currently working on the production of a label adapted to real estate which would take into consideration the specific features of this market and make it possible, in particular, to lay down an initial shared market guideline concerning the definition of what is a binding and significant approach for a real estate fund.

3.2.6. CONCLUSION

By developing a so-called *best-in-progress* approach, asset management companies specialised in real estate fund management wanted to reflect the specific features of this asset class. Since improvement of the environmental characteristics of the existing property stock is the main aspect by which asset management companies can act in favour of building energy efficiency, social and governance criteria appear to be used less by companies developing these products. Regarding this, although the development of thematic products focused on environmental issues

[43] Contrary to the SRI label, in France the GreenFin (formerly TEEC) label allows OPCIs and SCPIs to become labelled. The specific factors allowing labelling of these two types of funds are as follows:
- For SCPIs, the fund must invest at least 90% of its assets under management in green real estate defined by Appendix 1 to the label's reference document, comprising in particular buildings certified or labelled according to a certification process for new buildings, renovation and building operation. The remaining 10% must be invested in other bonds or other debt securities provided that they do not concern excluded activities;
- For SCPIs, green real estate must represent 60% of the fund's assets.

constitutes a positive dynamic, these products should not be assimilated to "SRI" products involving simultaneous consideration of the environmental, social and governance pillars.

Since the variety of approaches could create confusion for investors regarding a sector that is expanding rapidly, the AMF insists on the need to keep a sense of proportion in the information provided to investors concerning the approach implemented, according to its more or less binding nature with regard to asset selection and management, and issues recommendations for certain approaches (best-in-progress, thematic approaches).

Just like for listed asset managers, the AMF also identifies the important role of service providers in the provision of non-financial information on real estate assets. Hence, it recommends monitoring of said providers which goes beyond the due diligence performed for the monitoring and selection of traditional service providers selected by the AMCs. This monitoring may go hand-in-hand with the appending of a "Supplier ESG" charter to contracts signed with service providers specialised in this field.

3.3. MONEY MARKET FUNDS

Money market funds represented €336bn in assets under management as at 31 December 2018, distributed among 245 funds. Of these funds, 37 were identified as claiming "SRI" characteristics,[44] for €56bn in AUM, i.e. about 16% of the total in money market funds (including six SRI-labelled funds for €4.5bn in AUM). Although money market funds taking non-financial criteria into consideration in their investment policy are not very numerous,[45] they represent around one-third of the AUM of SRI funds, in other words they are the leading "SRI" asset class by AUM according to figures published by the AFG in 2018, and the No. 2 class in 2019.[46]

The AMF therefore wanted to examine the functioning of these funds. A review of the regulatory documents was performed, describing in detail the methodology applied, and supplemented by additional discussions with certain firms. A summary of this work is presented in part one. Secondly, the AMF endeavoured to assess the characteristic distinguishing these funds from other money market funds by conducting a quantitative study of the portfolios based on the data collected by Banque de France on CIUs, as at 31 December 2018.

This analysis is based mainly on a description of marketplace methods and portfolio data aggregates. **However, this analysis is not conclusive regarding the explanations for the observations presented below.** Moreover, such a study was not conducted on other asset classes and it is therefore not possible to conclude regarding the specific features of the money market.

3.3.1. METHODOLOGY OF MONEY MARKET FUNDS PRESENTING THEMSELVES AS SRI FUNDS

The documentation relating to seven money market funds presenting themselves as SRI funds was analysed by the AMF (KIID, prospectus, annual report, Transparency Code, "Article 173" information, monthly factsheets). A summary is presented of the observed approaches.

3.3.1.1. General approach of AMCs

All the AMCs managing these funds have adhered, directly or at the level of their parent Group, to the United Nations Principles for Responsible Investment.[47] Some AMCs may adhere to other types of charter (Diversity, Parenthood, etc.) or take part in other initiatives (CDP, etc.).

3.3.1.2. Investment policy

It is specified that this section presents a summary of the approaches noted for seven funds, and is therefore not representative of all marketplace practices.

All the funds studied adopt a sequenced approach. In the first stage, issuers not complying with the policy of the AMC or the fund in particular (especially in the case of dedicated funds, for which the investor exclusion policy is adopted) are excluded from the investment universe. In the second stage, the remaining issuers are selected according to their non-financial performance ("SRI filter"), measured by an ESG score. This selection may take two forms: on the one hand, in general, by an exclusion of a fraction of the investment universe having the lowest score, and on the other hand, for a fund, by constraints limiting the size of investments in the issuers having the

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[44] These funds were identified due to their SRI labelling, their name containing the terms "ISR", "SRI", "Responsible" or "Sustainable", or due to their presence on the list of signatory funds to the SRI Transparency Code presented by the AFG, together with a verification of highlighting of the "SRI" aspect in the prospectus.

[45] The figure of 37 funds can therefore be compared with the 500 or so funds mentioned by Novethic and presented in section 2.2.1 (less than 8% of funds).

[46] The divergences between the figures (€55bn in AUM versus about €51bn by reconstituting the figures of the AFG detailed in section 2) are due to the fact that the AFG statistics are produced based on the AMCs' reports whereas the AMF's approach was to identify SRI funds by various aspects including their labelling and their name.

[47] The PRI are six voluntary commitments launched by the United Nations in 2006, by which investors undertake to take ESG aspects into consideration in their decision-making process with regard to investment, shareholder dialogue, incentivising issuers to provide greater transparency, dissemination and partnership around PRIs, and reporting on the measures adopted. A transparency questionnaire is accordingly demanded of the signatories each year, and is partially available on the website of the UNPRI.

lowest scores. The present section first describes in detail the implementation of exclusion policies, and secondly implementation of the "SRI filter".

3.3.1.2.1. First stage: exclusion policy

Most funds implement an **exclusion** approach concerning matters of principle (non-cooperative tax jurisdictions, issuers producing cluster bombs or anti-personnel mines) or sector issues (coal). These exclusions are similar to those mentioned in section 2 of AMF Position-Recommendation 2020-03. Like what is indicated in that section, the differentiating aspect of these factors is in principle **not significant**, either because these exclusions are legally applicable by all, even though not all the firms have considered it necessary to report on this (Oslo and Ottawa conventions), or because certain exclusions in practice concern a very restricted universe (e.g. non-cooperative tax jurisdictions)[48].

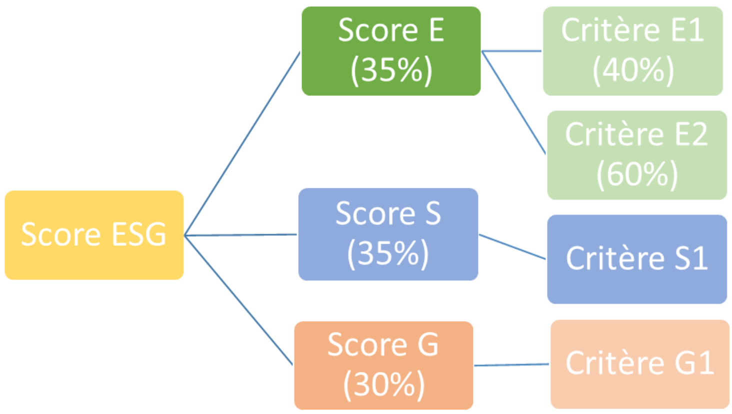
3.3.1.2.2. Second stage: "SRI filter"

Of the seven funds analysed, six stress the implementation of a best-in-class approach (cf. description below). One of the funds states in its prospectus that, in addition to executing a "conventional" ESG filter, it adds an issuer analysis approach according to procedures which are, however, not described in detail in the prospectus and which are in any case discretionary. The last fund presents an approach identified as *best-in-universe*. However, this approach is based on sector scores, which means this fund’s functioning is in practice very similar to "best-in-class".

- Principle of an ESG score

For all the funds, implementation of the "SRI filter" involves the use of an "ESG score". Most of the AMCs which manage these funds calculate this score according to an in-house methodology, based on metrics and data provided by service providers. An AMC relies directly on the scores provided by a service provider.

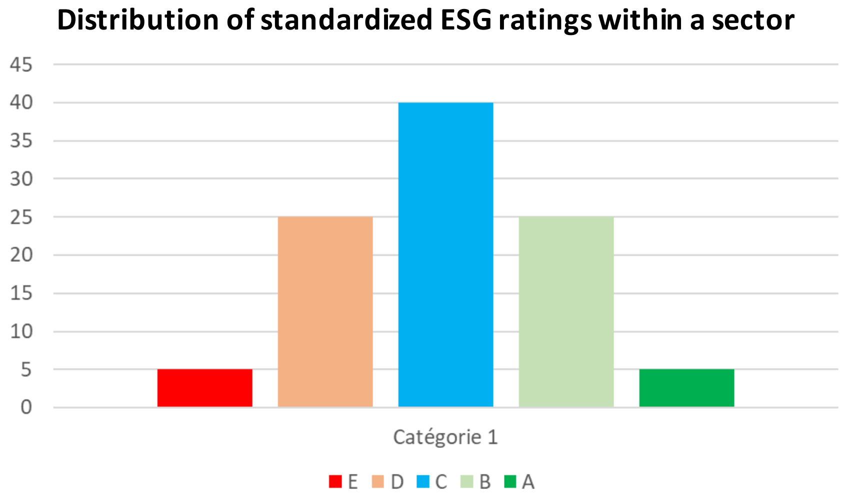
The ESG scores are calculated taking into consideration various E, S and G criteria for which each issuer, based on selected indicators for each criterion, is assigned a score[49]. These scores are then aggregated by weighting in the various E, S and G pillars, and then at the overall ESG level to obtain the final score, as presented in the following simplified example:



Source: AMF theoretical example

[48] The official ministerial decision of 12 February 2010, adopted pursuant to Article 238-0 A of the French General Tax Code, indicates, in its latest version dated January 2020, a list of thirteen states and territories: Anguilla, Bahamas, British Virgin Islands, Panama, Seychelles, Vanuatu, Fiji, Guam, US Virgin Islands, Oman, American Samoa, Samoa and Trinidad and Tobago.
[49] For example: the rate of absenteeism noted in a company to measure well-being at work, a criterion assigned to the "Social" pillar.

A score is then assigned in relative manner within a sector, e.g. by awarding scores from 1 (best) to 10 (worst), according to the uniformly distributed scores: 10% of the firms having the best ESG scores in this sector will be scored 1, the following 10% will be scored 2, etc. Another approach is to aim at a normalised (Gaussian) distribution of scores: for example in scoring from A to E, 5% of the issuers in a sector will be scored A, 25% will be scored B, 40% scored C, 25% scored D and 5% scored E, as shown in the following graph:



Source: AMF, fictitious example.

Compared with a uniform approach, this distribution makes it possible to focus on the best and worst issuers in a sector.

Several AMCs also provide for the possibility of adjusting the quantitative score, obtained mechanically, by a qualitative assessment of the ESG appraiser (e.g. assignment of a merit rating (bonus-malus) of +/-30% to a score of 0 to 100 on criteria considered material but not taken into account by the quantitative score), or else in a discretionary manner (decision of an ESG investment committee to reinstate an excluded stock). In the examples observed, all these operations are expressed formally and traced.

Accordingly, no "absolute" scoring approach (based, for example, on the distance of the issuers compared with an ideal situation relating, for example, to a level of greenhouse gas emissions, an absenteeism rate, a maximum wage gap in a company, etc.) was noted. Although the relative approach reduces the interpretability of the scores, it may be noted that an "absolute" approach, applied to an overall ESG score, would also be hard to interpret in the presence of very diverse issues (environmental, social and governance) to be aggregated into a single indicator.

Moreover, it should be noted that the sector definition is **not necessarily uniform from one actor to another** and may be adapted with a view to building homogeneous sectors in terms of non-financial issues but also of appropriate granularity notably with respect to the investment universe of the fund in question. Accordingly, a given company could be analysed in different sectors depending on the actor. Moreover, companies having diverse activities could, depending on the actor, either undergo allocation to a single sector according to its largest business, or be analysed by an ad hoc assessment methodology by distinguishing, for example, between its various business lines across several sectors to ultimately obtain an aggregate score.

- ESG criteria taken into consideration

Based on the information disclosed to investors, the AMF was unable to make an exhaustive comparison of ESG methodologies: their functioning is described with an uneven level of detail, and in any case it is not exhaustive (cf. 1.1.3).

Regarding the general information collected, the AMF notes that in general the AMCs take into consideration a set of themes common to all issuers. For example, the themes commonly mentioned are the climate (Environment pillar), safety or well-being at work (Social pillar) and managers' pay or the independence of the board of directors (Governance pillar). Moreover, criteria specific to each of the sectors are taken into consideration according to their relevance (e.g. more stringent governance criteria for the banking sector, or safety for industry). The total number of criteria taken into consideration may therefore vary significantly (between about ten and one hundred according to the AMF's observations). The impact of a single criterion (e.g. the combat against global warming) is thus potentially **diluted**, while the approaches from one AMC to another may result in potentially **variable** scores for the same issuer, depending on the aggregation and normalisation criteria, indicators and rules chosen. These results, at the level of the asset management companies, are also found at the level of the non-financial rating agencies, since the scores obtained by a company may vary significantly from one non-financial rating agency to another.

- Selection of issuers

The main approach noted for consideration of scores in the investment process is to **exclude a percentage of issuers** ("best-in-class" approach), e.g. 20% of 30% of the worst issuers (which would correspond to scores 9 and 10 respectively in the uniform example, or to scores D and E in the Gaussian example presented above). One actor adopts a different approach: it makes no exclusion, but limits the consideration of poor-scoring assets from an ESG standpoint to 10% of the net assets and imposes an overall average score for the portfolio (issuers' scores weighted by investments) greater than or equal to 2 on a scale from 0 to 4.

Finally, for several funds (three out of seven), it is specified that all the assets are not necessarily covered by the ESG rating, although with a stated minimum of 90%, consistent with the requirement of the French SRI label, even though none of the funds examined was labelled. As is permitted by the SRI label, however, the coverage rate is expressed on different assessment bases: as a percentage of the net assets for some, and as a percentage of the issuers in the portfolio for others.

3.3.1.3. Conclusion regarding the qualitative study

Although they have specific features in their investment policies and universes, the consideration of ESG criteria in the investment policy of the SRI money market funds reviewed takes place according to the customary processes deployed in SRI funds belonging to the other classifications.

However, despite an apparent methodological convergence, several factors of variability should be noted from one AMC to another, which may account for an intrinsic variability of the results of application of non-financial filters from one AMC to another: the variety of approaches (best-in-class vs best-in-universe when this is based on scores presenting sector biases), exclusion thresholds, divergence of the scoring methodologies (choices of criteria, of the associated metrics, of the weighting of each criteria and of each pillar…), divergence of data providers, divergence of sector exclusion policies, etc.

Regarding scoring methodologies in particular, an analysis of the information disclosed to investors illustrates the fact that, since ESG methodologies are considered as strategic in-house tools, their **degree of transparency** is variable from one AMC to another, and does not make it possible, in any of the seven cases considered, to obtain complete visibility of the methodology (indicators, scoring procedures, weightings, etc.). Moreover, in this type of approach taking several pillars into consideration simultaneously, it seems hard to imagine associating the investment process resulting from the application of the ESG filter to the achievement of precise objectives (such as, for example, the contribution to the energy transition, or the achievement of sustainable development objectives) as some funds may sometimes be tempted to do in their corporate communications.

3.3.2. ANALYSIS OF THE PORTFOLIOS OF SRI MONEY MARKET FUNDS

The qualitative study highlighted the difficult *ex ante* comparability of the SRI approaches of the main money market funds examined. On the basis of the line-by-line reporting of CIUs collected by Banque de France, the AMF made a comparative analysis of the portfolios of money market funds presenting themselves as "SRI" by comparison with others, with a view to assessing whether the SRI nature of the portfolios materialised in differences in the investment universes or portfolio weightings.

To do so, a database was formed covering the portfolio of 245 money market funds (including 36 identified as calling themselves SRI),[50] documenting:

- the ISIN code of the securities in the portfolio;
- the amount that they represented in the portfolio of each fund;
- the issuer group and the sector of activity to which that ISIN code is attached;
- the SRI nature or not of the fund holding the line.

An analysis was performed, on sectors of activity on the one hand and on issuer groups on the other hand, in order to assess the various types of funds.

This work of database building required several adjustment operations which all constitute limits to the significance of this study.[51]

[50] By comparison with the qualitative study carried out above, the data of an SRI fund were not available in the Banque de France database.
[51] To compile the data used as a basis for this study, the AMF used an excerpt from the "CIU collection", which inventories the portfolios of French CIUs line-by-line each month. The portfolios of 245 money market funds as at 31/12/2018 were analysed in this way. The ISIN codes relate to the securities themselves, and their assignment to issuers, issuer groups and sectors of activity required mapping work by the AMF.

3.3.2.1. Sector analysis

For each sub-group ("SRI" fund, other money market funds), the distribution of the proportions of assets invested by each fund in each sector of activity was calculated. Sectors of activity were determined by carrying over and adapting the widely used ICB classification (*Industry Classification Benchmark*). Funds of funds[52] were eliminated, reducing the sample to 134 funds, including 24 identified as SRI. Investments in other funds were also eliminated.[53] Note that each fund **was equally weighted**, given the diversity of sizes of money market funds (from €150m in assets under management to more than €40bn), in order to ensure the representativeness of all the strategies.

	Equal-weighted average of sector holding by MMF				
Sector	**SRI**	**Non-SRI**	***Difference in sector holdings observed between SRI and non-SRI funds***	***Standard deviation of the % of holdings in non-SRI MMFs[54]***	**All**
83 Banks	42.2%	43.7%	*-1.5%*	*20.9%*	43.4%
99 Public	10.5%	16.2%	*-5.7%*	*24.8%*	15.2%
33 Automobiles	6.5%	8.2%	*-1.7%*	*5.4%*	7.9%
50 Consumer Services	6.8%	6.6%	*0.2%*	*5.1%*	6.6%
20 Industrials	7.0%	5.8%	*1.2%*	*4.8%*	6.0%
86 Real Estate	6.5%	4.3%	*2.2%*	*1.9%*	4.7%
70 Utilities	5.2%	4.0%	*1.3%*	*3.8%*	4.2%
87 Financial Services	3.5%	1.9%	*1.6%*	*2.3%*	2.2%
60 Telecommunications	2.5%	1.9%	*0.6%*	*16.6%*	2.0%
85 Insurance	2.0%	1.9%	*0.1%*	*1.3%*	1.9%
30 Other Consum. goods	1.1%	1.8%	*-0.7%*	*2.8%*	1.7%
90 Technology	2.7%	1.2%	*1.5%*	*5.5%*	1.5%
10 Basic Materials	1.4%	1.0%	*0.4%*	*2.8%*	1.1%
40 Health Care	1.3%	0.7%	*0.6%*	*1.6%*	0.8%
00 Oil & Gas	0.7%	0.8%	*0.0%*	*1.4%*	0.8%

Source: AMF

Overall, therefore, slight sector disparities are observed between funds presenting themselves as SRI and the others. In all cases except one (real estate sector), it can be seen that the difference between funds presenting themselves as "SRI" and the others is far less than the standard deviation of the distribution of sector weightings on the latter. This standard deviation approach nevertheless remains **perfectible** given the lack of symmetry of the empirical distributions. **This observation is consistent with a best-in-class approach adopted by all the funds and which means that no sector is ignored**.

However, some differences can be noted. For example, while in general money market funds invest a large proportion of their portfolio in the banking sector (around 40%), the investment in public issuers is greater for non-SRI funds (16% versus 10% for funds presenting themselves as SRI funds). This could be explained in particular by the fact that the SRI nature of a public issuer is more complex to analyse than that of a company. Moreover, financing of the automotive sector appears lower for funds presenting themselves as SRI (slightly more than 6%

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52 Defined in the framework of this study as funds investing more than 50% of their assets in other funds.

53 Moreover, as described in detail in appendix, two "technical" sectors (for lines which were unable to be assigned to a sector of activity and for derivatives) were formed, and the proportions were therefore assessed ignoring these sectors.

54 For example, the average holding of industrial securities by MMF funds not identified as SRI is 5.8%, with a standard deviation of 4.8%. The observed deviation from the average investment in MMF funds identified as SRI (average investment of 7%, i.e. a 1.2% deviation) can therefore be seen as relatively insignificant.

versus 8% for the others), whereas one notes a slight over-investment in the utilities sector (5.2% versus 4%). Whatever the type of fund, the Oil & Gas sector represents only a small proportion of the assets of money market funds (less than 1%).

A variability analysis by a study of quantiles was also carried out to supplement this assessment based on a "mean" and to assess whether certain funds, SRI or not, might be invested in certain sectors more massively than their peers. This analysis is presented in an appendix. The analysis confirms the absence of a material sector deviation.

3.3.2.2. Analysis by issuer group

Money market funds' investments were allocated to more than 400 different issuers.[55] Several analyses were performed to assess the presence or absence of significant differences between SRI and non-SRI funds:

- An analysis regarding the amounts of investments made by each issuer in the sectors considered relevant (Bank, Automobile, and Oil & Gas sectors) in order to compare the amounts of investments in the various issuers by SRI and non-SRI funds;
- An analysis based on exclusion approaches: two tests were performed, one to identify issuers frequently invested in by non-SRI funds but not by SRI funds; and the other to compare the portfolios of funds presenting themselves as SRI, with an example of public exclusion policy, using that published by the Norwegian sovereign fund;
- Portfolio comparisons between funds of a given AMC (SRI fund on the one hand and non-SRI on the other hand) in order to assess the proportion of assets common to both of them.

The figures in this section **are not directly comparable** with those of the previous section, because for this study the weights of the equity stakes in the issuers were **not** amplified by eliminating equity stakes in funds, in contrast with the previous study.

[55] Issuers considered by consolidated accounting groups.

3.3.2.3. Sector analyses

3.3.2.3.1. Analysis of the banking sector

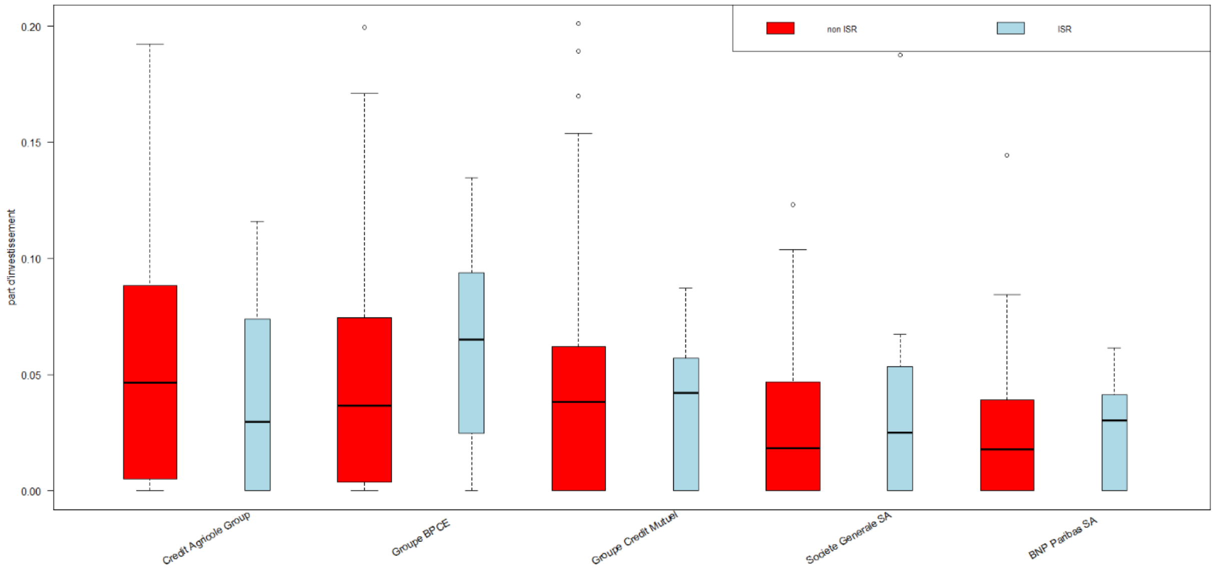
In this sector, the AMF selected the 15 leading bank groups invested in by funds overall. These 15 groups account for 48% of the total weight of the portfolio securities examined and 84% of the banking sector as a whole. For each issuer group, the average investment (equally weighted by fund) is reconstructed:

	Equal-weighted average of holding by MMF				
Sector	**SRI**	**Non-SRI**	***Difference in group holdings observed between SRI and non-SRI funds***	***Standard deviation of the percentage of holdings in non-SRI MMFs***	**All**
01 Credit Agricole Group	4.0%	5.4%	*-1.4%*	*4.9%*	5.2%
02 Groupe BPCE	6.1%	4.8%	*1.3%*	*4.6%*	5.0%
03 Groupe Credit Mutuel	3.6%	4.2%	*-0.7%*	*4.2%*	4.1%
04 Societe Generale SA	3.2%	2.7%	*0.5%*	*3.0%*	2.8%
05 BNP Paribas SA	2.3%	2.2%	*0.1%*	*2.4%*	2.2%
06 Intesa Sanpaolo SpA	2.2%	1.6%	*0.6%*	*2.6%*	1.7%
07 Barclays PLC	0.8%	1.6%	*-0.8%*	*1.8%*	1.4%
08 ING Groep NV	2.1%	1.2%	*0.8%*	*1.6%*	1.4%
09 Banco Santander SA	2.3%	1.5%	*0.9%*	*2.0%*	1.6%
10 UBS Group AG	1.0%	1.0%	*0.0%*	*1.6%*	1.0%
11 UniCredit SpA	1.0%	1.1%	*-0.1%*	*1.5%*	1.0%
12 Goldman Sachs Group Inc/The	0.4%	0.9%	*-0.5%*	*1.6%*	0.8%
13 Commerzbank AG	1.2%	0.9%	*0.2%*	*1.4%*	1.0%
14 Svenska Handelsbanken AB	0.3%	0.5%	*-0.1%*	*1.1%*	0.4%
15 Mediobanca Banca di Credito Fi	0.4%	0.3%	*0.0%*	*1.0%*	0.3%

Source: AMF

Thus, no general exclusion of these 15 leading bank groups by SRI funds is noted, and the proportion of investment in banks is apparently on the whole not very different for SRI and non-SRI funds (in particular, no mean deviation between SRI and non-SRI funds is greater, relatively, than the standard deviations noted between non-SRI funds. A more thorough analysis was carried out on the five leading bank groups (all French) invested in, to assess whether certain MMF funds excluded these banks from their investment universe:

Comparison of the investment share by issuer group



Source: AMF

How do you read a boxplot?

The boxplot is a visual representation making it possible to understand more easily the dispersion of a set of dots: 50% of the median values are grouped in the boxplot (coloured rectangle in the above graph), while the values outside the boxplot, 25% above and 25% below, are represented in the form of a line or, when they are very distant[56], directly in the form of dots.

We note that there is apparently no particular exclusion of these groups by SRI money market funds. The high proportion of funds showing zero investment, both for SRI funds and for the others, can be explained by the fact that half of the funds are not exposed simultaneously to the five groups (for example, about 20% of the funds are only exposed to one or two groups, and 30% to three or four). In this respect, no difference of behaviour was identified between funds presenting themselves as SRI and the others.

[56] Distance from the quartile greater than 1.5 times the interquartile deviation.

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3.3.2.3.2. Analysis of the automotive sector

The same analysis was performed on the automotive sector. This sector being more concentrated, only the five leading groups were selected. These groups account for 8% of the total weight of the portfolio securities examined and 87% of the automotive sector as a whole. For each issuer group, the average investment (equally weighted by fund) is reconstructed:

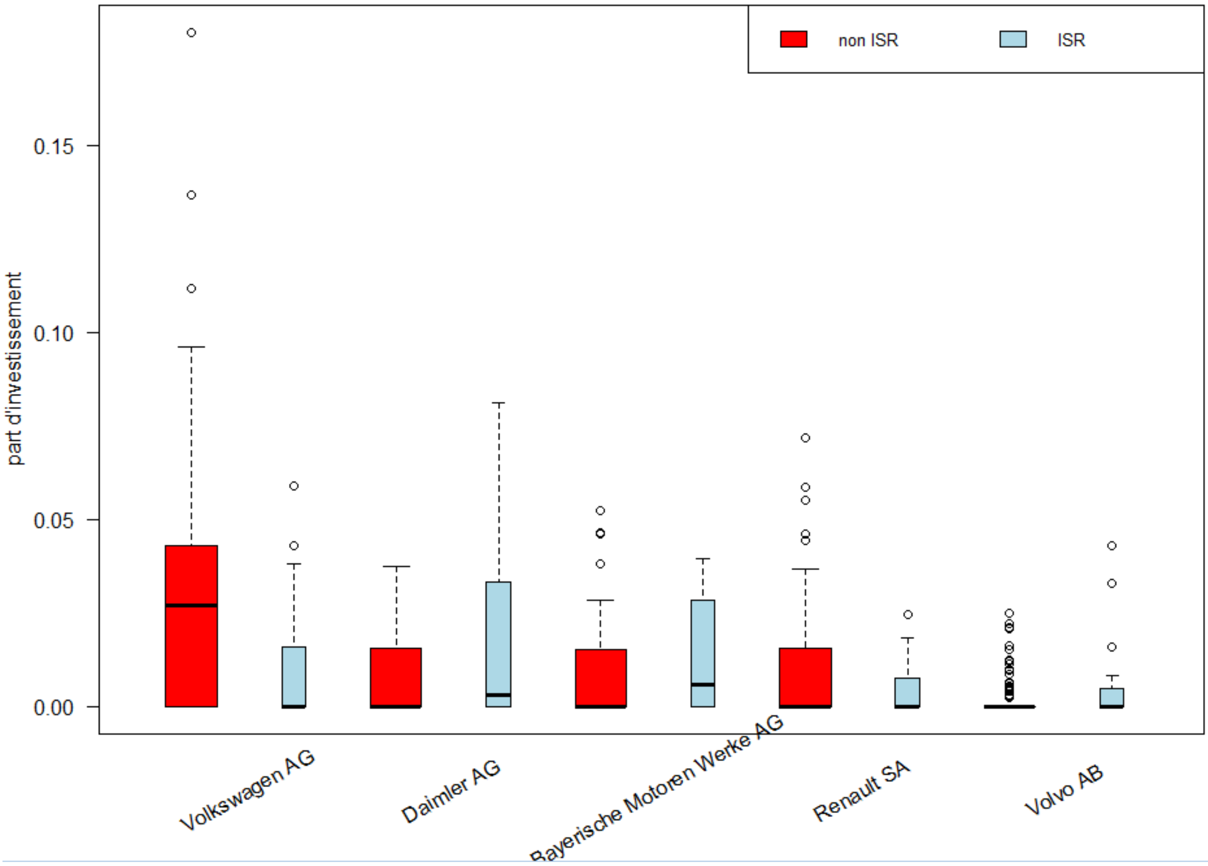
	Equal-weighted average of holding by MMF				
Sector	**SRI**	**Non-SRI**	***Difference in sector holdings observed between SRI and non-SRI funds***	***Standard deviation of the percentage of holdings in non-SRI MMFs***	**All**
1 Volkswagen AG	0.9%	3.0%	*-2.0%*	*3.4%*	2.6%
2 Daimler AG	1.7%	0.8%	*0.9%*	*1.1%*	1.0%
3 Bayerische Motoren Werke AG	1.4%	0.8%	*0.6%*	*1.2%*	0.9%
4 Renault SA	0.4%	0.9%	*-0.5%*	*1.5%*	0.9%
5 Volvo AB	0.5%	0.2%	*0.2%*	*0.6%*	0.3%

Source: AMF

As seen above, funds presenting themselves as SRI are on the whole less exposed to the automotive sector than non-SRI funds. Regarding the issuers in this sector, Volkswagen is the leading issuer for the universe of non-SRI funds (3%), while the proportion of investments is relatively lower for SRI funds (0.9%). Volkswagen thus seems to have been partially replaced in this sector by Mercedes (Daimler) and BMW, possibly due to its exclusion from the investment universe of certain SRI funds. However, the noted mean deviation remains lower than the standard deviation noted in non-SRI funds.

Analysis of the graph gives the following results and is able to confirm the above observations.

Comparison of the investment share by issuer group



Source: AMF

3.3.2.4. Search for excluded issuers

Another analysis approach is a search for issuers that might be potentially excluded from the investment universe of SRI funds. Most of the approaches identified in the first section involve the exclusion of part of the issuers (either by sector exclusion as for tobacco or arms, or by exclusion due to an insufficient ESG score). Therefore, the AMF endeavoured to identify such issuers. To do so, two approaches were implemented:

- On the one hand, an approach based on the exclusion list published by a sovereign fund recognised for its non-financial approach, the Norwegian sovereign fund;
- On the other hand, an empirical approach based on the fund investment observations in the available database.

The results of the two approaches are presented in the sections below.

3.3.2.4.1. Analysis of the Norwegian sovereign fund's exclusions

The Norwegian sovereign fund manages around €1,000 billion and is recognised for having been one of the first to take non-financial criteria into consideration in its investment policy. It publishes a list of companies excluded from its investment universe or placed under observation, specifying the reason for the decision (production of nuclear arms, coal or energy directly related to coal, tobacco, a situation of war or violation of human rights, major damage caused to the environment, etc.). A list of 155 companies was published in August 2019, with two potential statuses: exclusion or placing under observation.

The AMF cross-checked this list with the issuers held in the portfolios of French money market funds, and identified eight common issuers, plus one issuer for which one subsidiary is excluded from the Norwegian fund (Engie):[57]

Company	Criterion	Decision	Date
Airbus Finance BV	Nuclear arms	Exclusion	02.09.2005
Airbus SE	Nuclear arms	Exclusion	01.01.2006
Berkshire Hathaway Energy Co	Coal	Observation	10.07.2018
British American Tobacco Malaysia Bhd	Tobacco	Exclusion	19.01.2010
British American Tobacco Plc	Tobacco	Exclusion	19.01.2010
EDP - Energias de Portugal SA	Coal	Observation	21.12.2016
Engie Energia Chile SA	Coal	Exclusion	14.04.2016
Honeywell International Inc	Nuclear arms	Exclusion	05.01.2006
Imperial Brands Plc	Tobacco	Exclusion	19.01.2010
Philip Morris International Inc	Tobacco	Exclusion	19.01.2010
Safran SA	Nuclear arms	Exclusion	05.01.2006

Source: excerpt from the Norwegian sovereign fund's exclusion list, August 2019

An analysis of money market funds' holding of these issuers or not was performed, with the following results:

	SRI			Non-SRI			*Comparison*	
Issuer	Own funds invested	**Average**	Max.	Own funds invested	**Average**	Max.	*Deviation*	*σ non-SRI*
Imperial Brands PLC	13%	**0.4%**	4.6%	31%	**0.7%**	6.6%	*-0.3%*	*1.4%*
British American Tobacco PLC	4%	**0.0%**	1.0%	15%	**0.3%**	8.5%	*-0.3%*	*1.1%*
Philip Morris International Inc	0%	**0.0%**	0.0%	2%	**0.0%**	0.6%	*0.0%*	*0.1%*
EDP - Energias de Portugal SA	4%	**0.1%**	2.3%	5%	**0.1%**	2.9%	*0.0%*	*0.3%*
Engie SA	33%	**0.7%**	4.7%	24%	**0.5%**	4.6%	*0.2%*	*1.2%*
Airbus SE	0%	**0.0%**	0.0%	1%	**0.0%**	1.0%	*0.0%*	*0.1%*
Safran SA	33%	**0.7%**	4.7%	32%	**0.4%**	3.7%	*0.3%*	*0.9%*
Honeywell International Inc	4%	**0.2%**	5.9%	13%	**0.2%**	5.1%	*0.0%*	*0.8%*

Source: AMF

It is noted, therefore, that most of the issuers are very little invested in both by funds presenting themselves as SRI and by the others, with a few major exceptions:

- Imperial Brands, a company in the tobacco sector, seems to be regularly invested in by non-SRI funds, whereas only three SRI funds hold this issuer's securities. Generally speaking, only four equity stakes in tobacco are noted for SRI funds;
- The French company Engie seems to be regularly invested in by money market funds, notably those presenting themselves as SRI. Note that it is the Chilean subsidiary that is excluded by the Norwegian fund for the use of coal, and not the parent company;

[57] The sovereign fund has on two occasions excluded two entities of the same group: Airbus and BAT.

- Safran, a French company excluded by the Norwegian fund for its contribution to the production of nuclear arms, is regularly invested in both by funds presenting themselves as ISR and the others. The subject of nuclear arms seems to be analysed differently by responsible investment firms: for example, one notes that a fund presenting itself as SRI invests significantly in Honeywell, which is also excluded for its contribution to the production of nuclear arms.

This comparison has highlighted the effective nature of the exclusions, notably concerning tobacco, but also divergences of views in SRI approaches, especially with regard to nuclear arms. In any case, it is observed that the exposure of money market funds in these fields, including those which do not present themselves as SRI, remains low. All these issuers account for 2.1% of the investments of money market funds.

3.3.2.4.2. Empirical search for securities potentially excluded

Another approach involved trying to search, based on the data obtained, for issuers which, on the one hand, are not invested in by SRI funds (at most two funds out of the 24 in the study) and, on the other hand, seemed to be invested in frequently by non-SRI funds. To measure this concept of "frequency", the average rate of investment of non-SRI funds raised by one standard deviation[58] was measured for each sector. "Frequent" was defined as the presence of investments for a proportion higher than this percentage.

The application of these filters thus made it possible to identify three issuers in which non-SRI funds are *frequently* invested, as reconstructed here:

Group	Sector	Proportion of non-SRI funds holding securities of these issuers	Proportion of SRI funds holding securities of these issuers
British American Tobacco PLC	30 Other consumer goods	15%	4%
Goldman Sachs Group Inc	83 Banks	45%	8%
People's Republic of China	99 Public	20%	0%

Source: AMF

One of these issuers (British American Tobacco PLC), moreover, is excluded by the Norwegian sovereign fund (tobacco industry issuer). Of the other issuers, we can note the presence of a large US bank invested in heavily by non-SRI funds (more than 40% of the funds, i.e. 11 out of 24), but very seldom by SRI funds (8%, i.e. 2 funds out of 24), and China, whose securities appear in the portfolios of one-fifth of the non-SRI funds, but no SRI fund. However, these factors alone do not make it possible to conclude that most SRI funds would exclude these issuers from their SRI universe.

3.3.2.4.3. Conclusion on the search for securities excluded from the SRI investment universe

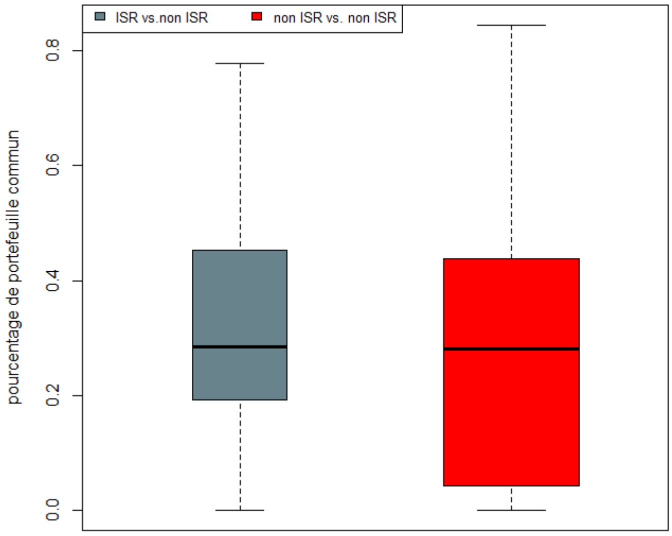
The work carried out on the search for issuers excluded from the investment universe of SRI funds shows the difficulties of this operation: due to the variability of portfolios from one fund to another, differences in the exclusion or selection policies implemented at the fund level, and differences in the ESG rating of the issuers depending on the methodologies applied and the data used. For example, it is difficult to identify which issuer would be excluded by SRI funds based on non-financial considerations.

3.3.2.5. Comparisons within a given AMC

[58] This average rate varies depending on the sector: for example, 15% on average for the banking sector with a standard deviatio nof 20%, and 6% for the public sector with a standard deviation of 11%.

Some AMCs propose both SRI money market funds and money market funds not highlighting this aspect. For these AMCs, a specific analysis was performed to assess the similarities and differences of both SRI and non-SRI funds. Thus, the common percentage of the investment portfolio at the level of issuer groups was calculated two by two,[59] funds of funds having been excluded from the study. The common percentages of SRI and non-SRI funds were then compared with one another to assess whether there are very similar funds in a given AMC, and placed in the perspective of variabilities existing between non-SRI funds. The results are presented below:

Comparison of portfolio similarities by AMCs



Source: AMF

One observes, for example, that one-quarter of SRI funds have more than 45% of their portfolio common with a non-SRI fund managed by the same AMC, some funds going as far as around 80%. These values are not fundamentally different from those observed between non-SRI funds (one-quarter above 42%, similarities up to 85%).

Therefore, while this operation makes it possible to check that there exists no SRI money market fund having an identical portfolio composition to that of a non-SRI fund, it does not make it possible to detect a systematic differentiation of portfolios.

3.3.2.6. Conclusion regarding the quantitative study

The quantitative study carried out on fund portfolios aimed to assess to what extent the impact of SRI policies on the portfolios of money market funds is identifiable. The results were able to highlight **isolated differences** between the portfolios of SRI and non-SRI funds, notably due to the effects of certain exclusions (tobacco). Moreover, the SRI impact seems to concern certain securities that have recently been the subject of controversies (Volkswagen). On the other hand, a lack of consensus between SRI funds is found on certain subjects such as nuclear power, while no security heavily exposed to coal was able to be identified in the portfolios of either SRI funds or non-SRI funds.

Furthermore, it is noted that SRI funds are on the whole generally invested in the same sectors of activity as non-SRI funds (which is consistent with their best-in-class approach), with a particular preponderance for bank issuers

[59] For example, if a fund A invests 30% in company X and 70% in company Y, and a fund B invests 50% in company X, 30% in company Y and 20% in company Z, the common investment percentage will be: 30% (common investment in X) + 30% (common investment in Y) + 0% (common investment in Z) = 60%.

specific to money market funds. Moreover, while the AMF identified no case of an SRI fund "copying" the investment portfolio of a conventional fund, the similarities may sometimes prove significant (around 80% of the portfolio invested in the same issuers by an SRI fund and a non-SRI fund managed by the same AMC).

Hence, this first quantitative study conducted on the subject, within a framework having certain limitations (one-off study at a given date, quality of process data on allocation by sectors/groups), **does not make it possible to conclude on the existence of a significant overall difference in the investments of SRI money market funds compared with other funds.** This lack of a significant difference on the aggregate level could have several explanations:

- **i.** The lack of consistency of funds' individual SRI approaches which, overall, would account for the lack of difference in SRI approaches compared with non-SRI approaches;
- **ii.** The weak statistical significance of the exclusions made in relation to the intrinsic variability of money market funds' investment approaches;
- **iii.** Possible specific features of the investment universe of money market funds operating in a universe selecting securities of positive credit quality;
- iv. The lack of factors of comparison relative to another asset class than money market instruments.

Note that this conclusion, which is collective, does not automatically call into question the significantly binding nature of the individual non-financial approaches implemented by managers in their money market funds.

This study sheds some initial light on the subject generally and, where applicable, could be supplemented in the future by studies concerning other sectors (equities, bonds), or more detailed analyses of types of specific SRI methodologies (e.g., SRI analysis of a financial entity). In any case, based on the initial results provided by this study, and without bringing into question the tangible effects of "responsible" approaches on the individual level,[60] the AMF wants to encourage AMCs **to be cautious** in their communication regarding the potential "collective" impact and reallocation aspect of socially responsible investment flows.

[60] For example, the AMF noted that AMCs had announced that they had been obliged to divest some short-dated paper normally held on a buy-and-hold basis, because the non-financial score had deteriorated.

3.4. USE OF DERIVATIVES AND SYNTHETIC EXPOSURE BY CIUS HAVING NON-FINANCIAL CHARACTERISTICS

In order to fulfill the financial objective of the CIU, AMCs can implement, exclusively or cumulatively, two kind of strategies. On one hand they can use the money collected from the client in order to **invest** it in the assets provisoned by the investment policy (e.g. for an index-tracking fund, invest in the underlying of the index). On the other hand, the portfolio manager can **expose** the CIU to the financial performance of the assets (for instance using a derivative contract). In such case there is no need to buy the asset. Such strategy is called « synthetic » exposition.

The AMF has noted that certain funds wanted to develop strategies of synthetic exposure to the performance of assets, baskets of funds or indices identified as "green" or "ESG". This type of strategy is practised regularly, notably for index-based management (e.g. a fund indexed to the CAC 40). In the particular context of funds incorporating a non-financial aspect, however, this type of mechanism raises the question of the effective impact of the investment made by the client given the exposure to which it may be subjected. The AMF therefore endeavoured to understand the mechanisms of these funds, by questioning several AMCs and banks which organise these funds. This section describes the functioning of these funds and proposes a series of recommendations and a position.

Apart from the last section, and in line with Position-Recommendation 2020-03, **this section does not deal specifically with structured products such as formula UCITS and 'FIVG' general investment funds.**

3.4.1. SYNTHETIC REPLICATION: THE USE OF TOTAL RETURN SWAPS

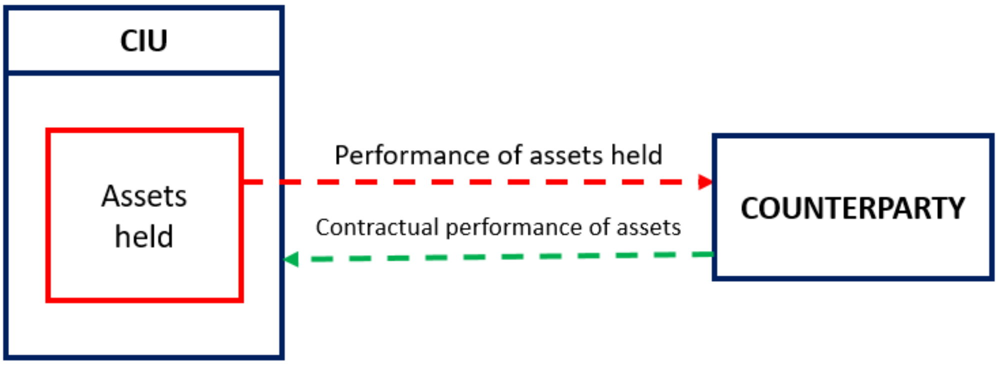
This section describes in detail the approach generally used by fund managers on account of the CIUs that they manage in order to expose them synthetically to a performance: exposition via derivative products, and in particular the use of total return swaps (**TRS**). Within the meaning of the SFTR regulation,[61] a TRS is a derivative contract "*by which a counterparty transfers the total economic performance of a benchmark bond, including interest income and fees, capital gains and capital losses resulting from price fluctuations, and credit losses, to another counterparty*".

In practice, this section deals with a specific TRS case: those which enable the CIU to define contractually the performance that it receives from one or more counterparties by swapping for that purpose the performance of securities that it holds. This system can be implemented either directly via the conclusion of a single TRS, or indirectly by swapping via a first TRS the performance of the basket of assets held in return for a market benchmark (e.g. LIBOR or EURIBOR adjusted by a contractual spread) before concluding a second TRS swapping a market benchmark adjusted by a contractual spread with the appropriate performance in order to achieve the promised return. Note that, for reasons of efficiency, each stage can in practice be performed with one or more counterparties (conclusion of one or more TRSs of the same type). This method is generally defined in opposition to that consisting for a CIU of achieving its investment objective by a "direct" investment in the securities to which it wants to be exposed. TRSs are used, for example, by systematic management funds including Exchange Traded Funds (**ETFs**) using so-called "synthetic" methods of replication of the index or asset basket, as opposed to those developing so-called "physical" replication methods which invest directly in the basket of securities or the index whose performance they promise to deliver. In practice, in the latter case, certain optimisation techniques make it possible, when the basket or the index are broad, to invest in only part of the asset basket or the index by limiting the tracking error in order to limit the operating costs of implementation.

The use of these instruments has numerous advantages, notably that of enabling CIUs to be exposed to markets on which access is costly, or else whose performance is hard to replicate (such as emerging markets, for example). It also makes it possible to have a potentially better quality of replication than that obtained by direct investment in securities, since the performance is promised contractually, whereas a physical replication ETF may be subject to unknown factors such as replication divergence or sampled replication tolerances which may generate tracking errors.

[61] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015.

The following simplified diagram[62] presents the general functioning of a synthetic replication fund with TRS :



Source: AMF

In practice, apart from the necessary remuneration of the counterparty, the contractual performance of the assets received may be adjusted by a spread factor, positive or negative. This spread depends on several market parameters, in particular lending and borrowing of the various securities.
As a result, two types of asset are to be considered in the functioning of this type of CIU:

- Assets to which the CIU **is exposed** without holding them: the fund does not hold these assets but receives their performance via the TRS;
- Assets **held** by the CIU without exposure to them: the fund holds these assets but sells their performance via the TRS. In an "unfunded" synthetic structure (a structure commonly used in France), the fund is the owner of these assets. Although they are the property of the fund, these securities are sometimes (improperly) called "**collateral**" for the CIU in that the CIU will not be exposed to the variation of their value except in the case of a counterparty default.

This diagram shows that, in the case of a synthetic replication, the assets actually **held** by the CIU are economically of secondary importance to the yield profile of the CIU (they are economically of importance for the fund only in the event of a counterparty default) by comparison with the securities to which the CIU is **exposed** via the TRS.

The use of this financial technique is widespread and regulated by several documents such as the ESMA guidelines [63] or the SFTR[64] which cover, in particular, the transparency for investors of the framework of use of these techniques. It must also take into consideration the requirements provided for by the EMIR[65] (reporting, contractual arrangements, counterparty risk management, etc.).

3.4.2. USE OF TOTAL RETURN SWAPS BY ESG OR THEMATIC FUNDS HAVING RESPONSIBLE INVESTMENT CHARACTERISTICS

The AMF notes an increase in the use of TRSs within the framework of funds stressing the consideration of ESG criteria in their communications. In July 2019, less than five French CIUs showing these characteristics were identified by the AMF. This trend appears more pronounced for other listed fixed-income products (*certificates, exchange traded notes,* etc.) and structured products.

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[62] In the present case, we consider replication with a single counterparty, and in a single stage without going through a market benchmark.
[63] ESMA guidelines on listed funds and other questions related to UCITS (ESMA 2014/937) with which the AMF complies (Position DOC-2013-06).
[64] Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 relating to the transparency of securities financing transactions.
[65] Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

Now, the use of derivatives is subject to misgivings in asset management with consideration of non-financial criteria. As an illustration, the use of TRSs for purposes of exposure is prohibited in the reference documents of the SRI and GreenFin public labels.[66] In contrast, other foreign labels such as the Belgian private label *Towards Sustainability* accept such derivatives, notably provided that the exposure portfolio and the portfolio held are in compliance with the label's requirements.[67] This use also includes an obligation of ESG due diligence on the counterparties of these instruments. The Luxembourg label LuxFlag does not exclude the use of derivatives and lays down no specific conditions.[68]

Without claiming across-the-board application to all situations (derivatives used for the purpose of hedging, etc.), the specific case of funds stressing the consideration of ESG criteria in selecting the securities to which they are exposed and using TRSs raises specific questions concerning the hedging operations performed by the **counterparties of the CIUs' TRSs**, and in particular:

1. Are the assets to which the CIUs are exposed - and whose selection takes ESG criteria into consideration - actually invested in by the TRS counterparties and, if so, in what conditions (proportion, systematicity, etc.)?
2. Are the assets held by the CIUs – and whose selection can also take ESG criteria into consideration - actually invested in, considering the entire structuring scheme (fund and counterparty)?

While the first question applies generally to derivatives offering exposure (swaps, futures, structured notes, etc.), the second is more specific to synthetic replication.

To answer these questions, the AMF questioned four of the largest French investment banks and the Association Française des Marchés Financiers (AMAFI). The descriptions given below are based on these discussions.

3.4.3. INVESTMENT IN THE SECURITIES TO WHICH CIUS ARE EXPOSED VIA THE TRS

The bank counterparties of the CIUs, which must pay to the funds the performance after consideration of ESG criteria, state that they cover the exposure by systematic physical replication of the exposures proposed to the funds without taking market risk. The counterparties say that they do not have a risk budget enabling them to make material deviations from the exposure proposed to the CIUs. In practice, the securities can be either taken from the counterparty's existing inventory, or bought.

The differences by comparison with an actual direct investment by the fund are apparently mainly intraday deviations due to proxy hedges used, for example, in response to a rapid adjustment of the notional amount (e.g. acquisition during a trading session of a Euro Stoxx 50 future as a proxy for exposure to the EURO iSTOXX® 50 ESG Focus).

At this stage, however, the counterparties stated that they gave no contractual commitment to CIUs concerning an actual investment in the assets to which they are exposed or reporting to enable them to assess the quantities of securities actually invested in by the security counterparties for their TRS covering.

Moreover, the counterparties can optimise their hedging portfolio (optimisation of long positions or "securities cash") and thereby improve the profitability of said counterparties, but also the financial conditions proposed to the funds. This improvement generally involves lending the securities held. All the counterparties questioned permit themselves to perform, without any limit of time or proportion, lending of securities held to cover the exposure delivered to CIUs. This possibility would have a material impact on the TRS financial conditions enjoyed

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[66] For equity fund management, the reference documents of the SRI label and the Greenfin label provide as follows: "*Use of derivatives for the purpose of exposure: the use for the purpose of exposure must be of a temporary nature. The fund's reporting and any supplements provided should enable each asset management company to explain how it proceeds, and in particular illustrate the temporary nature of the use of derivatives for the purpose of exposure.*"

[67] Regarding structured products, the label's reference document provides as follows: *"Structured products typically consist of an asset portfolio, providing the funding, and a derivatives part, providing the return. In principle, both parts of the portfolio need to be evaluated on their sustainability.* "

[68] Cf. reference document of the LuxFlag label

by CIUs: the impact depends on market conditions but was assessed at up to more than 20 basis points by some firms at May 2020. This is because, apart from the receipt of financial income, the use of securities lending also makes it possible to reduce the equity capital blocked for the leverage ratio. Hence, these securities could be lent, for example to allow the exercise of voting rights by a borrower or in order to perform short selling of the security. In this type of scheme, the fundholders benefit indirectly from part of the revenues resulting from the securities lending performed. Note that within the framework of a physical replication fund, the fund would also be able to lend the securities to itself. In that case, however, the applicable regulations would imply a higher level of information for the investor (the information appearing in the prospectus and the results in the regular reports). Also, in practice, many AMCs wanting to communicate concerning the non-financial aspects of this type of product limit this possibility of lending, notably to be able to exercise their voting rights.
Thus, since lending transactions are performed by the counterparty on assets which are not held by the fund, the fundholders, unlike in a physical replication scheme, are generally not informed of the possibility of performing securities lending transactions by the counterparties, or of the compatibility of such lending with the "governance" criterion that the CIUs may stress in their investment target or policy. Note that the securities held by banks can also be lent to other desks for their own requirements (e.g. market-making desk).

Regarding the optimisation techniques implemented thereby, the banking firms we met stated that they gave no precise details to CIUs concerning the securities lending that could be performed and the compatibility of that lending with the CIUs' investment policies and investment objectives. They also did not identify requests along these lines from the AMCs.

And yet, unlike the question of the effective investment of money in exposure assets, these questions of "optimisation" of CIUs' revenues by using securities lending are not specific to the use of TRS but concern more generally asset management with consideration of non-financial criteria.

3.4.4. INVESTMENT IN SECURITIES HELD BY THE CIU AND EXERCISE OF VOTING RIGHTS

The discussions with the counterparties show that the securities held by the CIUs are hedged by the counterparty by various methods, including in particular:

- **In-house offsetting** by a buying interest (use of the counterparty's in-house books);
- Establishment of a **short position** via a borrowing transaction. Although this scheme is not the only one employed, the counterparties may decide to perform these transactions for equity exposure by the following methods:
    - <u>At the time of the CIU's acquisition of the security:</u> The counterparty **borrows** the security over a long period[69] at a price P_0 given at the start of holding by the fund and simultaneously **sells** that security. The security can be sold to the CIU directly to avoid placing two orders on the market. That creates a short position on the bank's balance sheet which is compensated for by the regular receipt of the performance of the security held by the fund;
    - <u>When the security is sold by the CIU:</u> The counterparty **terminates the borrowing transaction,** and buys the security back at its price at the time P_t in order to honour its obligation of restitution to the lender counterparty: the transaction is without market risk for the counterparty.

  By this transaction, the counterparty is therefore exposed to fluctuations in the value of the security held by the CIU and sees the performance to which it is exposed via the TRS neutralised. The residual difference between the two transactions is due to the cost of borrowing the security incurred by the counterparty and which is replicated in the TRS.

Therefore, taking into consideration the entire scheme (CIU and counterparty), there is strictly speaking no investment (i.e. no net inflows on the securities in question) in the companies to which the funds are exposed: one actor (the CIU) has bought the security, and another (the counterparty) has shorted it or offset it with its in-house interests.

[69] Ideally, a duration corresponding to the date of expiry of the fund, or else a shorter duration which will make it necessary to roll the position in the future.

Regarding this, the highlighting of the consideration of ESG criteria in the choice of securities held by the CIU entails a risk of mis-selling. The aim is therefore to ensure consistency between the system put in place and the CIU's "image" with investors, so as not to "display" securities that might be controversial among the CIU's assets. And yet, these securities are generally not the same as those to which the CIU is exposed.

The discussions with the AMCs also show that there are heterogeneous practices regarding exercise of the voting rights of the securities held by the CIUs when they are equities. As mentioned above, some AMCs generally regard these securities as substitutable "collateral" with no long-term vision: they therefore do not all develop a policy of engagement regarding these securities. In particular, since the securities lending and borrowing market is usually more attractive at the time of general meetings, the securities held by the CIU may be replaced by other securities in the phase of exercising voting rights.
Moreover, regarding the securities to which the fund is exposed and which may be held by the counterparty, the discussions with the counterparties show that at this stage the latter exercise no voting right on the assets to which the CIUs are exposed, which is consistent with the lending or short selling of these assets by the counterparties.

3.4.5. COMPARISON WITH OBSERVED PRACTICES AND POLICY PROPOSAL

The aforementioned discussions with the French bank counterparties of TRSs highlight several specific features that must be taken into consideration when CIUs stress the consideration of ESG criteria, both in their assets held and the assets to which they are exposed.

For example:
- The assets to which the funds are exposed are in principle covered by an investment by the counterparties, although they do not give AMCs a contractual commitment or means of verification in this respect. The latter can, on the basis of these securities, perform securities lending transactions for the purpose of optimisation and generally do not exercise their voting right, which means the AMCs cannot communicate concerning the existence of an engagement policy on the exposure portfolio of these CIUs;
- The assets held by the funds are in principle subject to no net investment flow due to the hedge established by the counterparty;
- There are variable practices concerning the exercise of voting rights when these funds are exposed to equities.

The AMF notes that the regulatory documents of the CIUs using these practices generally stress:
- The building of an **exposure portfolio** consisting of assets selected by various approaches taking non-financial criteria into consideration: thematic approaches, best-in-universe with exclusion, etc. These documents give no precise details concerning the hedging portfolio established by the counterparty (actual investment in the assets, securities lending, etc.);
- The consideration of ESG criteria in selection of the **securities held**, in the investment objective and/or the investment policy of the CIU. Depending on the case, the fund may or may not apply a non-financial filter more or less demanding to these securities, which will then be described in detail in the prospectus or not. In the absence of such a filter, CIUs may decide to hold securities which have no direct relation to their thematic or ESG strategy (e.g. direct holding of automotive or textile stocks for thematic funds exposed to renewable energy stocks).

Also, one AMC wrongly indicated in its Transparency Code that its section on shareholder engagement applied to all its CIUs without mentioning that it did not apply to those using a synthetic replication approach.

Moreover, ex-post reporting on the CIU's ESG performance generally concerns the exposure portfolio and not the portfolio of assets held, although this is not always mentioned. For example:
- some CIUs stressing a reduction of their carbon footprint explain in the CIU's essential characteristics that the calculated carbon footprint only takes into consideration the assets to which the CIU is exposed, and not that resulting from the securities that it holds;
- some CIUs stressing a thematic sector exposure communicate concerning the ESG ratings of the exposure portfolio, without communicating concerning the portfolio held.

These observations lead the AMF to express the following position and recommendations.

Position no. 1 applicable to certain collective investment schemes communicating on the consideration of extra-financial criteria in the management of the fund.

In view of the existing operational or contractual framework, the communication on the consideration of extra-financial criteria for funds making very significant use of Total Return Swaps should be proportionate and limited to the reduced communication category (within the meaning of AMF Recommendation Position-2020-03), subject to meeting certain conditions mentioned below.

1. The AMF considers that, in the absence of certainty that the non-financial characteristics of the funds' exposure will not deteriorate as a result of the hedging method chosen by the counterparty, funds that use total return swaps (TRS) for a very significant proportion of their net assets cannot communicate centrally on the consideration of non-financial criteria.

2. In order to be able to communicate in a reduced way on the use of extra-financial criteria in funds that use TRS for a very significant proportion of their net assets, the AMF considers that:
    a. these funds must not mention in their marketing documents or DICI the extra-financial characteristics of the securities held by the funds and whose performance is exchanged through TRS ;
    b. overall, the approach implemented by the fund - including its exposure portfolio - must be significantly engaging;
    c. holders must be informed in the legal documentation that the voting rights attached to the securities to which the UCI is exposed will not be exercised by the counterparties, except in specific situations to be described;

This position is also included in the scope of position no. 7 of the position-recommendation DOC-2020-03 relating to the marketing in France of foreign UCITS. This position will come into force six months after the publication of this report for all relevant funds in existence at that date. If the funds concerned are unable to demonstrate that *there has been no deterioration in their non-financial characteristics as a result of the hedging method chosen by the counterparty*, they may, for example, take advantage of this period to adapt their communication on the consideration of non-financial criteria.

Ideas for work by market participants and the marketplace

In order to change the current context the emergence of best practices, counterparties and asset management companies could establish a robust and homogeneous framework for development of the offering of ESG exposure products, in relation, for example, with professional associations. This framework could allow CIUs, in particular, to:

- have information concerning the exposure hedging methods (without calling into question the need for separation between the activities of the counterparties and the funds);
- have a reasonable assurance which allows for the absence of degradation of extra-financial characteristics, possibly accompanied by periodic reporting on the amount of securities held in this way;
- where applicable, have information concerning the existence of lending transactions on the securities to which the CIU is exposed and their conditions: maximum percentage, repatriation of the securities at the time of voting on a significant resolution, etc.

AMF could assess the proposals and systems implemented by the market participants in response to this issue and, if necessary, review the scope of the aforementioned Position.

3.4.6. SPECIFIC CASES OF FORMULA FUNDS

Formula funds are a specific case of funds using TRSs to achieve their investment objective. These products, just like structured debt securities (and in particular structured EMTNs), generally use TRSs to deliver their formula. As indicated in the AMAFI-AFG guide, these products use as underlyings for their formulas indices using an "ESG filter" and thus stressing non-financial characteristics (low-carbon, energy transition funding, etc.). For the three banks surveyed, the assets under management relating to these products are significantly greater than the AUM on delta-one products described earlier.

Due to the presence of the formula's mechanisms, these products in practice invest only partially in the underlying index. This is because the counterparty has an evolving hedging portfolio consisting of various derivative financial instruments (options, volatility hedges, etc.). As a result, only **part** of the amounts invested is in fact allocated to the acquisition of components of the underlying assets of this index whose non-financial characteristics are stressed in the products' commercial documentation. This quantity is variable because it is determined by the definition of the hedging portfolio, which depends on changes in market conditions (evolution of the index, option volatilities, etc.), the formula in question, and the passage of time.

Due to the rapid growth of these products, the AMF will assess the advisability of making changes in its policy concerning the marketing of ESG index products, in cooperation with the professionals and their associations.

4. REFERENCE BY CIUS TO GREENHOUSE GAS EMISSIONS

4.1. INTRODUCTION

When presenting the "business growth and transformation action plan" (PACTE Law), the legislator entrusted the AMF with the role of "*monitoring the quality of information provided by collective investment management companies on their investment strategy and the way they manage risks related to the effects of climate change*".[70] This role reinforces the action already carried out by the AMF, notably within the framework of work performed for monitoring the implementation of "Article 173" (see section 5). In this new report, the AMF has decided to investigate the quality of information relating to greenhouse gas emissions (GHG), data that is used increasingly frequently by asset management companies for various purposes. This section will not cover the other climate metrics (in particular climate transition scores) since they are less mature and their use is still limited to certain market participants at the time of the investigations. Moreover, it should be pointed out that in this first work in this area the AMF focused on greenhouse gas emissions measured by the companies which are then invested in by the funds in the form of securities. Accordingly, measurement of the carbon footprint of a building, which is relevant in the context of a real estate fund, is not dealt with here.

How are greenhouse gas emissions measured?

As defined by the GHG Protocol, there are 6 families of greenhouse gases identified by the Kyoto Protocol.[71] Their influence on the climate system is calculated by their "global warming potential". This corresponds to the radiative forcing of one kilogram of the gas in question compared with that of one kilogram of CO_2 over a time frame of 100 years. For example, according to the fifth IPCC report, the warming power of methane is about thirty times greater than that of CO_2.[72] The greenhouse gas emissions of an entity over a given period of time are therefore measured **in tonnes of CO_2 equivalents** or **tCO_2e**.

Asset management companies use information relating to the carbon emissions of issuers (companies, governments) financed by the funds from various viewpoints and by various metrics. For example, this information can be used in order to:

- **inform investors** of GHG emission data for the portfolio to show the attention they pay to the subject, generally by comparing it with a benchmark;
- take carbon emissions into consideration in their **investment objective or investment policy**:
    - either by aggregating numerous other qualitative and quantitative data in the form of E, S and G scoring, or else as a direct and primary factor of **selection** (low-carbon funds which promise an investment portfolio having, for example, a carbon intensity 50% less than that of the benchmark investment universe, such as the stocks making up the Euro Stoxx 50 index);
    - or by highlighting an initiative concerning the absolute amount of emissions: funds for which the AMC "offsets" the carbon footprint by buying carbon certificates (which this year gave rise to the publication of an AMF Guide), but also funds stressing aspects of "neutralisation" of the carbon footprint, by developing methodologies offsetting "avoided" emissions and "induced" emissions;
- take them into consideration in their **risk management** (e.g. "transition" risks involved in the establishment of a low-carbon business model and which may result from the imposition of new

[70] Cf. Article L. 621-1 of the Monetary and Financial Code introduced by Act No. 2019-486 of 22 May 2019 relating to business growth and transformation (PACTE Law, Article 77 I 29°).
[71] Gases identified by Annex II to Directive 2003/87/EC: carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulphur hexafluoride (SF_6).
[72] The limitation of such a conversion is due notably to approximations in consideration of the time factor. The global warming potential of each greenhouse gas is not the same over time: one tonne of methane has a potential 28 times that of CO_2 over 100 years (and thus represents 28 CO_2 equivalents, 100 years being the default period taken into consideration), but a potential 84 times that of CO_2 over twenty years

regulations, changing consumer preferences or commodity prices, etc., and "physical risks" due, for example, to the increased frequency of natural disasters, especially concerning infrastructure funds);[73]
- take them into consideration for the purpose of dialogue with the issuer as part of an **engagement policy** of the AMC.

At this stage, the AMF notes that little use is made of these data for purposes of risk management or inclusion in engagement policy. However, the consideration of this information in risk management will probably increase as the risks related to global warming become more obvious, and to meet customer expectations. A number of fund managers, in France and worldwide, have also undertaken to apply the recommendations of the *Task Force on Climate-related Financial Disclosures* (TCFD) published in June 2017. Certain recommendations specifically concern asset management (pp. 38 et seq.):
- Regarding the strategy pillar, description by asset managers of the way in which the risks and opportunities related to climate change are factored into investment decisions; description of the impact of the low-carbon transition on financial products;
- Regarding risk management, description of engagement with the companies in the portfolio (including encouragement of greater transparency); description of the way in which the risks related to climate change are possibly identified and evaluated in each investment product or strategy (with details on the specific resources and tools);
- Regarding the metrics and targets, detailed description; description of changes in the metrics if necessary; while recognising the limitations, the TCFD recommends publishing the weighted mean of the carbon intensity of investment portfolios and strategies when the data is available or can be reasonably estimated; description of methodologies.

Lastly, regulatory developments will also encourage this trend:
- On the European level:
  - changes in the UCITS and AIFM frameworks to explicitly include the consideration of ESG risks in fund managers' organisations, processes and risk management;[74]
  - entry into force of European Regulation 2019/2088 (Disclosure Regulation) which requires that AMCs publish information at their level and at the level of their products regarding the consideration of, on the one hand, the risks of financial impact on investments ("sustainability risks"), and, on the other hand, the risks of negative externalities of those investments on ESG aspects ("sustainability factors"), cf. section **Erreur ! Aucun nom n'a été donné au signet.**.
- On the French level: updating of the Article 173 framework as provided for by the Energy and Climate law.

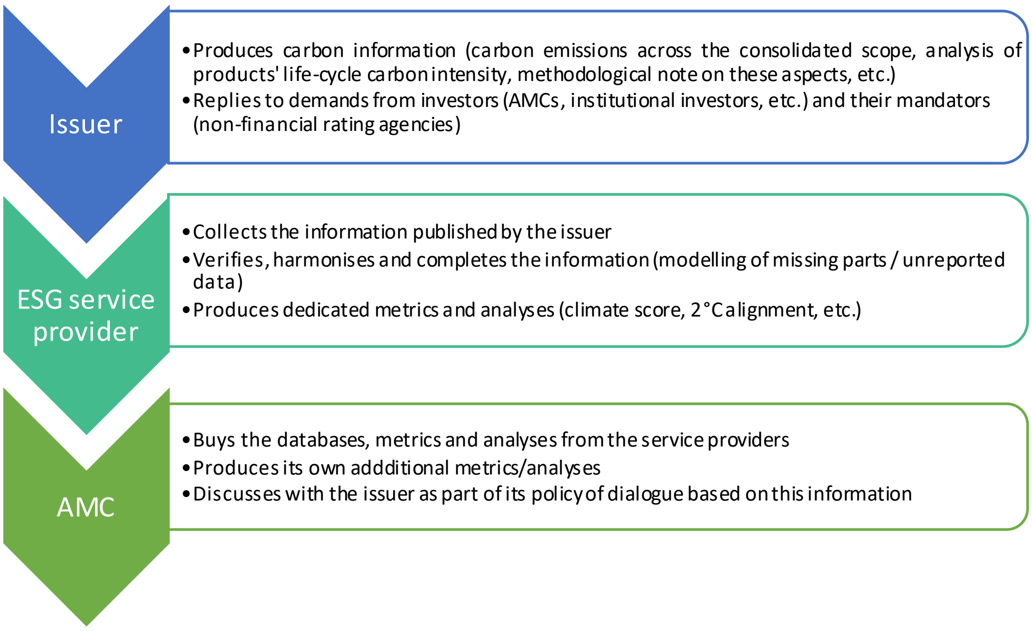
In this report, the analyses have focused mainly on the use of these data for the purpose of communication and for use in the investment objective or investment policy.

Depending on the case, carbon information could be of prime importance in CIUs' management style and communication. **To support this trend, and to monitor the conditions of development of this type of product, after reviewing existing practices the AMF wanted to clarify its requirements with regard to market participants using such data.**

In this respect, as recalled by the review of SPOT inspections on the SRI management frameworks systems of asset management companies and the integration of ESG criteria published by the AMF,[75] the various uses of data relating to greenhouse gas emissions imply, for the AMC, that it check the quality of the data, with specific features depending on the use. **As outlined in section 4.5, these requirements are proportional to the degree of sophistication of the use made of it.** For example, a lower level of vigilance is required for AMCs using this information for the purpose of ex-post reporting as compared with those incorporating it in their investment objective.

[73] See, for example, FFA, *Guide d'évaluation du risque climat dans les portefeuilles d'investissement* (2018); I4CE, Gérer les risques de transition de son portefeuille (2017).
[74] These changes, provided for by the European Commission's Action Plan, gave rise to an ESMA technical advice, published on 30 April 2019.
[75] Cf. Publication of the review on 12 July 2019.

The process of production and use of information relating to greenhouse gases is fairly similar to that for other ESG data. In practice, carbon data is generally produced by the issuer and then collected, verified, harmonised and completed by service providers (non-financial rating agencies, suppliers specialised in carbon ratings or methodologies). The AMCs then factor this information into their process and, where applicable, aggregate it at the portfolio level. In some cases, notably in the absence of data provided by the issuer, the data can also be estimated. The process can be illustrated in a simplified manner by the following diagram:



Source: AMF

However, this diagram does not apply systematically: for example, some AMCs endeavour to collect or model data themselves, without going through a service provider. As described in detail below, a non-profit organisation, CDP,[76] established the main reporting database, bringing together the information disclosed by more than 8,000 companies in 2019.

This section describes the main stages in the production of greenhouse gas emissions so as to analyse the **areas of attention for AMCs** when they use this data, notably within the framework of their investment objective, their investment policy and communication with clients.

It thus describes:

- **the use made of the carbon data** by AMCs in practice (metrics used, publications made, examples of funds taking this data into consideration), highlighting the main points requiring attention in order to ensure the data's relevance (underlying assumptions, limitations, checks);
- the process of **formation of carbon data** (principles for calculation of issuers' carbon emissions, case studies of the publication of a GHG balance by issuers);
- the **process of data collection to establish carbon databases**

The aim of this report is not to provide recommendations for issuers[77] or the non-financial rating agencies, but to illustrate how calculation and approximation procedures can have an impact on the uses ultimately made of the data by AMCs.

[76] Formerly *Carbon Disclosure Project*, founded in 2009.

[77] Readers interested in a more exhaustive view may refer to the AMF's 2019 CSR Report.

Good practice rules, positions and recommendations for AMCs are expressed throughout the document and are recapped at the end of the report. The positions and recommendations will be covered by an update of the AMF's policy.

4.2. USE OF GHG EMISSION DATA BY AMCS

One of the main uses of carbon data by AMCs is to allow the publication of carbon metrics at the level of **their funds**. Due to the very nature of the funds, it is the aggregation of the carbon emission metrics of the various companies held in the portfolio that makes it possible to obtain the metric at the fund level. This aggregation is based on several methodological choices and assumptions. **While these methodological choices are necessary for easier communication, they require the introduction of precautions and instructive explanations for investors.**

This section first outlines briefly the principles for construction of these metrics at the level of a fund, and its limitations, then describes the procedures for use of this information by the AMCs from two aspects: publication of the information and use in the fund's objective.

4.2.1. PUBLICATION OF CARBON DATA BY AMCS: WHICH METRIC FOR THE PORTFOLIO?

In its ESG questionnaire, the AMF asked 50 AMCs about their procedures for calculating the funds' carbon metrics. These AMCs are among the biggest in the marketplace or among those most involved in sustainable finance. The statistics appearing below can therefore not be mechanically extended to all the AMCs in the marketplace. They allow the less advanced AMCs to compare themselves with their peers.

This questionnaire shows that:

- The great majority of AMCs surveyed calculate a carbon footprint or intensity for at least one of the funds that they manage (92%). The AMCs not performing these calculations are specialised in specific asset classes (real estate, private equity, infrastructure);
- They generally do not calculate this type of metric for all their funds. Most focus on funds incorporating a climate aspect (SRI and thematic funds), having reached a certain level of assets under management (funds with more than €500m in AUM subject to the particular obligations of Article 173), or else invested in specific asset classes (limitation by some AMCs to their equity funds, for which the calculation of a carbon footprint can be done more easily, by an equity approach, see below).
- About **two-thirds of the AMCs state that they use a service provider** to help them perform calculation of portfolios' carbon footprint or intensity.

Two types of metrics are primarily used by AMCs:

- **The carbon footprint of the portfolio or of the fund's benchmark**, which assigns an estimated amount of carbon emissions based on the investments observed in the portfolio. Like the carbon footprints of issuers, this represents an **absolute** amount of emissions in **tCO_2e**. It therefore corresponds to an interpretable physical quantity. However, it is more complex to estimate than a metric at the level of a company (multiple booking of emissions, attribution of emissions to the portfolio, etc.). Moreover, so that the quantity may be directly meaningful to the investor, it is often divided by the fund's assets (tCO_2e/€m invested) so as to allow investors to have a clearer idea of the amount of greenhouse gas emissions related to their own investment.
- **The carbon intensity of the portfolio or benchmark**, which is a metric assessing the average emissions of the issuers in the portfolio relative to their revenue. Unlike the carbon footprint, this is a **portfolio average indicator** which is expressed in **tCO_2e/€m of revenue**. This quantity can be calculated more easily but is also more complex to interpret, because it does not correspond to a real quantity and is based on the fact that revenue is a relevant factor of explanation of emissions for all the sectors compared in this way[78].

[78] One of the suggested advantages of the intensity approach is that it can adjust for "volume effects": for example, between two carmakers producing 2 million and 5 million vehicles per year respectively, the former will in theory have less carbon emissions than the other due to the volume effect, which does not necessarily mean that it is more efficient from the viewpoint of carbon emissions relative to e ach vehicle

The following table lists the characteristics, advantages and disadvantages identified with regard to the two metrics.

Carbon footprint of the portfolio	Average carbon intensity of the portfolio
- tCO_2e or tCO_2e/€m invested - Measurement of physical emissions	- tCO_2e/€m in revenue - Assessment of the quantity of carbon needed for the production of an economic activity
Advantages: - Physical interpretability	Advantages: - Easy to calculate
Disadvantages: - Problems of attribution of emissions to the investor, multiple counting	Disadvantages: - Difficulty of interpretation (strong assumption of homogeneity of revenue)

Source: AMF

The choice of one or other of the metrics is a matter for each AMC in light of the specific features of the funds managed. On the other hand, certain investment objectives such as offsetting a carbon footprint are necessarily based on a metric of the carbon footprint and not carbon intensity. In any case, these are two static metrics which have the advantage of being able to be aggregated at the portfolio level and are therefore easy to report on, but which give absolutely no indication of the portfolio's positioning in relation to the effort for transition to a low-carbon economy. For example, the portfolio may be invested in a company which is at present a major carbon emitter/with high GHG intensity but which is committed to transformation initiatives which will be able to make a significant contribution to transition efforts in the coming years, or on the contrary in companies that have low carbon emissions/GHG intensity but which operate in sectors of activity (luxury goods, media, etc.) which in theory have no impact on the energy and ecological transition.
Moreover, the communication with investors must be adapted to each metric, taking into account its assumptions and its limitations.

Indeed, in order to calculate these indicators at the portfolio level, the AMC must answer several structural questions.

The most important of them is the meaning to be assigned to the aggregation of carbon metrics calculated at the level of the various issuers. Such an aggregation is based on an assumption of **comparability between the raw data of the issuers' carbon footprints.** This assumption is generally pooled with those related to the incorporation of carbon data in the investment objective and is discussed more fully below.

Other issues, more specific to the calculation of metrics at the portfolio level, are detailed in this table.

produced. Assuming homogeneity of products and prices, the intensity approach makes it possible to correct this bias. However, to return to the example above, it can be conjectured that the carmaker selling more vehicles will also have a higher market capitalisation and more debt: thus, for an equal amount of holdings in the fund's portfolio, the fraction of emissions assigned to the fund will be smaller.

Issue	Indicator at the CIU level	
	Carbon footprint	Carbon intensity
How to allow for **multiple emission counts** in the portfolio?	Concerned	Not concerned
How to calculate the proportion of issuer emissions for which the CIU is **responsible**?	Concerned	Not concerned
How to take into consideration **certain assets**: derivatives, cash, lending/borrowing, assets with missing data, etc.?	Concerned	Concerned

The AMCs, by themselves or via the service providers on which they rely, gave different answers to these questions, which results in variability in the metrics used, apart from the variability due to differences in the data used.

4.2.1.1. Carbon footprint: consideration of emissions for which the CIU is responsible

Just like for a company (see below), the metric of a portfolio's carbon footprint aims to measure the emissions for which a portfolio is regarded as being **responsible.** However, it is necessary to adapt this view to the nature of a fund, which usually holds only fractions of a company or assets, without a dominant influence.[79] In practice, a fraction of the emissions is attributed to the fund in proportion to the fund's "involvement" in the company. This involvement can be measured in two main forms:

- On the one hand, an ***equity*** approach in which the involvement is measured based on the percentage of the capital held by the fund (which could be seen as a good approximation for the percentage of voting rights): for example, a fund which owns 2% of the capital of a company will be attributed 2% of the company's emissions.
- On the other hand, an ***enterprise value*** approach in which the fund is attributed a percentage of carbon emissions corresponding, roughly speaking, to the company's funding (sum of the company's equity and debt). For example, a fund which owns €1m in shares and €3m in bonds of a company whose enterprise value is estimated at €400m will be attributed a fraction of (1+3)/400 = 1% of the company's emissions.

Note that these approaches are unable to account for allocated funding issues, such as, in particular, *green bonds*. A holder of green bonds could justify considering only differentiated carbon emissions related to the specific project that it finances. For consistency, therefore, it would be necessary for the other asset holders to isolate these specific emissions and the allocated amounts in order to calculate their carbon footprint (in principle higher) on the residual scopes.

These two approaches also raise questions of stability over time. For example, to go back to the example above, if we assume that the company carries out another debt issue for €50m, the percentage of emissions attributed to the fund will decrease from 1% to 4/(400+50) ~ 0.9%, i.e. a 10% reduction in carbon emissions without any tangible action by the company or the AMC. These approximations do not invalidate the AMCs' approaches as such, because they are necessary the disclosure of a simplified quantity to investors, subject to appropriate explanations.

4.2.1.2. Carbon footprint: emission scopes and multiple counts

The emissions of a company are reported by "scope", distinguishing between direct and indirect emissions.

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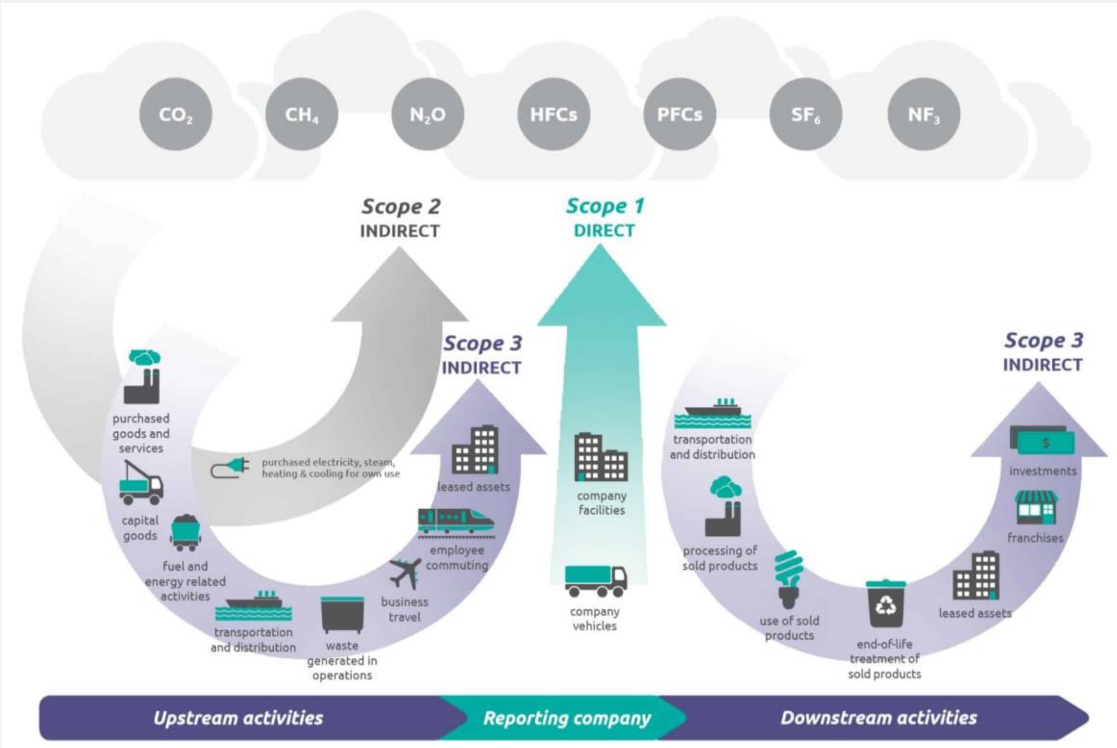
[79] Excluding real estate funds, which generally own whole buildings, and excluding private equity funds, which may have a dominant or even a majority influence in a company.

The emission scopes of a company

Calculation of a company's greenhouse gas balance is based on the principle of consideration of emissions for which a company can be considered economically **responsible**, and not merely the emissions that it **produces** directly. Accordingly, emissions are divided into three scopes:

- *Scope* 1: emissions generated directly by the company (e.g. the emissions of a factory chimney);
- *Scope* 2: emissions generated during production of the sources of energy used by a company (e.g. emissions related to production of the energy used by the company to run its factory);
- *Scope* 3: emissions produced by the company's entire user chain:
    - o **upstream** emissions (e.g. emissions generated by the raw materials used by a company, such as metals for a carmaker);
    - o **downstream** emissions: emissions generated by the use of a company's products (e.g. the use of a carmaker's vehicles by the user).

This approach is summarised by the following diagram:



Due to the overlapping of emission scopes, by mechanically adding together scopes 1, 2 and 3 for all the companies in the portfolio of a fund we obtain an amount of GHG emissions greater than the actual emissions of those companies. Schematically, if a fund invests in both an electricity producer and a company that is a customer of that producer, the application of the above methodologies will result in counting the electricity producer's carbon emissions twice: once in its scope 1, and a second time in scope 2 of the customer company. If the customer company supplies a product that is then used by a third-party company in the fund's portfolio, the latter will also count these emissions in its scope 3 if it takes it into consideration. In practice, since companies are seldom exclusively customers of one another, identifying these double counts is difficult.

The questionnaire produced by the AMF shows that the calculations of metrics take into consideration scopes 1 and 2. A single AMC stated that it only took into consideration scope 1, to avoid double counting. On the other hand, only **one-third of the AMCs said they took into consideration aspects of scope 3**, which is frequently calculated by a service provider. **And yet, as indicated below, such a lack of use could be understandable given that there is at present no consensus on these quantities or calculation on a substantial part of the investment universe.** It is therefore necessary to explain clearly to investors the choices made by the AMCs and their potential consequences.

Depending on the methodology, the consideration of scope 3 may be confined to the upstream scope (suppliers), or even to tier-one suppliers. **As a result, the question of multiple counts or the absence of consideration of scope 3 emissions potentially concerns numerous AMCs.**

Several approaches have been identified to deal with the problem of multiple counts:

- <u>Ignore the multiple counts</u>

This approach could be judged conservative if one wants to measure the carbon footprint in absolute terms (e.g. in order to offset it, cf. 4.2.3.3). In theory it does not make it possible to correctly analyse the comparisons between a portfolio and its benchmark. However, assuming homogeneous investment universes between the fund and the benchmark (in particular regarding the sectors of activity), it could be considered that the double-counting biases are similar between the benchmark and the fund.

- <u>Divide by 3 (in the event of consideration of scopes 1, 2 and 3) or by 2 (consideration of scopes 1 and 2)</u>

This approach makes it possible to correct the excessively conservative aspect of the previous approach, without impacting comparability (proportional ratio). It is based on strong assumptions, notably as follows:
- The fund invests in all the companies contributing to the life cycle of a product, in proportions consistent with the life cycle;
- The carbon emissions are all related to the production of energy (scope 1 of the energy producer), which is used to manufacture an intermediate good (scope 2 of the intermediate good manufacturer) which itself is used to deliver an end product (scope 3 of the end product manufacturer).

The reality is far more complex, with portfolio sector weightings not necessarily correlated to product life-cycle considerations, cases of loss of emissions (scope 1 without re-use by someone else) or longer processes involving numerous intermediary companies, each one incorporating the emissions of the previous one (for example, if a single good goes through five different intermediaries, all included in the fund's portfolio).

- <u>Adopt a "value chain" approach</u>

This approach consists in measuring the emissions of a product by a "life cycle" approach, then identifying the value added by each company at each stage in its manufacturing. Each company will be attributed an amount of emissions corresponding to the fraction of its value added in the chain. For this approach, which means attributing the carbon emissions of a product to the entity that profits from its value rather than the one that actually emits greenhouse gases, it must be possible to cross-check the product life cycles with companies' operations, and this may prove complex. In practice, the AMF has observed no concrete implementation of this approach.

Moreover, since certain companies own all or part of other companies, double counting may occur, especially in cases where a company and its subsidiary, both in the portfolio, report emissions, each in its scope, with the scope of the parent company including that of the subsidiary. Double counting would be even more significant if consideration were given to estimated emissions on sovereign bonds, which include all the corporate emissions generated on the sovereign's territory. However, this case has apparently not occurred in practice.

Hence, the various methodologies described for elimination of multiple counts appear **either impossible to implement in practice, or subject to significant biases and limitations**. Accordingly, at the present time there apparently exists no harmonised methodology, and this may adversely affect the legibility and comparability of carbon footprints.

4.2.1.3. Consideration of particular assets

A fund's portfolio consists of equities and corporate debt securities, but also sovereign bonds, cash, derivatives, securities lending and borrowing transactions, etc. Methods exist for estimating the carbon footprint or carbon intensity of countries based on corporate approaches (modelling of unreported data by means of proportional approaches to metrics such as gross domestic product, the attribution of a fraction to a fund in proportion to the fraction of the government debt held, etc.). However, these methods seem marginal and very uncertain due to the small amount of available data and the extremely aggregated nature of the intensity indicator taken into consideration (GDP).

For other assets, questions of principle are posed which are not very obvious: for a derivative, should one take into consideration the emissions of the counterparty? How to assess the emissions based on a derivative of negative market value? The AMF notes that some AMCs have carried out work on the consideration of derivatives. The approaches identified consist of assessing only the derivatives directly linked to an underlying asset (single-name or equity-indexed futures or options) by a transparency approach (in delta). The long and short positions are apparently not offset, and the carbon footprint emitted by the counterparty is apparently not taken into consideration.

Furthermore, the funds may own units of other funds. The AMCs may therefore take this type of asset into consideration either by transparency (which makes it possible to ensure a methodological uniformity at the portfolio level but requires having the composition of the target fund), or based on the reporting performed by the manager of the fund held (which then creates the risk of having differentiated approaches, for example if the fund held adopts an "equity" approach and that which holds it adopts an "enterprise value" approach).

A final option used by some AMCs is **not to take these assets into consideration**. The AMCs will in that case proceed either by ignoring those assets and providing a carbon footprint only on a portion of the portfolio, or proceeding by extrapolation in order to post a carbon footprint on all their fund's portfolio: hence, the AMC will assume that the emissions coming from the "unknown" part of a fund's portfolio are proportional to those of the "known" part (e.g., if the known carbon emissions of a fund's portfolio come from companies accounting for 75% of the fund's portfolio and amount to 3 tonnes of CO_2e, then the AMC will estimate at 25%/75%*3 = 1 tonne of CO_2e the emissions on the missing part, estimating the total footprint of the portfolio at 3+1 = 4 tonnes of CO_2e). This approach is, in practice, also used for vanilla assets (e.g. corporate securities) on which the AMC has no emissions data.

In practice and on the basis of the questionnaire produced by the AMF:

- <u>Debt securities</u>: **About 40% of AMCs state that they do not take debt securities into consideration** in calculating the carbon footprint of their portfolio, confining themselves to equity securities ("equity" approach). This can be explained in some cases by the fact that these AMCs manage or calculate their carbon footprint only on equity funds.
- <u>Deposits and cash:</u> **94% of the sample do not take into consideration the cash position** of CIUs. The three AMCs which state that they take cash into consideration aggregate the deposits with the total exposure to the issuer (credit institution) and use an "enterprise value" type approach to the issuer in order to determine the proportion of carbon emissions to be attributed to the fund.
- <u>Derivatives and temporary securities transactions:</u> Likewise, **94% of the sample do not take into consideration derivatives and temporary securities transactions**. A specific case of the consideration of derivatives in total return swap situations is discussed in section 0 of the report: since the fund is economically fully exposed to the performance of the basket of assets received, the fund's carbon footprint is generally calculated on this basket of assets and not on the assets held directly by the fund.

As a result, therefore, the publications of CIUs' carbon metrics are at this stage concentrated mainly on a part of equity-fund assets.

The remarks made in this section on particular assets are valid for both carbon footprint and intensity approaches. Indeed, not taking certain assets into consideration in calculating the average intensity of the portfolio inevitably amounts to considering that they have an intensity equal to the mean of the others.

4.2.2. PUBLICATION OF CARBON DATA BY AMCS

As described above, the use of carbon data is a generally complex operation which depends on several assumptions necessary to form intelligible metrics, representative of the portfolio. A review of the publications made by several AMCs led to the following observations:

- The information can be disclosed in various ways: as part of the "Article 173" information dedicated to the fund (in a dedicated report or in the funds' annual reports, cf. section 5), but also in monthly factsheets.
- The metric which seems to be used most is that for the carbon intensity (tCO_2e/€m revenue), ahead of the investment intensity (tCO_2e/€m investment). In both cases, the metric is compared with the equivalent metric of an imaginary portfolio invested in the fund's financial benchmark (e.g. comparison of the fund's revenue intensity with the revenue intensity of the CAC 40).

In the examples investigated, the source of the service provider used is always mentioned. The coverage rate of the fund's portfolio (given the lack of consideration of certain assets, such as cash, derivatives, etc., cf. section 4.2.1.3), is less frequently mentioned.

Some of the firms surveyed also indicated that they were starting to develop communication metrics focused on the funds' "**2°C or 1.5°C alignment**", either in qualitative form or by expressing the GHG emissions trajectory in the form of a temperature rise (for example, considering that the fund's GHG emissions are aligned with a temperature rise trajectory of +3°C, whereas the benchmark would be aligned on "+4°C"). The scenarios are varied and cover diverse environmental factors, without taking all these factors into consideration similarly: environmental challenges (climate change; water constraints); evolution of natural resources (shale gas, phosphate, etc.); regulatory changes (carbon price, air pollution); lower cost of clean energies; changing social norms and consumer behaviour; litigation risks, etc. Moreover, their degrees of granularity differ, which impacts analysis of the portfolio: some are situated at the level of the economy (macro), others at the level of a given sector or resource, and others at the level of a company. Moreover, the sector coverage of these scenarios diverges substantially. There are accordingly a diversity of approaches that can result in different amplitudes, making it impossible to compare the alignment of one fund with another. The firms surveyed say they are aware of the major methodological limitations of such a metric, but emphasise on the one hand the easily understandable nature of this method of communication, and also the fact that it is widely used in a scientific context, itself based on numerous approximations (extrapolation of the performance of a portfolio to a global economy with demographic and energy assumptions, etc., variability of climate models, etc.).

While it is noted that some AMCs clearly explain the principles of carbon footprint calculation in their communications with fundholders, the AMF only seldom noted an explicit presentation of methodological limitations, such as:

- No consideration of scope 3 and the reasons for this (data quality, little coverage of the entities in the investment universe, etc.);
- Difficulties inherent in the aggregation of carbon data from various issuers;
- Biases due to comparison with the benchmark indicator when the fund is invested in assets for which the GHG emissions are underestimated or even not calculated relative to the index. This is the case, for example, when the scope 1 and 2 carbon footprints of a fund invested significantly in the transport or energy sector are compared with a benchmark in which this sector is more diluted, insofar as the emissions for which this sector is considered responsible are concentrated massively on the use of vehicles (scope 3 downstream) and the mining of materials needed for their manufacture (scope 3 upstream);
- Moreover, the information is sometimes reported in a positive form (mentioning the factors taken into consideration in calculating the carbon footprint), so that it is not possible for the unsophisticated reader to identify the missing factors or assess the relevance of the information presented.

4.2.3. FUND INCORPORATING A "CARBON" PROMISE

As mentioned in the introduction, AMCs can use the carbon data collected within the framework of the CIU's investment objective. In this case, these data play a fundamental role, and their quality and reliability are especially critical.

An overview of the various strategies observed in the firms related to the carbon theme (low-carbon funds, offsetting, carbon neutrality) is presented below, highlighting special points for attention.

4.2.3.1. Best-in-class and best-in-universe funds

Some funds develop issuer selection methodologies based on a scoring system of which one component could be the carbon footprint or carbon intensity.

This results in a need for comparability of data from one issuer to another to be able to distinguish between two issuers on the basis of their GHG emissions data. This need is especially significant for best-in-class approaches which require comparison between issuers operating in identical sectors.

4.2.3.2. Low-carbon funds

Several funds, customarily using a designation such as "low-carbon", aim, within a given investment universe and in accordance with more or less pronounced sector constraints, to integrate a carbon metric and objective into their investment policy.

The stated objective varies. It may be to exclude the most carbon-intensive issuers (best-in-class approach based on revenue carbon intensity), or to have a target for the total reduction in the portfolio's carbon footprint compared with its investment universe (a binding approach, e.g. to reduce by 50% the carbon emissions attributed to the fund compared with the investment universe). The investment universe is generally based on the composition of a recognised index (e.g. the CAC 40). The index providers can, moreover, sometimes directly provide a low-carbon version of the index by reweighting: the fund could then be an index fund tracking that low-carbon index.

In order to meet this quantified objective, the AMCs generally use systematic management models. This ensures that the stated reduction promise is achieved, while avoiding portfolio concentrations on a few sectors or a few issuers. In that case, constrained optimisations of the initial investment universe are performed (minimisation of the carbon footprint of the portfolio under constraint of diversification by sectors and by issuers, or of the tracking error relative to the benchmark index) in accordance with mechanical rules. In these circumstances the AMF recommends mentioning the binding nature of the investment policy in the investment objective.[80] Moreover, in the case of UCITS, these additional constraints must be covered by a detailed presentation in the investment objective.[81]

This type of methodology may require providing information concerning the absolute amount of emissions of the fund's portfolio. This requirement therefore goes beyond a mere comparability between issuers.

4.2.3.3. "Carbon offset" funds

[80] Cf. Position-Recommendation DOC-2011-05 relating to the regulatory documents of CIUs: "*When a UCITS implements a systematic investment strategy using a mathematical model, the AMF recommends mentioning this characteristic in the investment objective.*"
[81] Cf. Question 8c of the ESMA UCITS Q&A.

The principle of the "carbon offset" fund is to buy and destroy carbon reduction certificates for an amount corresponding to the amount of emissions calculated for the fund.

So far, this type of strategy has developed on portfolios having been subjected to a first "decarbonisation" filter limiting the amount of the carbon footprint attributed to the portfolio (and hence the cost of the residual offsetting). Moreover, as yet no fund proposes offsetting on scopes 1, 2 and 3 (only scopes 1 and 2).

This approach, which promotes a tangible impact on carbon emissions by stimulating the market for issuance of carbon certificates, was the subject of the AMF publication of a guide identifying points for attention and good practices, including in particular, with regard to the carbon footprint itself:

(1) the fact of presenting comprehensive and precise information on sources of data;
(2) the fact of measuring the carbon footprint day after day and not at the end of a given period, to avoid any risk of "window dressing" and represent precisely the carbon emissions attributed to the portfolio actually held throughout the period;
(3) the fact of specifying the emission scopes used to perform this offsetting and of illustrating the existence of non-offset carbon emissions by means of examples.

To be able to highlight a "neutralisation" of the carbon footprint, this type of approach requires capturing precisely, or failing that in a conservative manner, the "absolute" amount of the carbon emissions attributed to the portfolio.

4.2.3.4. Use of avoided emissions

Certain funds marketed in France refer to **avoided emissions**, either by incorporating this metric in the fund's investment process, or as part of its communication in the case of a fund financing decarbonisation projects (e.g. a green bond fund).

Avoided emissions

Avoided emissions correspond to the emissions that the investments made by the company have enabled it to avoid, or have enabled others to avoid. The development of this metric is designed to quantify **the transition efforts** made by a firm, or the carbon benefits expected from the implementation of a "green" project, in terms of GHG emission data.

For example, the installation of a train line helps limit travel by car, which is more polluting, while the development of renewable energies makes it possible, for a lower carbon cost, to produce a quantity of energy which would otherwise have had to be generated by more polluting methods (e.g. coal-fired power stations).

The use of avoided emissions can allow the development of investment approaches giving priority to issuers engaged in the transition to a low-carbon economy, or be disclosed to investors for the funding of a "green" project. However, communication on the consideration of avoided emissions in the selection of issuers by AMCs should be kept under control. Like the emissions actually generated, avoided emissions are the resultant of assumptions and estimates, standardisation of which is the subject of work at the level of the GHG Protocol[82].

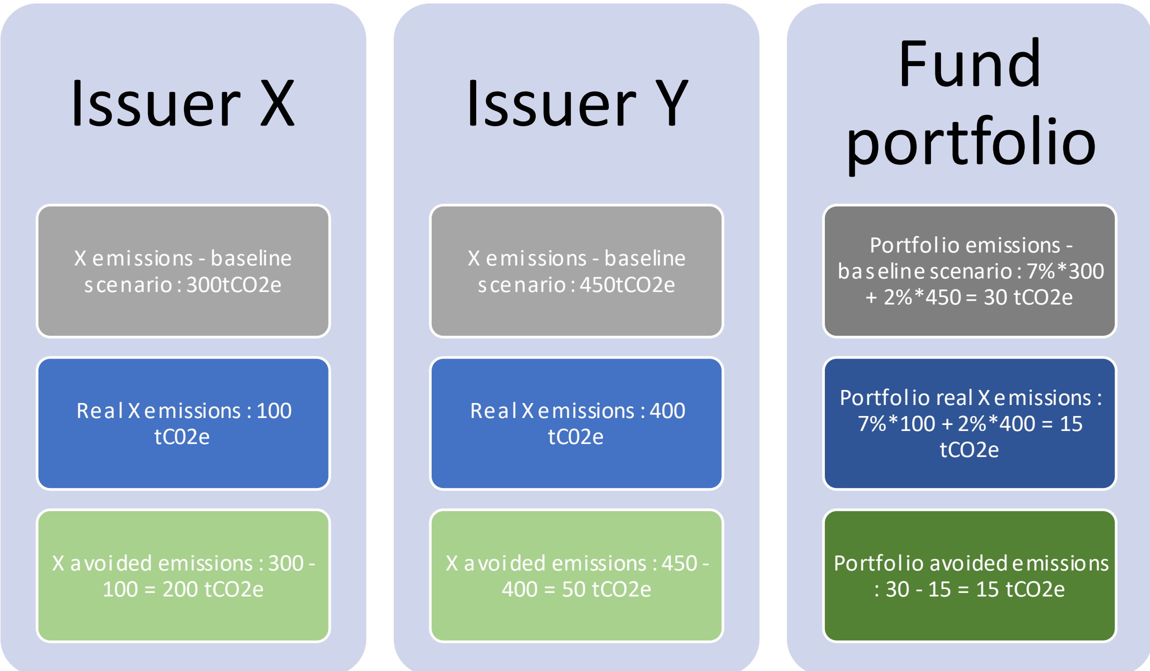
Moreover, it must be remembered that avoided emissions are a hypothetical quantity (they are assessed based on the difference between a given scenario and the emissions actually detected) which are therefore by nature not taken into consideration in the issuer's carbon balance and cannot be taken into consideration for offsetting emissions actually generated.

[82] Cf. in particular the WRI document on the GHG website: "*Estimating and reporting the comparative emissions impacts of products*", January 2019, for a progress report on this subject.

For more information, the AMF suggests that interested readers refer to the technical data sheet produced by the ADEME in January 2020, which summarises the functioning of this quantity and the issues posed by it.

The AMF has noted certain AMCs which use avoided emissions estimate per issuer, according to methods provided by service providers (and not merely based on issuers reporting that they have this type of emissions, who are too scarce). These avoided emissions can then be aggregated at the portfolio level by the same principles as for actual emissions. This quantity may be **useful** because it makes it possible to quantify the total effort to limit greenhouse gas emissions by the issuers in a portfolio.

In some cases, however, the AMF has noted that certain firms communicated concerning these avoided emissions by presenting them as a "decarbonisation tool" in the case of project funding (green bonds), or that in other cases these avoided emissions were **placed opposite** generated emissions, with the fund's portfolio being built so as to ensure that the two quantities are of **equivalent size**.[83] To illustrate this second case, a simplified example in which a fund invests in two companies, A and B, up to 7% of the market capitalisation for the former and 2% for the latter, is provided below :



Source: AMF: imaginary examples

Conceptually, avoided emissions and generated emissions are not homogeneous: the former are hypothetical, and the latter already in fact reflect the optimisation work performed by the issuers (transition from 300 to 100 tonnes of CO_2 equivalent for company X and from 450 to 400 for company Y in the above example). **Thus, it does not seem possible to carry out this second stage of "subtraction" of avoided emissions from generated emissions because the avoided emissions are already deducted from generated emissions.**

Moreover, the AMF has endeavoured to understand the procedures for building estimates of avoided emissions at the level of an issuer. Generally, it seems that the amount of emissions is estimated according to methods which

83 Like for low-carbon funds, constraints of diversification by issuer and by sector or tracking-error constraints are established in order to build a product weakly decorrelated from "conventional" funds within a systematic investment management framework.

vary depending on the sectors of activity and the data available (e.g. for the energy sector: comparison of emission factors with those resulting from the target energy mix in the IEA's 2°C scenario in 2025, for the sector…).

This approach, which is then aggregated at the level of a portfolio, is technically advanced and requires numerous simplifying assumptions given the limitations described earlier: carbon emissions are calculated from emission factors containing margins of uncertainty, and issuers may be present in several sectors, which are not necessarily homogeneous. Moreover, the methods for calculation and publication of companies' carbon emissions, even within a given sector, cannot guarantee their comparability.

On the other hand, if these avoided emissions are calculated in an appropriate and auditable manner, they may be used as an indicator of the transition efforts made by an issuer or of the beneficial contribution of a "green" project to the climate. Depending on its method of estimation, the consideration of avoided emissions in investment decisions can therefore be used by funds implementing an investment strategy giving priority to firms committed to the reduction of their GHG emissions or firms helping to avoid emissions in sectors that are significant greenhouse gas emitters.

Use of greenhouse gas emissions data by AMCs: main points

Regarding AMCs' disclosure of greenhouse gas emissions data for the funds managed by them:

- ✓ Numerous AMCs calculate and publish a metric of greenhouse gas emissions for at least one of the funds that they manage. These publications are mostly focused on equity funds of CIUs having a non-financial investment objective or pursuant to Article 173;
- ✓ Two methods of calculation are predominant: GHG emissions and the carbon intensity of the portfolio. Each method is based on a common principle of aggregation of issuers' data. Their implementation depends on choices and assumptions specific to each AMC (scopes of instruments taken into consideration, existence of double counting, etc.).

And yet, the AMF observes that the AMCs do not communicate very frequently on the methodological limitations of the data presented, even for very advanced calculations of trajectories of portfolios' contribution to global warming. Moreover, it is noted that fixed methods of division of funds' greenhouse gas emissions by fixed factors (e.g. division by 2 or 3) are used to deal with questions of multiple counts, which could result in an underestimation of the reported emissions.

Regarding the use of greenhouse gas emission data in the investment objective of the funds managed, several approaches have developed:

- ✓ fund with objectives of selection of entities generating the least emissions (best-in-class or best-in-universe);
- ✓ funds with an objective of reducing emissions (low-carbon);
- ✓ funds with an objective of offsetting their carbon footprint;
- ✓ funds taking into consideration avoided emissions to quantify issuers' transition efforts.

These investment objectives are sometimes ambitious, e.g. for funds whose objective is to have a small or even zero carbon footprint. They require data that are comparable between issuers or precise in absolute terms, depending on the investment objective aimed at.

4.3. PRODUCTION OF CARBON DATA BY ISSUERS

Issuers disclose information concerning their greenhouse gas emissions mainly via their non-financial statements, whose regulatory framework is described first. Secondly, the principles of carbon emissions calculation are described briefly. A final section presents concrete examples of the publication of carbon data by a sample group of companies in order to illustrate certain points for attention to be taken into consideration by AMCs.

4.3.1. INFORMATION TO BE PRODUCED IN THE NON-FINANCIAL STATEMENT

There are at present no regulatory requirements on the European level concerning regular and exhaustive publication of companies' carbon balances[84].

The non-financial statement to be included in the management report is provided for by Directive 2014/95/EU (the "Non-Financial Directive"). The French system applies it to listed and unlisted companies exceeding certain revenue thresholds,[85] and provides for due diligence on two levels:

- All companies having published a non-financial statement are subject to an obligation of certification of presence of the statement[86] issued by a Statutory Auditor;
- If certain revenue thresholds are exceeded,[87] companies must also have the information verified by an accredited outside service provider ("independent third-party organisation" - **ITPO**), which checks the procedure that led to the production and publication of the data (consolidation, application of the definitions and collection procedures) and the consistency of the indicators adopted with regard to identified risks. The ITPO does not check monitoring of the indicators in themselves.

Regarding climate issues, the system requires publication of the policies and main relevant greenhouse gas emission components together with the measures taken to combat global warming and the proactive reduction objectives for the medium or long term.[88] The stipulated scope is that of the consolidated accounts. The nature of the publication (organisational scope, scope of emissions, chosen metric) is left to the judgment of the issuer.

In practice, various initiatives have developed upstream, complementing the regulations in order to produce recommendations, questionnaires and reports on a voluntary basis, and there are several existing standards: SASB, GRI, recommendations of the TCFD,[89] CDP questionnaire, etc. For its part, the European Commission has issued recommendations supplementing Directive 2014/95/EU,[90] and concerning, in particular, the fact of using a recognised marketplace standard to calculate carbon emissions (methodology of the greenhouse gas protocol or ISO Standard 14064-1:2018), the use of a harmonised presentation table, the fact of publishing 100% of scope 1, the presentation of factors relating to the reliability of information, and various additional guidelines relating to each emission scope.

4.3.1.1. Principles of calculation of a company's GHG balance

Source: AMF

[84] See, in particular, the May 2019 report by Patrick de Cambourg presented to the Minister for the Economy and Finance: *Ensuring the appropriateness and quality of companies' non-financial information: an ambition and an asset for a sustainable Europe*.
[85] Cf. Article R. 225-104 of the French Commercial Code.
[86] Fourth paragraph of Article L. 823-10 of the French Commercial Code.
[87] Article R. 225-105-2, I and II of the French Commercial Code
[88] Cf. Articles L. 225-102-1 and R. 225-105 of the French Commercial Code.
[89] *Task Force on Climate-related Financial Disclosures*, an initiative of the Bloomberg Foundation.
[90] In particular the guidelines of the European Commission in support of Directive 2014/95/EU relating to companies' non-financial information, and Recommendation 179/2013 of the Commission relating to universal methods for measuring GHG performance by the life cycle approach.

The principles of calculation of these emissions are defined by the GHG Protocol.[91] Standards extensively replicating the GHG Protocol have also been established, such as ISO Standard 14064-1 2018, and sector guides have emerged.[92] The document entitled "*Method for producing greenhouse gas emission balances in accordance with Article L. 229-25 of the Environment Code*" (hereinafter "Environment Code methodology") presents in an instructive and detailed manner the steps in calculation of a company's carbon balance. For these reasons, this guide will be used for instructive purposes as a benchmark in the present section, although without constituting a recommendation of use.

The purpose of the company's establishment of a GHG balance is to enable it to identify the major emission components on which it can act, in order to contribute to the reduction of emissions and combat global warming. In the mind of its designers, the GHG balance is **therefore a business-centred decision aid tool, in principle not designed for comparability, as indicated by the warning notices produced by the Environment Code methodology[93] and by the GHG Protocol respectively.[94]**

The duality of use of this data is specified by the European Commission in its guidelines. "[T]he Non-Financial Reporting Directive has a double materiality perspective:

1. The reference to the company's "development, performance [and] position" indicates financial materiality, in the broad sense of affecting the value of the company. Climate-related information should be reported if it is necessary for an understanding of the development, performance and position of the company. This perspective is typically of most interest to investors.
2. The reference to "impact of [the company's] activities" indicates environmental and social materiality. Climate-related information should be reported if it is necessary for an understanding of the external impacts of the company. This perspective is typically of most interest to citizens, consumers, employees, business partners, communities and civil society organisations. However, an increasing number of investors also need to know about the climate impacts of investee companies in order to better understand and measure the climate impacts of their investment portfolios."

Thus, the use of GHG emissions for purposes of comparison between issuers to know the impact of a company on its environment was not the original framework in which the carbon balance was conceived. However, the importance now being acquired by non-financial risks and opportunities have led to development of the concept of materiality in accordance with the second meaning, which incentivises issuers to produce more comparable information.

Determination of the GHG balance of an issuer is in practice based on:

- determination of the scopes that can be covered by reporting: scope of **responsibility** in the chain of the production and use of goods and services, and **organisational** scope of the company (subsidiaries and controlled entities covered);
- definition, in these scopes, of **activity data** relating to the issuer (number of kilometres travelled by a company's vehicles, quantity of goods produced, number of employees, etc.) and application of **emission factors** to this data to convert it into carbon emissions.

These various aspects require making **methodological choices** which may vary from one issuer to another. This section focuses on the main sources of differentiation identified.

4.3.1.2. Determination of scopes

[91] GHG for *GreenHouse Gas*.
[92] For example, a methodological guide for the oil sector published by the IPIECA trade association.
[93] Environment Code methodology, notice to the reader, p. 8: "*7) The application of this method may result in different methodological choices by its users. As a consequence, the GHG emission balances resulting from the use of this method cannot be used for purposes of comparison without having verified beforehand that any methodological differences will create no significant biases in the comparisons*."
[94] GHG FAQ on scope 3: "*The Corporate Value Chain (Scope 3) Standard is designed to enable comparisons of a company's GHG emissions over time. It is not designed to support comparisons between companies based on their scope 3 emissions. Differences in reported emissions may be a result of differences in inventory methodology, company size or structure*."

4.3.1.2.1. Emission scopes

Calculation of a company's greenhouse gas balance is based on the principle of consideration of emissions for which the company **is responsible**, and not merely the emissions that it **produces** directly.

Scopes 1 and 2 are generally regarded as easier to report based on the company's in-house data (production of goods, energy bills, etc.). The principal emission-generating companies relating to these scopes are energy and fuel producers. By comparison, service companies generate relatively few emissions directly or via their energy consumption.[95]

The situation is different for scope 3, on the other hand, which is by nature harder to analyse due to the large number of emission components concerned and the difficulty of estimating the related carbon emissions. Communication on scope 3 therefore varies from one company to another in practice, with some choosing not to communicate concerning the subject, and others partially/selectively according to their perception of the materiality of these emission components and the availability of the related data. However, scope 3 accounts for a significant proportion of the emissions attributable to companies in certain sectors (automotive sector, banks, etc.) and therefore represents information that is potentially important for an assessment of the company by the investor.

4.3.1.2.2. Organisational scope

Regarding the question of a company's subsidiaries and controlled entities, several approaches are possible:[96]

- "Share of capital" approach in which the reporting company consolidates emissions of the goods and activities in line with its equity investment (e.g. taking into consideration 20% of the emissions of a company in which it owns 20% of the capital);
- "Control" approach in which the company consolidates 100% of the emissions of the installations over which it exercises financial control (entities fully consolidated in the consolidated accounts) or operational control (e.g. a plant owned by a company but operated in practice by the company which establishes its GHG balance, and which therefore has control over all the decision-making processes capable of impacting the plant's greenhouse gas emissions).

A financial control approach has the advantage of similarity of scope with the scope of consolidation of the accounts, but the disadvantage, unlike an operational control approach, of not accounting for the whole scope of emissions on which the company can act directly in order to reduce them (e.g. a production plant whose management is delegated to a third party). Depending on the use made of the data by the AMC (for purposes of comparison, or for purposes of dialogue), a preference may take shape for one or the other approach.

4.3.1.3. Activity data and emission factors

The carbon emissions of a process (e.g. manufacturing of a product) are measured by recording the masses of greenhouse gases[97] concerned in CO_2 equivalents emitted over a given period of time (generally one year) during the various stages of its manufacturing (e.g. recording the quantity of gas emitted by a factory chimney for production). Since it is usually not possible to measure in real time the greenhouse gas emissions of all a company's activities, in practice approximations are used, based on a rule by which in principle the quantity of gas emitted is proportional to an appropriate measurable quantity ("**activity data**"): litres of fuel consumed, kilograms of material burned. For example, it is estimated that one kilogram of burnt wood produces about 73 grams of CO_2e.[98]

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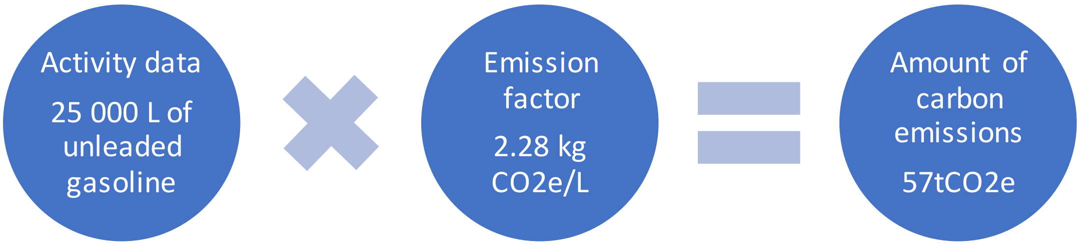
[95] Accordingly, a comparative study of the carbon data relating to about twenty CAC 40 issuers in various sectors showed that three issuers together accounted for about 95% of scope 1 emissions and 65% of scope 2.
[96] Cf. Environment Code methodology, section 6.
[97] Gases identified by Annex II to Directive 2003/87/EC: carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and sulphur hexafluoride (SF_6).
[98] Wood containing 20% moisture. See the ADEME GHG balance website for detailed explanations concerning this example.

The factor for "converting" the activity data into CO_2 equivalent emissions is called the **"emission factor"**. This method has the advantage, at the cost of approximations on this proportionality relation, of not requiring continuous measurement over the entire production chain to calculate GHG emissions. Hence, this method has established itself as in most widespread use by issuers.



Source: AMF, emission factor in bilan-ges.ademe.fr for road use

There are various sources of emission factors that are more or less granular, which can be brought together at the instigation of public organisations such as ADEME, by NGOs, etc. Issuers can also conduct their own analyses to refine their approach to emission factors. For example, they can distinguish between two manufacturing processes for a given fuel and attribute a different emission factor to each of them. Hence, due to the large number of processes involved in the calculation of carbon emissions across all sectors of activity, geographic differences, the variety of activity data available, etc., there is no **exhaustive reference document of the emission factors and activity data** used by issuers, nor **any obligation for companies to refer to a particular source**.[99]

The methodological differences relating to the calculation of scope 2 (indirect emissions due to the company's use of energy) illustrate the diversity of approaches that may exist among issuers for calculating a metric that is in principle comparable from one issuer to another. There are in practice two methods of calculation:[100]

- The location-based approach aims to ascertain the **average energy mix of a country or region** (what quantity of energy is produced from what type of source: coal-fired power station, nuclear power, renewable energies, etc.). Based on this information an average emission factor can be calculated and applied to the quantity of energy used by the company in that country;
- The market-based approach using **contractual recognition of energy sources**. Contractual instruments make it possible to certify the source of an energy, in particular a renewable energy (energy attribute certificates,[101] bilateral contracts with energy suppliers, etc.). They can be acquired by companies, which can associate with them the emission factor consistent with the certified energy source. Using this market-based methodology for the calculation of emissions, an emission factor estimated on the residual mix of non-certified energies is applied to the energy sources not identified by a contractual instrument (unclaimed energy).

The location-based approach is the easiest to implement, since the market-based approach, which can highlight issuers' efforts, requires justifications. In practice, some issuers communicate on a location-based approach, and others on a market-based approach. Some communicate concerning a combination of both: market-based in certain regions in which such contractual instruments exist and are used, and location-based in other regions. The information associated with issuers' publications does not necessarily make it possible to identify which approach is adopted.

4.3.2. ILLUSTRATION OF POINTS FOR ATTENTION FOR AMCS

The non-financial statements of a restricted sample group of four CAC 40 issuers all belonging to different sectors were analysed by the AMF with a view to providing AMCs with tangible examples of companies' establishment of

[99] The Environment Code methodology requires (p. 21) using by default the emission factors of the ADEME database but allows the use of specific factors provided that justifications be given.
[100] Cf. in particular the [guidelines of the *GHG Protocol*](guidelines of the GHG Protocol) on the calculation of scope 2.
[101] Miscellaneous instruments issued in accordance with international standards often adopted on a voluntary basis.

and communication concerning their GHG emissions. This work illustrates for AMCs the diversity of approaches adopted and the multitude of choices made by companies in light of the regulatory and methodological framework described above.[102] This information can therefore guide AMCs in their analysis of this information. The AMF's 2019 report on CSR extends these findings to a broader sample of companies. In short, the following points for attention were noted concerning the reliability and comparability of data.

4.3.2.1. Location of information

The four non-financial statements examined are included in the issuers' registration document. It was noted that some issuers, although not identifying carbon emissions as a priority risk due to their activity, provide detailed information on each of the scopes to comply with marketplace standards or in anticipation of investors' requirements. In the four cases examined, the information presented in the statement is enriched by a methodological note presented at the end of the statement which specifies, in particular, the scope selected for production of the figures (geographic, by sector of activity, etc.) and the major methodological principles of calculation (calculation standard applied, source of emission factors).

In the case of three issuers, documents supplementing the non-financial statement were produced on a voluntary basis: specific climate report, Corporate Social Responsibility (CSR) report, and thematic fact sheets available on the website.

4.3.2.2. Verifications

As mentioned before, companies exceeding the thresholds provided for in the regulations[103] must have their non-financial statement verified by an independent third-party organisation (ITPO). A presentation of the due diligence performed and a reasoned opinion indicating the absence of any "significant" anomaly are accordingly recorded in an "independent third-party organisation report" which is appended to each of the four non-financial statements. These verifications are especially difficult to perform in that the reporting reference frameworks differ substantially in their construction from one issuer to another, notably because of references to different standards (e.g. GRI vs SASB, see above). In practice, the reports of third-party organisations distinguish between the concepts of "moderate assurance" and "reasonable assurance", depending on the extent of the due diligence performed. Based on the observations regarding the four issuers, the third-party organisations communicate concerning the aspects audited, without always emphasising those which were not, so that in this case it is not possible for the AMC to easily comprehend the level of validation of the figures (e.g. scope 3 may not have undergone sample checks by the independent third-party organisation, even in cases where it accounts for a large proportion of emissions).

In the case of one issuer, the AMF noted imprecision regarding the scope of verification: for example, the ITPO report indicates that "direct and indirect GHG emissions" are covered, whereas in practice the scope 1 and 2 emission indicators are taken into consideration, without considering scope 3, contrary to what the wording might suggest.

Furthermore, the AMF noted that one company stated in reply to a CDP questionnaire that 100% of its scope 1 and 2 emissions were audited, whereas on reading the latest ITPO report it can be deduced that a smaller proportion of the consolidated data on key indicators (including scopes 1 and 2) was audited. Also, for one of the companies an error was noted between the sum of scope 1 and scope 2 emissions, and the total amount of scope 1 and scope 2 emissions, in the same table. These indications illustrate that the fact that information has been audited or declared 100% audited without additional information concerning the nature of the audit work performed does not necessarily provide non-financial rating agencies and AMCs with an assurance of the reliability of the figures produced.

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[102] Readers interested in a more exhaustive view may refer to the AMF's 2019 CSR Report.

[103] Cf. section 1.1.1: companies with a balance sheet of more than €100m, or more than €100m revenue, or 500 employees.

4.3.2.3. Scope

Regarding the organisational scope, out of the four non-financial statements by French companies examined by the AMF as part of this study, three chose a financial control approach, and the fourth an operational control approach. Some companies exclude subsidiaries from their scope for reasons of materiality. Moreover, some companies may choose to exclude subsidiaries because they make separate statements. It is noted that a given company may communicate concerning different scopes depending on the document in question: for example, one company included a subsidiary in its non-financial statement and excluded it from its CSR report. All these factors could be liable to influence the non-financial rating agencies' and AMCs' perception of the issuer, whether in a context of comparability or estimation of the total amount of emissions of a portfolio, especially if the emissions in different scopes depending on the issuer are added together.

Regarding the emission scopes, the consideration of emission components is variable from one company to another, notably depending on the assessment of the materiality of certain components depending on the sector of activity. Moreover, the scope may change over time. For example, in 2018 a company incorporated the emission figures for its commercial vehicle fleet, which represented about 20% of its scope 1.

In some cases, it was noted that the figures reported in relation to a given financial year varied from one report to another (for example, the scope 1 figure for 2017 is not the same between the 2017 and 2018 reports). These differences are partly due to variations in the organisational scope (acquisition or disposal of subsidiaries), and partly to progress in the methodologies (consideration of new emission components), but also to updating of emission factors. In order to provide the most accurate possible information, for example, the issuer recalculates the figure for the previous year on a pro forma basis. However, the information provided in the methodological note is not always sufficiently detailed to make it possible to understand all these factors of variability. The consideration, for a given reporting period, of one amount of emissions rather than another requires making a choice and may lead to different results for the non-financial rating agencies and AMCs.

4.3.2.4. Calculation of emissions

Regarding the calculation of scope 2 by a location-based or market-based approach, for the four issuers examined, the practices are different: only one issuer, which communicates concerning a combination of the two approaches, describes its methodology in detail. In the other three cases, no methodological information is provided but the approach used is in practice location-based.

Moreover, since companies do not necessarily have relevant data on all their facilities, or do not want to repeat certain measurement operations each year, approximations can be put in place (e.g. based on the observation that a component accounts for 25% of the total emissions in a financial year, reconstitute an approximated figure the following year). On the basis of the four issuers examined, these approximations, which may concern significant components, are not always described in the issuers' non-financial statements or in sources that are easily accessible to the public. Generally, none of the companies surveyed presented qualitative or quantitative information relating to the uncertainty involved in the carbon emission measurements performed.[104] These examples show that the non-financial rating agencies and AMCs do not necessarily have access to items of information making it possible to assess the uncertainty inherent in the calculation of a company's carbon emissions, which could potentially affect their perception of the issuers.

4.3.3. CONCLUSION

Production of GHG emission data by issuers: main points

[104] The production of information relating to uncertainty is covered by recommendations in the European Commission's guidelines.

As noted throughout this section, establishing the greenhouse gas emissions balance for a company requires a large number of assumptions and implementation choices (emission factors, definition of the scope). Moreover, the estimated emissions contain a fraction of uncertainty related both to the measurement of activity data and emission factors (potentially imperfect estimation of activity data, e.g. the number of kilometres travelled by the company's vehicles, existence of significant confidence intervals for emission factors, as shown by the ADEME's database of factors) and the simplifying choices made for certain emission components (application of rules of three).

The communication examples presented for a small number of issuers show that the information relating to the options taken is not always exhaustive, whereas that relating to uncertainty was not noted in practice. In addition, occasional shortcomings regarding the production of this information (differences of figures and scope) were noted.

In the spirit of the non-financial statement, the GHG balance is a tool to be used first of all by the company to quantify the impact of such emissions on its valuation. However, in a context of use by AMCs, the GHG balance is liable to influence their perception of the issuer when they are interested in the issuer's impact on its environment. Therefore, both the Environment Code methodology[105] and the GHG Protocol[106] produce warning notices relating to the comparability of carbon balances.

This context explains the need to use verifications and audits by parallel sources on the quality and comparability of the data disclosed.

4.4. ESTABLISHMENT OF CARBON DATABASES BY ESG SERVICE PROVIDERS

Source: AMF

The information presented in this section results from discussions held by the AMF with several carbon service providers, non-financial rating agencies and asset management companies.

4.4.1. COLLECTION PROCESS

As mentioned before, there is currently no regular and standardised reporting requirement for companies' carbon data across all their activities. Carbon information from all the issuers in the investment universe is therefore collected by various means:

- Direct request to issuers for their own calculation (e.g. by means of ESG questionnaires);
- Manual collection of the information available in documents published by the company (in particular the non-financial statement);
- Lookup in private databases produced by non-profit organisations (CDP in particular), by service providers or by non-financial rating agencies.

Manual collection is in practice tedious for AMCs (especially in light of comparability difficulties), while sending out questionnaires is tedious for issuers. Hence, various intermediaries have developed all-inclusive offerings providing

105 Methodology L.229-95, notice to the reader, p. 8: "*7) The application of this method may result in different methodological choices by its users. As a consequence, the GHG emission balances resulting from the use of this method cannot be used for purposes of comparison without having verified beforehand that any methodological differences will create no significant biases in the comparisons.*"
106 GHG FAQ on scope 3: "*The Corporate Value Chain (Scope 3) Standard is designed to enable comparisons of a company's GHG emissions over time. It is not designed to support comparisons between companies based on their scope 3 emissions. Differences in reported emissions may be a result of differences in inventory methodology, company size or structure.*"

access to issuers' large carbon databases. This data is collected in practice either by sending out a questionnaire to the issuers (a questionnaire which may serve as a reference due to the critical size reached by the intermediary, which increases the chances of a reply from companies), or by collecting the publicly available information (which from an overall standpoint amounts to the AMCs pooling the manual collection efforts described above). For example, every year a non-profit organisation, CDP,[107] sends to issuers regarded as critical questionnaires concerning climate change generally and collecting, in particular, information on their greenhouse gas emissions. This organisation collects in this way about 6,000 answers a year from companies worldwide, and provides its collected data in a partially monetised manner, serving as a reference for numerous AMCs and service providers. Moreover, certain non-financial rating agencies choose to rely solely on the information available in public databases (including the CDP database), without endeavouring to collect the information individually by themselves. In some cases, the service providers may also check, correct or add to the carbon data, where appropriate by modelling. Finally, some AMCs, motivated by considerations of cost, data quality and information management, have developed their own processes for collecting and modelling carbon data. The processes developed by these AMCs, notably modelling, are similar in their principles to those of the other actors.

4.4.2. MODELLING PROCESS

4.4.2.1. Modelling principles

If the data is not available, most of the actors perform modelling to add to their database. Modelling may also be performed to verify the reported data.[108] To do this, several approaches were noted; the main ones are described below. They mostly proceed by the following steps:

1. Assignment of the company to a sector/breakdown by sector;
2. For each sector, modelling of carbon emissions or intensity;
3. If necessary, aggregation of sector emissions to obtain the modelled carbon data.

- Assignment by sector

The company is assigned to a sector of activity, or, where applicable, its activities are broken down among several sectors of activity, defined by the owner of the methodology. A more or less strong granularity was noted: between about thirty and over one hundred sectors.

Several actors stressed that they had developed their own sector approach, usually adapted from standard or commonly used sector references (GICS,[109] ICB,[110] sector NAF,[111] etc.), in order to identify homogeneous sectors in terms of carbon risk profile. For example, one actor stressed that an oil transport operator, which could be classified in the oil sector from an economic viewpoint, was classified in the transport sector in its "carbon" map of sectors, to take into consideration the emissions generated (which are in principle identical whatever the identity of the goods transported).

- Modelling methodologies

For each sector of activity, the company's carbon emissions are modelled by an approach specific to that sector. Two approaches for this were identified: the "physical" approach and the "statistical" approach.

The "physical" approach aims to identify appropriate available activity data and emission factors in that sector, on the basis of the available information published by the issuers, or themselves modelled (kilometres travelled,

[107] Formerly Carbon Disclosure Project, founded in 2009.

[108] One actor does not develop this offer and indicates in case of absence that the data was not reported. Another performs systematic modelling of its investment universe covered, whether the data has been reported or not.

[109] Global Industry Classification Standard (GICS) designed and maintained by MSCI and S&P.

[110] Industry Classification Benchmark (ICB launched by Dow Jones and FTSE.

[111] Nomenclature d'activités françaises (NAF) produced by INSEE.

tonnes of cement produced, number of employees, etc.) in order to "recalculate" the carbon emissions. The determination of activity data and emission factors can be based on the expertise of the actors[112] and on public sources (GHG, ADEME, etc.).

In the "statistical" approach, carbon emissions are **deduced from comparable data observed on sector peers**, which implies an assumption of uniformity of behaviour of the various issuers in the sector. Two sub-approaches are identified: on the one hand, the use of sector averages (attribution to a company of the observed sector average of the emissions of companies in its sector in proportion to their revenue), and on the other hand, the use of linear regressions on the basis of explanatory factors (revenue, number of employees, etc.).

- Scope of coverage of the modelled data

The various service providers indicate that they cover issuer bases of variable size (between 5,000 and 25,000 issuers). The AMF endeavoured to estimate the proportion of data modelled in all the databases made available to the AMCs by the service providers. **However, this information was not disclosed by some of the actors surveyed**. By way of illustration, one actor makes estimates for about 80% of the number of issuers covered, which would represent 35% of scope 1 and 2 emissions.

4.4.2.2. Transparency with regard to AMCs

Some actors offer their clients complete transparency of the carbon data collection process (initial figures, dialogue, end figures), but most provide only the end figures, possibly accompanied by an analysis. Sometimes, the source of these figures is disclosed, at least in the reported/modelled form. In other cases, the information is not indicated in the database but is available at the client's request. Moreover, although all the actors met stated that they indicate to their clients the main principles of data collection and modelling, complete transparency regarding the process, and in particular regarding the modelling methodologies, is not systematic, the latter being regarded as expertise to be protected. For example, in an informal context the AMF asked several unregulated actors to send their carbon methodology, without obtaining a response.

4.4.2.3. Points for attention noted by the AMF

The approach by sector averages is easy to implement. However, while it is useful especially for approximation of the total carbon footprint of a portfolio, it may be noted that it **creates an incentive not to disclose the data for the companies with the highest carbon emissions in a sector**. If they do not report a figure, these companies will be attributed the sector average by default, and this will unduly improve the perception that a rather inattentive user will have of this company.

In general, moreover, the statistical methods are based on the CO_2 equivalents reported by the companies. The modelling of carbon emissions is therefore based on a core assumption: that emissions behave homogeneously from one company to another in a sector. **This assumption limits the comparison that can be made between the emissions of two actors in a given sector. And yet, depending on the investment objectives, such a comparison may be intrinsic to the method of selection of the securities in the portfolio**.

Finally, the suitability of these methods may be questioned if insufficient observed data is available in a sector. For example, one firm indicated that it had established a rule demanding at least two observed data items per sector to be able to perform modelling. However, no rule for controlling the ratio of modelled information to observed information was noted: it could therefore be assumed that it is possible to have about fifty issuers modelled on the basis of a couple of them for a given sector.

As already mentioned, the issuers seldom mention the uncertainty related to their carbon reporting (which may depend on the uncertainty related to the emission factors themselves or the simplifying rules for assessment of

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[112] Some actors perform the roles of both adviser to the issuers and provider of data to financial market participants.

certain components). The service providers using a "physical" modelling approach do not mention these uncertainties either. As regards the service providers using a "statistical" approach, it was noted that one actor indicates a confidence interval based not on the intrinsic uncertainty of the emissions, but on the modelling deviations relative to the observed data (standard deviation of the data that was used to build the sector average). This uncertainty can therefore not be interpreted directly in absolute amounts, but rather to assess the relevance of the sector uniformity assumption. Finally, one actor gives a more qualitative report on a "confidence score" built from various items: controversies, proportion of emissions audited, etc.

4.4.3. PROCESS OF VERIFICATION/VALIDATION BY SERVICE PROVIDERS

The verification of carbon emissions reported by a company entails consistency checks on sources (e.g. by comparing the non-financial statement, the company's website, the information available from other marketplace actors), trend checks (variation of carbon emissions reported by an issuer over time), and sector checks (comparison of carbon emissions with companies in the same sector).

Most of the actors provide for a dialogue with the company, by submitting to it the figure that they have selected as constituting their carbon emissions (possibly within the broader framework of their ESG analysis of the issuer), so as to prompt them to respond. The response rates are variable depending, in particular, on the company's size and geographic region. This dialogue can sometimes lead the company to disclose new information or correct its publications.

Production of GHG emission data by ESG service providers: main points

The providers of GHG emission data perform work of collection and enrichment of the data forwarded by the issuers. Due to the current fragmentation of reporting, such a stage is necessary for building a database that can be used by AMCs.

This enrichment phase involves modelling. This modelling can be based on methodological principles similar to those employed by the issuers (physical approaches), but with inevitably less granularity. This type of approach allows actors to gain in terms of comparability at the expense of data precision. Modelling can also use peer-based statistical approaches. This type of method may give the illusion of having data concerning issuers when it merely uses extrapolation from sector averages. The use of these statistical approaches therefore does not make it possible, in principle, to compare issuers closely, especially when sector emission averages are used.

In this respect, the use of these methods may also raise questions of transparency of the methodology used, because some of the actors surveyed were reluctant to provide the AMF with detailed methodological information.

4.5. CONCLUSION REGARDING THE QUALITY OF GHG EMISSIONS INFORMATION AND AMCS' CHECKING SYSTEM

4.5.1. AMCS' CHECKING OF PORTFOLIO CARBON FOOTPRINT CALCULATIONS

The checks performed by AMCs on the greenhouse gas emission data of issuers in the portfolio involves ab initio selection of these service providers and ex-post checks on the quality of the reported data.

4.5.1.1. Ab initio checks: selection of service providers

The ESG questionnaire sent to about fifty AMCs asked questions freely on the criteria for selection of ESG service providers. The answers were analysed from the viewpoint of the criteria recurring most often. Those most frequently mentioned are the coverage rate (slightly more than 60% of respondents), the cost (40% of respondents), quality of analysis (38%) and availability and quality of data (34%). Aspects such as the transparency of the methodology and the independence of the service provider are found less often, with 15 % and 9% respectively of mentions by AMCs. This dispersion can also be explained by diverse needs: some AMCs need only raw data to enrich their internal models and their own work, and others need in-depth analyses.

Hence, the data quality and independence criteria are not mentioned in first position by the AMCs. Various service providers surveyed stated that they provided services both to issuer companies (production of the company's carbon balance, strategic counselling) and to investors (provision of carbon databases, analyses, establishment of carbon metrics/reports). The combination of the two activities could result in conflicts of interest (e.g. favouring in the analysis for investors a company which is also a client). In practice, the actors surveyed indicated that they separated the two activities (Chinese walls) in order to prevent such conflicts of interest. Of the AMCs surveyed, some indicated that they considered this aspect important, while another judged it secondary.

In practice, the AMCs interviewed (mostly of large size) stated that they conduct due diligence in advance to assess the quality of the data modelling methodologies and, where appropriate, the suitability of the methodology for the use that will be made of it. Regarding this, several AMCs noted that the service providers' methodologies were subject to change, and that they expected a systematic notification by their service providers in that case. However, it seems that this practice is not covered by a contractual arrangement between the AMC and the service provider.

4.5.1.2. Ex-post checks: greenhouse gas emission data

The review of SPOT inspections published in July 2019 specifies that none of the five AMCs inspected performs checks on the quality of ESG data during their life. The answers received to the questionnaire sent to about fifty AMCs, among the largest and/or most engaged in responsible investment, confirm that a significant proportion of AMCs perform no checks on ESG analyses and metrics in general:

- **50% of the AMCs surveyed state that they regularly check the portfolio's carbon footprint** (this includes the existence of overall consistency checks between various sources of data). It may be a check performed by the AMC on the service providers, e.g. by means of recalculation with a proprietary tool, or a check by a service provider on the work of the AMC or of another service provider/another source of data. The figures may also be reviewed by the fund manager (within the framework of checks on the fund's reporting) or by the fund's Statutory Auditor. The checks may consist, in particular, of consistency checks, on the main quantities and on year-on-year trends. Several AMCs mentioned that they had started work to establish more checking in this area (in particular by putting in place industrialised checks on reconciliation between two sources);
- **15 % of the AMCs surveyed state that they perform a regular ex-post sample check on the ESG data provided by their service providers** (these data include the issuers' carbon footprint in particular);
- **One of the fifty or so AMCs surveyed mentions that it performs a regular ex-post sample reconciliation with the data coming from issuers' non-financial publications.**

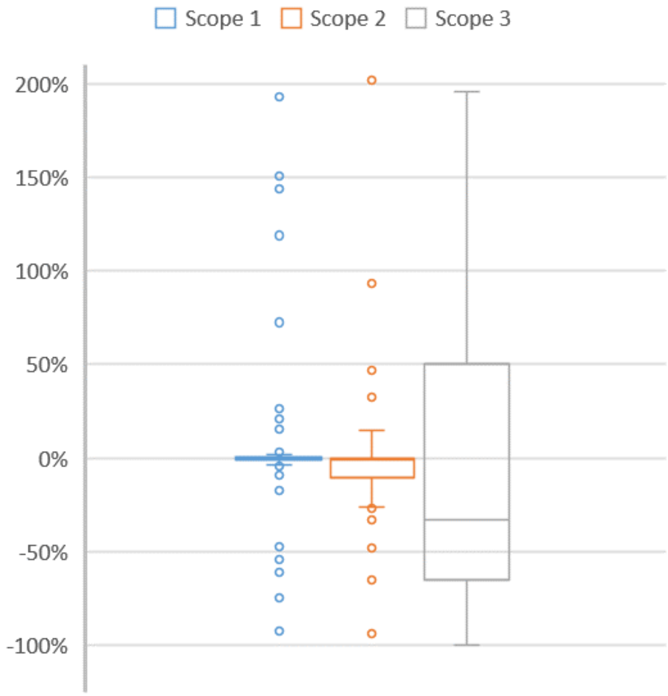
Several AMCs consider that the existence of specialist non-financial service providers can ensure a sufficient quality of the information used, without having to establish checks. Several AMCs also stressed the extra costs and resources that would be required to put in place checks.

4.5.2. ILLUSTRATION OF DATA VARIABILITY: SAMPLE OF 28 ISSUERS

To illustrate the convergence of estimates of greenhouse gas emission data, the AMF asked several actors (non-financial rating agencies, carbon service providers, asset management companies themselves using service providers), for their carbon data relating to a list of slightly less than thirty major French companies in the SBF 120 Index. Among the four unregulated actors asked, only two responded positively to the request. On the collected answers, the AMF performed checks by cross-checking the information from various actors and, on two examples, by comparing it with the issuers' data.

The following graph shows the relative differences in greenhouse gas emissions between the four aforementioned sources (containing both AMCs and service providers) of data on the 28 issuers. Each boxplot represents the relative deviation from the mean of the data reported for 28 issuers x 4 reporting entities.

Relative differences in tC02 reported in 2017 on 28 issuers between 4 data sources:



- The lower line of the boxplot represents the first quartile (25% of values are below it).
- The median line of the boxplot represents the median (50% of values are below it).
- The upper line of the boxplot represents the third quartile (75% of values are below it).
- The values outside this range represent extreme data (outliers). Note that for greater clarity the outliers of scope 3 have been truncated (since the principal outlier shows up to a 4800% deviation from the mean).

Source: AMF

The results show:

- Significantly smaller deviations on scopes 1 and 2 than for scope 3. Nevertheless, these two scopes show a variability which is not insignificant: the mean of the absolute value of relative deviations is equal to 16% for scope 1 and 13% for scope 2. This variability can apparently be explained basically by the size of the issuers concerned, because these deviations are especially small for the large issuers in the portfolio (no deviation on scope 1 for issuers in the energy sector). However, one notes regularly that three of the four sources show identical amounts for scopes 1 and 2. And yet, no systematic source bias was able to be identified.
- The scope 3 data show very substantial variability, with an average absolute value of relative deviations equal to 218%. On these data, the absolute deviation from the mean was less than 20% in only 10% of cases. As a result of this, therefore, and consistent with the difficulties of consideration of scope 3 mentioned above, there is great uncertainty regarding these amounts.

Hence, even for major issuers, the AMCs have to use data that are sometimes significantly different. **This variability illustrates the current lack of convergence of the method for estimating GHG emissions, and the need to perform proportional checks on service providers in order to have an understanding of the data used.**

Moreover, in some cases the AMF noted that two actors mentioned the same data source (CDP in this case), but giving a different figure. This could be explained by the fact that this actor, in addition to a data collection activity, also makes its own estimates and verifications and produces a second data set corrected and supplemented with this information. Hence, the actor's mention alone may not be sufficient to characterise a data source.

The AMF questioned the AMCs on their willingness to publish the line-by-line details of the carbon footprint of their funds' portfolio, for example in their report on the composition of their portfolio. **Half of the AMCs questioned said they were favourable to this.** The main reasons mentioned by the AMCs unfavourable to this practice are the impossibility of disclosing the data, the fact that the data are the property of the service provider, the lack of a methodological consensus which would bring into broad daylight the disparities and lack of coverage of the whole portfolio. However, several AMCs stated that they held the information available for investors if requested.

Regarding the consistency of the information with that published by the issuers concerning a company, it is noted that one actor indicated as its source the non-financial statement, although the AMF was unable to find the figure in said report. Moreover, another figure pointed to an incorrect source (the non-financial statement for the previous year). Also, for one issuer having chosen to communicate concerning a strategic subsidiary (consolidated in the accounts) in one source and not include it in another source, the AMF noted that one actor had adopted in its database the figure excluding the subsidiary, although this point was not mentioned in the accompanying analysis.

4.5.3. POINTS FOR ATTENTION CONCERNING THE QUALITY OF DATA RELATING TO GHG EMISSIONS

In light of all the uncertainties emphasised, the use of greenhouse gas emission data requires establishing appropriate checks to comply with regulatory requirements.[113]

When this data is essential for the investment objective, the nature of the carbon information produced by issuers requires checks and a thorough review to be able to guarantee its comparability and the relevance of the absolute amounts of emissions produced. This requirement is strengthened by the diversity of processes for the collection, harmonisation, verification and completion of information. The AMF also noted in some cases that the figures reported by the service providers did not correct the biases observed at the issuer level, or else could contain unexplained deviations from the published sources. Furthermore, certain modelling methodologies used by the service providers make the data rather unsuitable for certain uses (the use of sector averages does not allow comparability, for example). For the few observed cases in which the service provider indicates some assessment of the data's uncertainty, the measured uncertainty concerns either the modelling deviation relative to the reporting by the issuers, or a more qualitative assessment relating to the confidence to be assigned to the figure given by the issuer. Hence, the intrinsic uncertainty relating to the amount of emissions (due in particular to the uncertainty concerning emission factors) is not captured, and this may prove problematic for the comparison and estimation of absolute amounts.

And yet, only half of the AMCs state that they perform checks, the nature of which often remains confined to consistency checks between indirect sources, without cross-checking with, in particular, the issuer itself, and only 15% say that they perform sample checks on ESG data. As a consequence, in order to guide AMCs and strengthen the carbon information feedback system, the AMF introduces a Position and a series of good practices. The purpose of this Position is to make the regulatory obligation to perform checks on data quality **proportional** to the criticality of its use. Therefore, and to encourage the use of these data by AMCs, the AMF considers that their use for the purpose of ex-post reporting or risk management, without commitments in the CIU's investment objective or investment policy, requires less due diligence than their use in the framework of the investment process.

Position 2 applicable to asset management companies authorised in France

Checking of data relating to GHG emissions

(1) In order to have reliable data, AMCs which use greenhouse gas emission data should put in place a system for checking the quality and consistency of these data, proportional to the criticality of use of these data. When they determine the frequency and scope of this system of checks, AMCs take into consideration their use, by decreasing

[113] Obligation to provide the investor with information that is clear, accurate and not misleading (Article L. 533-22-2-1 of the Monetary and Financial Code) and obligations to have robust and credible data for risk management (Article 321-81 of the AMF General Regulation for UCITS and Article 45 of Delegated Regulation (EU) 231/2013 for AIFs).

order of criticality: (a) in the investment process or (b) in the information disclosed to investors or the risk management of those funds.

Recommendation 4 applicable to funds authorised for marketing in France

(1) The AMF recommends to AMCs which use a service provider to obtain greenhouse gas emission data that they check that said service provider:
- includes in its process for production of these data a stage of verification of the quality of the data produced;
- monitor the consistency of the exchange rates used in the various aspects of production of greenhouse gas emission data (modelling, aggregation to measure the carbon intensity of a portfolio, etc.).

Good practice 2

When selecting the service provider
(1) Have an instructive presentation and ask to have access to the data collection and modelling methodology in order to understand:
- the principles involved (e.g., the existence of a dialogue with the issuer, the use of modelling by a physical approach rather than by sector average, etc.);
- the limitations and their significance (assumptions of uniformity of behaviour by sector, approximation of activity data by proportional rules and frequency of cases in which that occurs, etc.);
- the rules established to prevent or manage these limitations (existence and relevance of confidence interval metrics, observation sample of minimum size to perform extrapolations, etc.).

During the provision of services
(2) Always ask for the source of the data (source of information if reported, precise details concerning the total/partial modelling of data, date on which the data was collected, etc.). The source should, in particular, be sufficiently precise to be able to ensure its uniqueness (accordingly, citing a service provider as a source may be insufficient if the latter provides several data sets, depending on the quality of the checks that it applies);
(3) Ask to be systematically kept informed of changes of methodology;
(4) Ask for the methodological documents to systematically and conspicuously recap the main assumptions and limitations underpinning the methodologies used, and the precautions for use.

Ex-post checking
(5) In proportion to the use made of the data (and in particular the investment objective), perform regular sample checks in order to compare the information produced by companies and the information provided by the service providers.

Other aspects of data checking
(6) Check issuers' carbon intensity or emissions data by means of:
- consistency checks by sector or in time;
- comparisons with alternative data sources (information available in public databases, produced by a different service provider from the service provider used, etc.);

Ideas for work by market participants and the marketplace
(1) Given that some of these practices depend on relations between AMCs and service providers, professional associations could promote **thinking concerning a universal framework for dialogue between service providers and asset management companies**, like the initiative conducted with companies by various entities including the MEDEF and AFEP and published in January 2019, or again **the preparation of model contractual provisions with service providers** allowing extensive dissemination of these good practices.

(2) Actors could **develop robust methodologies for estimation of the uncertainty** relating to the data and to communicate relevant information on this subject. The AMF notes, for example, that emission factor databases,

such as that of the ADEME, contain an estimate of the uncertainty related to each emission factor making it possible to measure that uncertainty by a "physical" approach.

4.5.4. POINTS FOR ATTENTION CONCERNING THE HIGHLIGHTING OF GHG EMISSION DATA BY CIUS

All the factors noted above show the existence of good practices, but also current limitations to the use of carbon data (quality of data, lack of checking work), and the resulting risks with regard to communication. Hence, it is necessary for AMCs to ensure they communicate in a balanced manner on the promises made by certain funds or the use of certain methods to ensure that the information provided is clear, accurate and not misleading.

As a consequence, the AMF issues the following positions, recommendations and good and poor practices. The positions and recommendations will be ultimately incorporated in the AMF Policy.

Position 3 applicable to funds authorised for marketing in France

Calculation of metrics relating to GHG emissions

(1) To ensure that the information provided to investors is correct, clear and not misleading, the AMF considers that, to be able to communicate concerning portfolio carbon footprint metrics correcting the effects of multiple counting by means of fixed factors based on expert opinion (e.g. division by 2 or 3), it is necessary to demonstrate the conservative nature of the factor thus adopted and to make that demonstration public, or at least keep the demonstration available to anyone who requests it.

(2) Usually, the absence of data of sufficient quality/available methodologies means it is not possible to calculate the carbon metric in question for all the assets forming the fund's portfolio. Under these conditions, certain practices involve extrapolating this metric to the entire portfolio from the known data for a subset. To ensure that the information provided to investors is correct, clear and not misleading, the AMF considers that, to be able to communicate **ex-post** concerning greenhouse gas metrics used in this way, it is necessary to demonstrate the appropriateness of the metric in light of the use made of it, and to make that demonstration public, or at least keep the demonstration available to anyone who requests it.

Consideration in investment policy

(3) Given the complexity of the process for producing greenhouse gas emission metrics, and in particular the numerous methodological decisions, assumptions made and approximations performed, generating in particular uncertainties concerning the amounts and insufficiently conservative aggregation biases, the AMF considers that, to be able to communicate regarding a CIU on aspects such as "neutralisation" of the carbon impact or the achievement of a "zero carbon" objective, AMCs must at least be able to demonstrate the conservative nature of the approach employed to estimate the carbon footprint. This requires, in particular, the consideration of all relevant emissions of the issuers in the portfolio (in particular scope 3, despite the difficulties of assessing it). Moreover, this demonstration must be public, or at least kept available for anyone who requests it.

(4) Funds taking avoided emissions into consideration cannot highlight offsetting effects (e.g. asserting that a portfolio is carbon "neutral" because the avoided emissions are equivalent to the emissions generated), or suggest a comparison between those emissions and the emissions generated. However, these funds may communicate concerning the methodological benefits of this practice in quantifying issuers' efforts to limit greenhouse gases. Moreover, funds whose purpose is to fund "decarbonisation" projects may communicate concerning the emissions avoided by implementing these projects.

(5) Funds wanting to highlight the consideration of greenhouse gas emissions in their investment objective must insert in their KIID a warning notice indicating that these data are based on estimates. Furthermore, and where applicable, the following warnings must also be mentioned in the funds' KIID:

- absence of consideration of scope 3, explaining, where applicable, the reasons for such an absence (insufficient available data, etc.);

- the fact that the strategy implemented may lead to investment in stocks that are significant emitters of greenhouse gases (e.g. a low-carbon fund which reduces the weighting of this type of issuer in the portfolio without excluding them).

This position is included in the scope of Position 7 of Position-Recommendation 2020-03 relating to the marketing of foreign UCITS in France.

Recommendation 5 applicable to funds authorised for marketing in France

Instructive presentation of the use, calculation and limitations of data relating to GHG emissions
(1) When the investment objective includes GHG data, and in order to ensure that the information provided to investors is correct, clear and not misleading, the AMF recommends that AMCs indicate to investors: (a) the uses made of GHG data in the investment management process, (b) the process of production of these data (including processing performed by any intermediaries), and (c) the limitations of these data. This information could be reported in a separate document from the regulatory or commercial documentation, which would then refer to this document (e.g. an "instructive guide on greenhouse gas emissions", a Transparency Code or in an "Article 173" report).

As an illustration, this information could, in particular, include the following aspects:
- issuers' process for measuring the carbon balance (activity data, emission factors, emission scopes), associated limitations and checks (existence or absence of an audit and nature of that audit, significant approximations, providing examples);
- the process of collection of these data, and in particular the fact that they can be derived from modelling, while specifying the principles, limitations and checks for this;
- an indication of the emission scopes that have not been taken into account when estimating a carbon footprint, together with the reasons for these exclusions, and an illustration of the existence of carbon emissions not taken into consideration, by means of examples;
- a description of the process of calculation of the carbon footprint or carbon intensity of the portfolio, and in particular the aggregation methodology adopted and its limitations (equity approach, enterprise value approach, intensity, etc.);
- information specifying how the metric is appropriate for the use made of it, in light of these limitations.

In addition, the following good and poor practices are noted:

Good practice 3

Publication of data relating to GHG emissions
(1) In the communication document, provide an instructive introduction to the principles of calculation of the carbon footprint or intensity of a fund, and refer to a more detailed source.
(2) Following on from good practice 1 of the 2017 AMF report on sustainable finance in collective investment management relating to publication of the methodological limitations, disclose the portfolio coverage rate, indicating, where applicable, the nature of the items not covered (issuers with no data, assets not covered) and the rule adopted for the part not covered (extrapolated with justifications of the adequacy of this approach, or ignored).

Consideration in investment policy
(3) Given the current limitations of the quantitative approaches, supplement the quantitative carbon-based investment strategies with qualitative approaches making it possible to assess issuers' climate strategy and their effective emission reduction efforts.

Framework for consideration of avoided emissions

(4) The technical data sheet published by ADEME in January 2020 sets out a series of recommendations (criteria for selection of the benchmark scenario, critical review by an independent third party, no fragmentation of emissions among "those responsible", conditions of communication regarding clean emissions). The AMF incentivises AMCs which use and communicate concerning avoided emissions to comply with these recommendations when they estimate avoided emissions themselves, or to make sure that these recommendations are complied with by their service providers/by the issuers in the portfolio where applicable.

Poor practice 3:

Publication of data relating to GHG emissions
(1) In the case of a comparative publication with a benchmark, not checking the suitability of comparison of data relating to GHG emissions, notably with regard to the following aspects: absence of bias due to the limitation of scopes, coverage rate, and methodological divergences in building the data.[114]
(2) Indicating the scope of calculation of the data relating to GHG emissions in the form of an exhaustive list of items taken into consideration, without indicating explicitly the missing items nor their relevance (for example, indicating that only scopes 1 and 2 are taken into consideration instead of indicating that scope 3 is not taken into consideration, and that the latter could be significant in the presented context of use).
(3) Communicating concerning an alignment of the portfolio with a transition scenario without presenting the principles, limitations and methodological biases of the approach.

4.6. FUTURE WORK ON CLIMATE AND ESG REPORTING

Many asset management actors note, during interviews conducted by the AMF or in other contexts, their growing concern about the cost, opacity and quality of ESG data in general, and carbon data in particular. These AMCs would therefore like to see the emergence of mandatory standardised reporting of non-financial information for issuers on the European level, or even globally, so as to be able to collect comparable data easily and at less cost.

For their part, issuers mention the increasing, and increasingly diverse demands concerning non-financial aspects from investors, rating agencies (non-financial or conventional), or again index providers, implying increased resources and costs to cope with this.

So far, a principal-cause approach defined by materiality (assessed by the issuer itself) has been preferred by the European regulations. However, there are many voices demanding further progress on the subject of climate and non-financial reporting (on this subject, see the report cited above submitted to the Minister for the Economy and Finance by Patrick de Cambourg in June 2019, which proposes **an action plan in order to achieve, at least on the European level,[115] a standardisation of non-financial information** (themes, indicators, methodologies, common terminology) so that the latter may have a similar status to that of financial information). The question of the framework, supervision and rules (transparency, organisation, conflicts of interest, etc.) applicable to non-financial data providers and rating agencies will also be posed, in light of their increasingly decisive role for financial markets, as confirmed by the analyses performed for this report. Moreover, the European Commission's technical expert group has already recommended the establishment of a system of accreditation of the outside auditors used within the framework of green bond issuance.

Finally, within the framework of the European Commission’s Action Plan for Sustainable Finance, indices labelled "carbon transition" and "aligned on the Paris Agreement" are expected to appear, while new ESG transparency requirements will be imposed on conventional indices, in accordance with technical specifications currently being prepared.[116] These technical specifications, and the associated reporting requirements, could provide a reference

[114] Regarding this, it should be noted that Article 8 1 (b) of the Disclosure Regulation, for financial products which promote environmental characteristics, provides that "*if an index has been designated as benchmark index, information indicating whether and how that index is appropriate for those characteristics*".
[115] Proposal confirmed by V. Dombrovskis in his speech of 28 January 2020 on the European Green Deal.
[116] TEG Final Report on Climate Benchmarks and ESG Disclosures, September 2019. It is then planned for the European Commission to publish a draft delegated act for consultation, before formal enactment.

framework helping to achieve market convergence on aspects of calculation of the carbon footprint of fund portfolios.

5. IMPLEMENTATION OF ESG INFORMATION OBLIGATIONS ("ARTICLE 173-VI LTECV" FRAMEWORK)

Article L. 533-22-1 of the Monetary and Financial Code[117] requires that AMCs, on behalf of their funds,[118] publish information concerning the procedures for taking ESG criteria into consideration in the investment policy, specifying the nature of the criteria taken into consideration and, where applicable, the way in which voting rights are exercised in accordance with these criteria. This article is supplemented by Article D. 533-16-1 of the Monetary and Financial Code.

A review of application of this setup, co-signed by the Treasury, the Ministry for the Ecological and Solidarity Transition, ACPR and the AMF has been published in early July 2019, analysing the information provided by the thirty leading asset management companies in terms of assets under management. This application review reveals the great diversity of publications in terms of quality, quantity, relevance and comparability, explained by the lack of maturity of the indicators and methodologies, especially regarding assessment of the contribution to compliance with long-term environmental goals.

Following on from this work on the substance of "Article 173" publications, the AMF decided to carry out a review of the form, by making **an exhaustive inventory** of the existence of regulatory publications produced by the whole perimeter of application, namely 510 asset management companies and 500 funds having assets exceeding €500m noted in June 2019.[119] A qualitative analysis of the content of the information was also performed on several of these funds.[120]
Following a recap of the European regulatory requirements and developments expected in this area, a summary of this work is produced. Conclusions of this work lead AMF to issue positions, recommendations, good and practices that supplements the one expressed in the previous AMF report on the topic.

5.1. RECAP OF REPORTING REQUIREMENTS AND THE OUTLOOK

5.1.1. RECAP OF REPORTING REQUIREMENTS

Article D. 533-16-1 of the Monetary and Financial Code provisions that in practice, AMCs must produce information **on two levels**:
- firstly **on the level of the AMC itself** (in 1° of II of the article: presentation of the general approach, content, means of information of clients, list of funds including E, S and G criteria simultaneously and proportion of assets under management, the entity's adherence to initiatives, ESG risk management policy where applicable);
- and secondly **on the level of each fund** for which the assets under management exceed €500m, with more detailed information on the consideration of ESG criteria (in 2° of II of the article: nature, criteria, source of data, methodologies, impact on investment policy).

Also, "Article 173" information documents must be mentioned in the prospectuses of all the funds, as provided for by the second paragraph of Article L. 533-22-1 of the Monetary and Financial Code.

[117] Provisions enacted by paragraph VI of Article 173 of Act No. 2015-992 of 17 August 2015 on energy transition for green growth (LTECV).
[118] All UCITS and AIFs excluding real estate, securitisations and: UCITS, 'FIVG' general investment funds, private equity funds, funds of alternative funds, FPVG, FPS, SLP and employee savings scheme funds (Article D. 533-16-1 of the Monetary and Financial Code, I 1°).
[119] Due to fluctuations in assets under management and authorisation withdrawals/awards, the figures vary depending on the period of time considered.
[120] Since information at the fund level was not investigated in the application review.

The information on the AMC level must be presented "*in an easily identifiable manner on the entity's website and updated each year*".[121] The information on the level of each fund must be presented in the fund's annual report and also on the asset management company's website. Professional funds and general investment funds (FIVGs) reserved for at most twenty fundholders are not subject to this requirement of publication on the website, except those for which there is no publication elsewhere on the AMC's website.[122]

These obligations have been in force since 30 June 2017.[123] The standardised presentation of the approaches, without any constraint regarding how to take ESG criteria into consideration and the public nature of the information, were designed to allow comparison between actors and promote the emergence of best practices. After two years in application, as provided for by Article 4 of Decree 2015-1850, the DGT/MTES/ACPR/AMF joint report presented a review of the application of these measures. This review observes great heterogeneity of the approaches and identifies several good practices, which are incorporated in the good practices issued by the AMF, presented in sections 6.2.3 and 6.3.5 respectively.

5.1.2. OUTLOOK: EUROPEAN DISCLOSURE REGULATION AND ARTICLE 173

Within the framework of the Action Plan on Sustainable Finance proposed by the European Commission in March 2018, the European Union in April 2019 enacted a European Regulation on the publication of information relating to sustainable investment and sustainability risks (the "Disclosure Regulation"). As described in detail by the AMF's July 2019 publication on the subject (*European regulatory progress review: progress on sustainable finance work (Disclosure and Benchmark)*), this regulation aims to define on the European level harmonised rules applicable to all financial market professionals for the publication of information relating to sustainable investment and sustainability risks.

Regarding information which does not concern the regulatory or commercial documentation for the products, the objectives of the Disclosure Regulation are similar to those of Article 173-VI in France, which preceded and inspired it. The Disclosure Regulation carries over the **principle of information on two levels (information on the level of the entity and on the level of the product)** and, in a limited fashion, the **principle of "*comply or explain*"**. However, the "Disclosure" framework differs from the "Article 173" framework on several aspects, as summarised below.

[121] Cf. 2° of IV of Article D. 533-16-1 of the Monetary and Financial Code.
[122] Cf. 3° of IV of Article D. 533-16-1 of the Monetary and Financial Code. "*unless they are the subject of a publication on the asset management company's website*", the following funds are exempted from publication on the website: FFA, FPVG, FPS, FPCI, SLP and FIVG coming under Article L. 214-26-1 of the Monetary and Financial Code which are reserved for at most 20 fundholders.
[123] Cf. Article 2 of Decree 2015-1850.

Type	Article 173 – Article D. 533-16-1 CMF		Disclosure Regulation	
On the entity level	AMCs managing UCITS and certain AIFs (excluding securitisation and real estate in particular)		AMCs managing UCITS and AIFs	
	§II | 1°	Description of the consideration of ESG criteria or risks at the level of the actor, list of products taking non-financial criteria into consideration, adherence to charters, codes, etc.	Art. 3 & 4	Information on policy relating to the integration of sustainability risks Publication on consideration of the negative sustainability consequences: • Transparency on consideration ("explain"); • Declaration on *reasonable due diligence policies* ("comply") for entities with more than 500 employees.
On the product level (excluding information in the regulatory and commercial documents)	For UCITS and certain AIFs having AUM exceeding €500m		For UCITS and AIFs promoting non-financial criteria ("**Article 8**") or having a sustainable investment objective ("**Article 9**")	
	§II | 2°	Ex-ante: Description of the nature and methods of consideration of ESG criteria in investment management and in voting and engagement Ex-post: • Review of implementation of voting and engagement policy; • Contribution to meeting environmental targets	Art. 10 & 11	Ex-ante: Description of the ESG characteristics (Art. 8) or the sustainable investment objective (Art. 9) and the methods used Ex-post: Description of the extent to which the ESG characteristics are complied with (Art. 8) or the overall sustainability impact of the fund by means of appropriate indicators (Art. 9)

Regarding **the scope of application** in the area of asset management, the Disclosure Regulation applies to AMCs and all the funds that they manage, whereas the "Article 173" framework does not cover certain AIFs (including securitisation and real estate funds).

Regarding **the content**, the Disclosure Regulation requires that actors communicate, on the level of the entity and for all their products[124]:

- the main negative impacts of the investments (both the financial impact through the consideration of sustainability risks[125] and the product's negative impact on sustainability factors),[126]
- for those funds stressing ESG characteristics (Articles 8 and 9), how they achieve their objective.

Article 173, for its part, aims to describe more generally the consideration of ESG criteria in the investment policy, with a focus on compliance with global warming limitation goals. The "risk" aspect, when it is taken into consideration, is limited to the AMC level.

Finally, regarding **the location of information relating to the products**, the Disclosure Regulation provides for information first on the level of precontractual information and on the entity's website, and in routine reports only for products having ESG characteristics. The "Article 173" framework, for its part, covers precontractual information only by a reference to the prospectuses on the website and in the annual report,[127] and requires information in the annual reports for all the strategies (including those not stressing ESG characteristics, in that case by an "explain" approach), but including a condition of minimum size of the fund (€500m in AUM).

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[124] The Disclosure Regulation also imposes consideration of the negative impacts of the investment policy on sustainability factors for AMCs exceeding a threshold of 500 employees, with no possibility of applying an "explain" policy. This approach is a paradigm change by comparison with Article 173, where the "comply or explain" approach is systematic. However, the scope of this change should be tempered by the high threshold of activity which should in practice concern only a small number of AMCs in the French market.

[125] *"sustainability risk", an event or situation in the environmental, social or governance field which, if it occurs, could have a major negative impact, real or potential, on the value of the investment resulting from a negative sustainability impact;*

[126] *"sustainability factors", environmental, social and personnel issues, respect for human rights and combating corruption and acts of corruption*

[127] Article L. 533-22-1 of the Monetary and Financial Code: "[the Article 173 information documents] *are mentioned in the UCITS or AIF prospectus coming within* [the scope of application of Article 173]."

Moreover, the content of the Disclosure Regulation obligations will depend very significantly on the level-2 documents currently being prepared. For example, since the European document does not have maximum harmonisation, the energy and climate law amended the text of Article L. 533-22-1 of the Monetary and Financial Code based on the "Article 173" framework to take into consideration this new European reality while keeping the specific features of the French framework. For example, the amended text makes it possible, in particular, to maintain the publication by French financial actors of information on their contribution to the energy transition, and on the alignment of investment strategies on the international climate change limitation goals. Furthermore, the reference to indicative targets consistent with the National Low-Carbon Strategy was kept. Finally, the amended text allows an extension of the framework to the consideration of risks related to biodiversity.

The positions, recommendations and good and poor practices presented in this section are therefore of great importance for preparing the entry into force of the new Disclosure Regulation.

5.2. IMPLEMENTATION ON THE LEVEL OF ASSET MANAGEMENT COMPANIES

5.2.1. INVENTORY OF PUBLICATIONS

The AMF inventoried the information published on the websites of the 500 or so AMCs coming within the scope of application of Article 173, firstly by a letter, then by follow-up correspondence and finally by manual searches on the entities' websites. Following this analysis, the AMCs were classified partly according to whether or not a publication exists on their website (which is a regulatory obligation), and partly, if there is such a publication, on its overall quality. Regarding this, three categories emerged:

- On the one hand, AMCs which state that they take ESG criteria into consideration (at least one E, S or G criterion, for at least one of their funds);
- On the other hand, AMCs which state that they do not take ESG criteria into consideration; and
- Finally, a last category of AMCs which do not take ESG criteria into consideration for at least one of their CIUs but state that they are "sensitive to" ESG issues.

The latter category is a reflection of the numerous actors who state that they do not take ESG criteria into consideration formally but that they pay qualitative attention to the subject, watch future developments before committing themselves, or whose formal ESG approach consists merely of the application of mandatory normative filters (e.g. issuers not complying with the Oslo Convention which bans involvement in the production of cluster bombs). These standards, having a not very differentiating effect for a European investment universe, must in practice be applied by all AMCs, although not all of them choose to communicate concerning this.
The results of the inventory work, updated since the information presented in the application review of Article 173[128] and finalised at the end of September 2019, are presented in summary form below.

	Number of AMCs	Percentage of the number of AMCs	Percentage of assets under management by AMCs in the category
Total number of AMCs	510	100%	100%
Publication of information	508	99.6%	100.0%
Those taking ESG criteria into consideration	*199*	*39.0%*	*88.3%*
Those not taking ESG criteria into consideration	*135*	*26.5%*	*3.4%*
Those not taking ESG criteria into consideration but saying they are sensitive to the issue	*174*	*34.1%*	*8.3%*

[128] In particular, the total number of AMCs between the two documents decreased from 521 to 510 as a result of AMCs that discontinued their business or, after verification, were found to manage only funds outside the scope of Article 173. Moreover, the number of AMCs not reporting fell from 49 to a few following reminders and additional investigations conducted by the AMF. Lastly, the situation of the three AMCs mentioned in the application review of Article 173 was regularised.

No publication	2	0.4%	0.0%

Source: AMF

The 2017 figures, which did not include the category of AMCs "sensitive to" ESG issues, are recapped below.

2017	Number of AMCs	Percentage of the number of AMCs	Percentage of assets under management by AMCs in the category
Total number of AMCs	516	100%	100%
Publication of information	350	68%	88%
Those taking ESG criteria into consideration	*194*	*38%*	*78%*
Those not taking ESG criteria into consideration	*156*	*30%*	*4%*
No publication of information	166	32%	12%

Source: AMF

The comparison between the two studies shows **an increase in the publications inventoried by the AMF** (almost 100% in 2018 versus 68% of AMCs representing 88% of AUM in 2017). The number of AMCs stating that they take ESG criteria into consideration for at least one of their funds has remained practically stable (slightly less than 200). The reader's attention is drawn to the fact that when an AMC says it takes ESG criteria into consideration for at least one of its funds, that does not mean that 100% of its assets take ESG criteria into consideration, or not in the same way. For example, the figure of 88% of AUM represented by the AMCs stating that they take ESG criteria into consideration for at least one of their funds does not mean that 88% of the AUM of the investment funds take ESG criteria into consideration. It simply indicates that most of the large actors state that they take ESG criteria into consideration for at least one of their funds.

During its work, the AMF held instructive discussions with AMCs on several occasions to prompt them to improve their information, or to publish it if this was not yet done (especially for small AMCs or AMCs forming part of a group which had not identified the regulatory requirement to produce information on the AMC level). Thus, several AMCs organised publication, and others improved the accessibility and quality of the information available following these discussions.

Moreover, in some cases, the AMCs do not have a website (very small organisations, or AMCs operating within a group). This situation is not provided for by the Monetary and Financial Code. It is noted that in this case the AMCs concerned disseminated the information either via the website of an organisation in their group, or via management reports of the AMC or each of its funds. This situation was considered acceptable by the AMF, which in the above table classified the AMCs as having published information.

As regards the residual AMCs that have not published information, these are very small AMCs. The AMF is working to regularise their situation.

5.2.2. PRACTICES NOTED

5.2.2.1. Location of information

The "Article 173" information is usually lodged either in a dedicated "ESG", "SRI" or "responsible investment" tab available directly on the AMC's home page, or in the "Regulatory Information" at the bottom of the page, alongside other information that must be published on the entity's website (conflict of interest management, selection of intermediaries, etc.). For some small organisations, the information is merged with the mandatory information specific to the website ("legal notice" or "legal and regulatory notice").
More rarely, the information is presented in a somewhat less obvious manner in one of the tabs of the AMC's website such as "strategy", "our philosophy"/"our values", or "get to know us".
For some AMCs which highlight a "responsible" offer, the information is sometimes not easily accessible or distinguishable from marketing information related to that offer.

5.2.2.2. Information structure

The information may be delivered in the form of a report or a dedicated policy downloadable on the AMC's website, or in the form of a page/part of a page.
When the ESG criteria are taken into consideration, the level of detail of the information is highly variable: some "Article 173" reports on the AMC level may have about thirty pages, others merely a few paragraphs.
Although a model plan is provided for by the implementing decree,[129] not all the AMCs comply with it, and this may sometimes detract from the clarity of the information.

5.2.2.3. Content of the information

For those AMCs which state that they take ESG criteria into consideration, the information will cover aspects such as a description of the investment process (exclusions, ESG rating methodology, etc.), the technical and human resources deployed, and the voting and engagement policy. Due to the failure to follow the model plan mentioned above, certain information is sometimes seldom or poorly documented (in particular, the list of managed CIUs which simultaneously take into consideration ESG criteria and the proportion of these CIUs in the total amount of assets managed by the AMC).[130] Also, some AMCs noted that they did not want to disclose the name of professional funds or reserved 'FIVG' general investment funds which, moreover, are the subject of no communication on their website (these funds being, for example, dedicated funds bearing the name of their investor).
As regards specifically the risks associated with the ESG criteria,[131] it is noted that these risks and the procedures employed to identify and measure them are seldom mentioned. Several AMCs and the AFG were questioned to obtain a better understanding of this lack of information. It seems that this concept of "risks associated with ESG criteria", which is covered by no regulatory definition in national law, is understood in various ways. Some speak of the impact of an "ESG" event on the financial performance of an asset (e.g. a scandal concerning an issuer, a natural disaster destroying means of production, etc.), while others may communicate concerning the negative externalities (alignment of portfolios with a transition scenario). Lastly, other AMCs, in line with what the AFG proposes in its professional guide on Article 173, include in "ESG risks" a risk of failure to comply with the investment constraints of funds taking ESG criteria into consideration, which would be more like a compliance risk.[132]
The AMF notes that the Disclosure Regulation proposes a definition of "sustainability risk" based on E, S and G aspects and focused on the financial impact.[133]
More specifically regarding AMCs acting within a group (insurer subsidiary AMC, AMC in a group of several AMCs, etc.), it was found on several occasions that the "Article 173" information produced was identical to or referred to the information available on the group level, or relating to another entity (insurer, AMC), without permitting a clear distinction between the framework applicable to the AMC (e.g. pooled ESG research) and aspects which are not applicable to it.

5.2.2.4. Specific cases

Information provided by AMCs which state that they do not take ESG criteria into consideration

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[129] In 1° of II of Article D. 533-16-1 of the Monetary and Financial Code: presentation of the general approach, content, means of information of clients, list of funds including E, S and G criteria simultaneously and proportion of assets under management, the entity's adherence to initiatives, ESG risk management policy where applicable.
[130] Third indent of 1° of II of Article D. 533-16-1 of the Monetary and Financial Code: " […] *list of managed undertakings for collective investment mentioned in 1° of I which simultaneously consider social, environmental and governance quality criteria; proportion, as a percentage, of the assets of those organisations in the total amount of assets managed by the asset management company;*"
[131] Fifth indent of 1° of II of Article D. 533-16-1 of the Monetary and Financial Code: "*when the entity implements a risk management policy, general description of its internal procedures to identify the risks associated with social, environmental and governance quality criteria and the exposure of its business to those risks, and general description of those risks*".
[132] Question 4.9 of the Professional guide on Article 173: "[…] *Accordingly, level-two checks may be performed by asset management companies to verify that the investment constraints determined by the client in the mandate or defined in the prospectus are complied with.*"
[133] Article 2(22) of the Disclosure Regulation : " *22) "sustainability risk": an event or situation in the environmental, social or governance field which, if it occurs, could have a major negative impact, real or potential, on the value of the investment ;*".

Despite the recommendations published by the AFG professional guide,[134] numerous AMCs often merely mention that there is no consideration of ESG criteria without explaining why, even though this is explicitly required by the implementing decree.[135]
Of those which provide reasons, the AMF notes, in particular, certain small AMCs, specialised in private equity, which point out that from their viewpoint ESG concerns are not yet a priority for this type of issuer in their life cycle, or that they do not have resources to devote to this. Others manage index funds and develop no engagement policy. Finally, others cite the lack of appetite on the part of clients, or else the lack of mature methodologies for consideration of these criteria.

AMCs which do not take ESG criteria into consideration but indicate sensitivity to the issue

For several AMCs, ambiguous expressions were noted, which mean that the reader cannot easily understand whether or not ESG criteria are taken into consideration, and in particular their binding and significant nature. For example, some AMCs provide, sometimes at length, a definition of what ESG is, or of the UN Principles for Responsible Investment (PRI), while others give details of "engagement" and "attention" paid to ESG issues, or else the fact of "endeavouring" to take ESG criteria into consideration. The fact that, in practice, ESG criteria are not taken into consideration formally, or else that the AMC focuses on the financial aspect of investments, is specified only at the end of the communication.[136] Such information therefore appears **disproportionate** to the system actually established by the AMC.
Conversely, some AMCs start their communication by first stating clearly that they do not take ESG criteria into consideration formally, and explaining the reasons for this, before then describing in detail possible initiatives, qualitative approaches and other research aspects.

5.2.3. CONCLUSION – "ARTICLE 173" INFORMATION ON THE AMC LEVEL

The AMF notes **progress in terms of publication** by AMCs compared with its previous report, especially following the reminders sent out.
Despite this progress, the AMF notes the persistence **of major problems**:

- In many cases, when there is no consideration of ESG criteria, the information provided does not explain the reasons, which could be considered as **contrary to the requirements of Article D. 533-16-1 II-4° of the Monetary and Financial Code**;
- The model plan for information relating to the AMC (1° of II) is seldom respected, and the practice of the table of correspondence suggested in the previous AMF report is seldom complied with; as a consequence, it is difficult for the AMF to effectively assess the compliance of the information with the regulatory requirements **and this does not permit comparability of the AMCs' systems**;
- Some AMCs within a group produce automated information which does not always reflect with sufficient precision the system applicable to the AMC in its group;
- Some AMCs, despite the lack of formal consideration of ESG criteria, want to communicate concerning their initiatives, approaches and research on the subject, without the information necessarily being proportionate or expressed in a manner that enables the reader to **understand clearly** the lack of systematic and formal consideration of ESG criteria.

A large number of these observations remain relevant within the framework of the Disclosure Regulation (cf. 5.1.2) which requires, in particular, whenever the AMC fails to take into consideration the main negative impacts of sustainability factors, "clear" information regarding this lack of consideration (Article 4 1 b).

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[134] Questions 4.1 and 4.2. of the Professional guide on Article 173 which provide examples of reasons for the failure to take ESG criteria into consideration.
[135] 4° of II of Article D. 533-16-1 of the Monetary and Financial Code: "*Where applicable,* [indicate the] *reasons why the entity provides only partially or does not provide some of the information mentioned in 1°* […] *of II*."
[136] For example, on a 9-page document representing its "Article 173" information, an AMC outlines its general philosophy, top-down and bottom-up integration processes, and examples of criteria, before mentioning on page 5 that: "*these criteria are taken into consideration by the investment teams on a qualitative basis, when they are judged relevant*". The information therefore appears disproportionate.

Accordingly, in line with the good practices identified respectively by the previous AMF reports on sustainable finance, the review of the application of Article 173, and the reminders of the regulations that it gave in its Review of SPOT inspections on SRI management systems published in July 2019, the AMF presents below a review of the regulatory reminders, positions, recommendations and good practices identified in relation to the "Article 173" information produced on the AMC level. This review supersedes the material presented in the previous AMF report.

Reminders of the regulations on the publication of information under "Article 173"

AMCs not taking ESG criteria into consideration
In accordance with the requirements of 4° of II of Article D. 533-16-1 of the Monetary and Financial Code, AMCs must explain the reasons why the AMC does not provide, or provides only part of the information mentioned in 1° of II of said article.

Position 4

Legibility of the information
(1) In order to ensure its clarity and comparability, and in accordance with the provisions of Article L. 533-22-2-1 of the Monetary and Financial Code, AMCs must comply with the model plan described in detail in 1° of II of Article D. 533-16-1 of the Monetary and Financial Code, where applicable in accordance with a code produced by a professional association as provided for by the last paragraph of 3° of IV of Article D. 533-16-1. Failing that, a table of correspondence of the information provided with this plan is demanded.

Information on the list of UCIs simultaneously considering ESG criteria
(2) AMCs that manage funds simultaneously considering the E, S and G criteria, which are reserved funds (funds coming under Article L. 214-26-1 of the Monetary and Financial Code) or professional funds which, moreover, are the subject of no communication on their website, must either disclose the list in accordance with the third indent of 1° of II of Article D. 533-16-1 of the Monetary and Financial Code, or explain the reasons for the lack of publication in accordance with 4° of II of said article.

AMC part of a group
(3) The information required by 1° of II of Article D. 533-16-1 of the Monetary and Financial Code is specific to each AMC. An AMC acting within a group must describe the ESG framework that is applicable to it and cannot be content to reproduce the description of the group system or to refer to the information issued by the latter.

Recommendation 6
Legibility of the information
(1) The AMF recommends publishing information relating to the AMC (1° of II of Article D. 533-16-1 of the Monetary and Financial Code) in a single document, easily accessible on the AMC's website (for example, via links from the pages dealing with sustainable development subjects) and written in French if the AMC is addressing retail investors in France.

Good practice 4

Legibility of the information
(1) Insert a lexicon or glossary listing the terms used and defining the main concepts addressed (ESG criteria chosen, in particular metrics relating to climate change).

Description of the approach
(2) Describe the prospects for changes in the entity's strategy and points for improvement and efforts to be made to improve the system.

(3) In the information provided by the AMC clearly distinguish between approaches applied to all the funds and approaches applied to certain funds only (SRI funds, thematic funds, etc.).

Poor practice 4:

Legibility of the information
(1) For some AMCs which highlight a "responsible" offer, the information available on the website is not easily accessible or distinguishable from marketing information.

Risk management
(2) In response to the fifth indent of 1° of I of Article D. 533-16-1 of the Monetary and Financial Code which requires a description of the system for management of the risks associated with environmental, social and governance criteria, some AMCs describe the compliance risk related to funds presenting ESG characteristics. This information seems inappropriate.

5.3. IMPLEMENTATION ON THE FUND LEVEL

The AMF performed identification of all the funds having assets under management exceeding €500m in June 2019 (500 funds). For all these funds, it performed identification of the "Article 173" information relating to the fund available (i) in the fund's annual report and (ii) on the AMC's website, asking for the information from the AMCs managing the greatest number of funds concerned and verifying manually for the others. For a sample of about one hundred of the largest funds, a more thorough analysis was performed in order to better understand the structure and content of the information in relation to the detailed plan proposed by 2° and 3° of II of Article D. 533-16-1 of the Monetary and Financial Code.

5.3.1. SUPERVISION OF THE SCOPE OF OBLIGED FUNDS

1° of IV of Article D. 533-16-1 of the Monetary and Financial Code limits the obligation of production of specific information at the fund level to funds having AUM exceeding €500m without specifying at what time this requirement should be assessed. A fund may temporarily go above the €500m threshold.
The AFG Guide proposes to the actors an annual spot check: "[…] *reporting on "Investment ESG information" must be performed whenever the individual net assets appearing in the inventory exceed €500m. The reporting date may be the CIU closing date or any other date judged more appropriate for reporting ESG information (in particular, on 31 December or the closing date of the asset management company managing the CIU* […]".
During checking on the presence of the "Article 173" information at the fund level, the AMF questioned the leading AMCs concerning their practices. The five answers received show that most AMCs obey the AFG's recommendations and perform a spot check at the end of the fund's reporting period. Some AMCs establish supervision in the preceding month or weeks to anticipate the workload due to the number of reports to be produced. Others, finally, have chosen to systematically include this information for all their funds, whatever their size.
For example, some funds may have exceeded or gone below the €500m threshold between the date determining the need to establish "Article 173" information specific to the fund and the date chosen by the AMF to carry out its study.

5.3.2. INVENTORY OF PUBLICATIONS

5.3.2.1. Publication in the annual report

The work on identification of "Article 173" information presented in the annual report of funds having assets under management exceeding €500m in June 2019 provided the following overall results:

Information available in the annual report			
	Number	% of number	% of AUM (%)
Yes	432	86.4%	91.0%
No - fund launched recently or below thresholds	22	4.4%	1.7%
No - non-compliant	19	3.8%	2.8%
Other	14	2.8%	2.8%
Of which funds where the information consists of a mere reference to the information at the AMC level	*11*	*2.2%*	*2.5%*
Of which funds having a lifetime of less than one year	*3*	*0.6%*	*0.3%*
No access to the annual report - impossible to perform verification	13	2.6%	1.6%
Total number of funds	500	100%	100%

Source: AMF

For most funds the AMCs produced "ESG" information in accordance with the regulatory requirements. For more visibility, certain AMCs chose to produce a dedicated report for each fund, appended to the annual report. Some AMCs do so systematically, and others only for funds which highlight ESG aspects (responsible investment or thematic funds). In some cases, however, no mention is made of this dedicated report in the annual report, which detracts from the visibility of the information and does not allow full compliance with the provisions of Article D. 533-16-1 of the Monetary and Financial Code which requires that the information be recorded in the annual report. Three funds having a lifetime of less than one year and not requiring the production of an annual report were noted.
Regarding the absence of information, this may be due to the fact that the funds have not yet published their first annual report. In two cases, the AMC, which also manages other funds for which the obligation is complied with, said that the absence of information was due to an operating problem that it undertook to correct for the next financial year. In the other cases, the AMCs apparently had a poor knowledge of the regulatory requirements. Certain fund annual reports (13 reports representing 1.6% of the funds) were unable to be consulted.

5.3.2.2. Publication on the website

The work on identification of "Article 173" information provided on the website of the AMCs in relation to funds having assets under management exceeding €500m in June 2019 provided the following overall results:

Information available on the website			
	Number	% of number	% of AUM (%)
Yes	311	62.2%	76.0%
No - fund launched recently or below thresholds	15	3.0%	1.2%
No - non-compliant	15	3.0%	1.8%
Of which open-ended UCITS and FIVG funds	*14*	2.8%	*1.8%*
Of which pro funds or reserved FIVG funds with communication on the website	*1*	0.2%	*0.1%*
Other	15	3.0%	1.6%
Of which open-ended UCITS or FIVG funds, in practice reserved	13	2.6%	1.4%

Of which CIUs open to marketing exclusively via a distributor	2	0.4%	0.2%
Pro and reserved funds without communication	144	28.8%	19.4%
Total number of funds	500	100%	100%

Source: AMF

The findings should be viewed cautiously with regard to the availability of information on the website. For example, certain AMCs that were asked to fill in an analysis file beforehand indicated that the information was available by pointing to the "Article 173" information relating to the AMC and not to each fund. Sample checks were performed in this case.
As mentioned in section 5.1, the information relating to the funds must be published on the AMC's website, except for the professional funds and FIVG general investment funds referred to in Article L. 214-26-1 which, moreover, are the subject of no communication on the AMC's website.[137]
It is noted in practice that most AMCs place the fund's annual report online on the fund's dedicated page on their website, as well as the dedicated "Article 173" report of each fund where applicable, to comply with the requirements concerning the publication of information on the website. Moreover, one AMC chose to produce a single Article 173 report available on its website for several funds of the same category, in accordance with the provisions of Article D. 533-16-1 of the Monetary and Financial Code.

5.3.3. QUALITATIVE REVIEW OF FUNDS' "ARTICLE 173" INFORMATION

A more thorough analysis of the quality of the "Article 173" information of the funds was performed on about one hundred of them.
This analysis shows that, although the plan provided for by 2° and 3° of II of Article D. 533-16-1 of the Monetary and Financial Code is very detailed, the information provided is very often far poorer. For example, the annual report of relatively few funds complies with the plan stipulated by the decree:

- Nature of criteria considered;
- Information used for the analysis and implementation of these criteria;
- Methodology and results of the analysis implemented on the criteria;
- Incorporation of the results of the analysis in the investment policy.

This failure to comply with the plan in the decree meant that it was not possible to perform a thorough comparative study of the funds. However, the following general observations were able to be made.
In practice, those reports providing detailed information will, sometimes after briefly recapping the methodological principles applied, provide quantitative information on ESG indicators of their portfolio, sometimes relative to benchmarks. Some funds provide qualitative comments, and in particular they produce focus studies of the best rated issuers, and issuers that are the subject of controversy or are rated poorly, providing information to justify their presence in the portfolio.

5.3.3.1. Links between the information at the fund level and the information at the AMC level

In cases where the fund has no specific feature compared with the general ESG framework of the AMC, certain AMCs indicate this clearly, and mention the major principles of this framework before referring to the information available at the AMC level. This presentation procedure facilitates reading for the investor.

In other cases, on the other hand, the links between the information available at the fund level and that available at the AMC level is **less clear**. The following situations were identified:

[137] 3° of IV of Article D. 533-16-1 of the Monetary and Financial Code.

- In their annual reports, certain AMCs merely make references to the AMC's website without any other comment,[138] which very adversely affects the legibility of the information.
- When the fund has a different approach from the general approach described at the AMC level, the information available sometimes consists of a generic communication replicating the information available at the AMC level. This situation may occur in particular:
    - o when the fund highlights a specific ESG characteristic (SRI, thematic, etc.);
    - o when the fund does not apply the AMC's framework (dedicated fund with its specific framework, fund not considering ESG criteria);
    - o when the system presented at the AMC level is not appropriate for it (e.g. in the case of an employee savings scheme fund invested in securities of the employee's company for which the broad integration system described as applied to all the funds is not relevant).

Moreover, for AMCs using a single "Article 173" information model deployed for all their funds, the AMF observes **aspects that are sometimes ambiguous**:

- For example, in the case of one AMC, the single model starts with a rather long presentation of the AMC's general process of consideration of ESG criteria (7 pages). For one of this AMC's funds **which does not take ESG criteria into consideration**, it is only on the eighth page that the reader has information on this absence of consideration, invalidating de facto the seven preceding pages of presentation.
- Another AMC, for funds not taking ESG criteria into consideration, promotes in its "Article 173" information at the fund level the existence of other funds taking such criteria into consideration, as part of a general presentation of the AMC's approach.
- Finally, one AMC, after presenting on one page its engagements and its history, says briefly that the fund "*does not claim to currently factor in E, S and G aspects formally*", before disclosing a report presenting the portfolio breakdown by ESG score, a comparison of the fund's average score and that of its index, and carbon information. The fact that the words indicating the absence of formal consideration of ESG criteria are inserted between two sets of ESG information diminishes the clarity of the information.

Thus, the "Article 173" information produced is not always appropriate for the fund.

- On the one hand, when the fund adopts a specific ESG approach relative to the AMC's general approach (e.g. particular exclusions, responsible investment or thematic fund), the level of information provided does not correspond to the requirements of 2° of II of Article D. 533-16-1 of the Monetary and Financial Code.
- On the other hand, when the fund adopts an ESG approach which has lower requirements than the general framework presented by the AMC, or is even non-existent, the information provided concerning the approaches applied by the AMC elsewhere could potentially lead the reader into error.

5.3.3.2. Consistency of information between funds

While, as seen above, the information produced by AMCs at the level of each fund is sometimes too standardised and inappropriate for each fund, the AMF also noted cases in which the information from various funds of the same AMC results in potentially inconsistent messages. For example, one AMC asserts in the "Article 173" information of a fund which does not consider ESG criteria that here is not enough information to calculate a carbon footprint, whereas for another SRI-labelled fund, this footprint is calculated and published in a monthly factsheet. Now, in the first case the benchmark index is the Euro Stoxx 50 while in the second case the index is the MSCI Europe, consisting of 450 stocks including very extensively the stocks forming the Euro Stoxx 50.[139] It seems hardly credible that there is not enough data to calculate the carbon footprint of a portfolio consisting of 50 stocks on the one hand, but enough to calculate the carbon footprint of a portfolio containing 450 stock, including very extensively those 50 stocks, on the other hand.

[138] For example, in the form of the following indication: "*The information concerning criteria relating to compliance with social, environmental, and governance quality (ESG) objectives is available on the website of the asset management company* [link to the AMC's website]".
[139] A comparison was made between the two indices one month apart (July 2019 for the MSCI Europe and August 2019 for the Euro Stoxx50). This showed a single stock of the Euro Stoxx 50 index not included in the MSCI Europe index.

5.3.3.3. Lack of consideration of ESG criteria

For those funds which do not consider ESG criteria, the AMF identified **only few fund annual reports presenting explanations for this lack of information**, which could be considered as contrary to the requirements of 4° of II of Article D. 533-16-1 of the Monetary and Financial Code. The AMCs contacted on this subject reported that they would produce this information by the next deadlines.

5.3.3.4. Engagement strategy

Lastly, the AMF identified **few cases** in which information was provided concerning the fund's engagement strategy, in accordance with the provisions of Article D. 533-16-1 of the Monetary and Financial Code.[140] However, in order to comply with the requirements of said article, the fund's "Article 173" information should explain the failure to report this information.[141]

5.3.4. INFORMATION AVAILABLE IN THE PROSPECTUS

The AMF conducted a partial review of the prospectuses of funds coming within the scope of application of the "Article 173" system. In light of the provisions of the second paragraph of Article L. 533-22-1 of the Monetary and Financial Code, "Article 173" information documents should be mentioned in the prospectuses of all the funds covered by the scope of application of the "Article 173" framework (whether they be above or below the €500m threshold).
Based on the investigations performed, we noted, in line with regulatory requirements, generic indications in the prospectuses of funds of varying sizes (above or below €500m), presenting ESG characteristics or not, referring to the information available on the AMC's website and to the CIU's annual report: "*information relating to the ESG criteria taken into consideration by the asset management company is available on its website at the following address:* [link] *or in the CIU's annual report*". On the other hand, one AMC chose to indicate that this information is available "*simply on the written request of the fundholder*".[142]

It was also noted for certain private equity funds that this information is **absent from the prospectuses**. Regarding this, it should be remembered that for employee savings scheme funds and private equity funds, the prospectus may consist of the regulations or the statutes,[143] which must in that case comply with the obligations of Article L. 533-22-1 of the Monetary and Financial Code.

Within the framework of the Disclosure Regulation (cf. 5.1.2), the AMF notes that information relating to the consideration of ESG criteria for funds which stress this aspect will be **included directly in the precontractual documentation**.

5.3.5. CONCLUSION – "ARTICLE 173" INFORMATION ON THE FUND LEVEL

The AMF notes that on the whole most of the funds having more than €500m in assets under management produce dedicated information in relation to the "Article 173" requirements. Regarding the content, it is noted that the information produced very seldom exploits all the possibilities offered by Article 173. Moreover, **there are still problems**. For example, when there is no consideration of ESG criteria, it is noted that in many cases the information provided does not explain the reasons for this, which could be considered as **contrary to the requirements of Article D. 533-16-1 II-4° of the Monetary and Financial Code**. Furthermore, the model plan

[140] D. 533-16-1 II-2° d ii of the Monetary and Financial Code: "*ii. Implementation of a strategy of engagement with issuers:*
– presentation of engagement policies applied with issuers;
– presentation of the voting policy;
– review of the implementation of these policies."
[141] In accordance with the provisions of Article D. 533-16-1 II-4° d ii of the Monetary and Financial Code: "*Where applicable, reasons why the entity provides only partially or does not provide some of the information mentioned in 1° to 3° of II.*"
[142] Excerpt from the prospectus of a CIU: "*The Fund's full prospectus, the latest annual report, information on ESG criteria and the latest interim statement will be sent within one week simply on a written request by the fundholder.*"
[143] Cf. Article 25 II of AMF Instruction 2011-21 relating to employee savings scheme funds and Article 5-2 of AMF Instruction 2011-22 relating to private equity funds.

stipulated by this article for information relating to the fund (2° of II) is seldom respected, while the practice of the table of correspondence mentioned in the previous AMF report is seldom complied with. Given this situation, it is not possible to effectively assess the information's compliance with the regulatory requirements **and this adversely affects the comparability of systems** from one fund to another.

Also, some AMCs produce for their funds industrialised information which does not always reflect with sufficient precision the system applicable to the fund.

Lastly, the indications inserted in the prospectuses with regard to the requirements of the second paragraph of Article L. 533-22-1 of the Monetary and Financial Code are not always clarified sufficiently, and this obligation is not always complied with.

Many of these factors remain relevant within the framework of the Disclosure Regulation (cf. 5.1.2) where the information links between AMC and fund still exist. In addition, it is requested that, where there is no consideration by AMCs of sustainability risks for their funds, the precontractual information should contain "clear and concise" information concerning this lack of consideration (Article 6 1), and reasoned explanations if there is no consideration by the AMC of the main negative impacts of sustainability factors (Article 7 2).

Hence, following on in particular from the reminders of the regulations given in its review of SPOT inspections on SRI management systems published in July 2019, the AMF wants to present a review of the regulatory reminders, positions, recommendations, and identified good and poor practices applicable to funds.

Recap of the regulations

Funds not taking ESG criteria into consideration
(1) In accordance with the requirements of 4° of II of Article D. 533-16-1 of the Monetary and Financial Code, funds' annual reports must explain the reasons why the information mentioned in 2° of II of said article is not provided or is provided only partially.

Information in funds' prospectuses
(2) In accordance with the requirements of the second paragraph of Article L. 533-22-1 of the Monetary and Financial Code, "Article 173" information documents should be mentioned in the prospectuses of all the funds covered by the scope of application of the "Article 173" framework. It should be remembered that this provision applies for all the funds concerned by Article 173, whatever the size of their AUM, including funds whose prospectus consists of regulations or statutes (employee savings scheme funds, private equity funds).

Position 14

Legibility of the information
(1) The "Article 173" information relating to the fund must contain appropriate information on the consideration of ESG criteria by the fund, within the framework of the model plan detailed in 2° of II of Article D. 533-16-1 of the Monetary and Financial Code. In this regard:
- When the AMC applies to a fund a specific ESG framework by comparison with that which it describes at its own level, it is not possible to proceed by reference to or replication of the "Article 173" information relating to the AMC without providing additional information.
- In order to ensure information that is clear, accurate and not misleading, when the fund does not take ESG criteria into consideration, or takes them into consideration less than under the AMC's general framework, the "Article 173" information relating to the fund must mention this clearly, limit references to the AMC's general framework in the part applicable to the fund, and contextualise the presentation of any additional ESG information (e.g. when presenting a score allocation or carbon information by comparison with an index, warn that said comparison is associated with no objective, and specify the reason for said presentation).
(2) 3° of IV of Article D. 533-16-1 of the Monetary and Financial Code requires that "Article 173" information at the fund level be presented in the fund's annual report. As a consequence, when the fund's "Article 173" information

is the subject of a dedicated report, the annual report must explicitly mention that dedicated report so as to allow the reader to easily refer to it. The dedicated report may also be appended to the fund's annual report.
(3) The "Article 173" information relating to the fund must contain information on the engagement strategy applied to the fund in accordance with the provisions of Article D. 533-16-1 II-2° d ii of the Monetary and Financial Code. If the fund's strategy is similar to that of the AMC, this information must be presented clearly.
(4) In order to ensure its clarity and comparability, and in accordance with the provisions of Article L. 533-22-2-1 of the Monetary and Financial Code, the information relating to funds must comply with the model plan detailed in 2° of II of Article D. 533-16-1 of the Monetary and Financial Code, where applicable in accordance with a code produced by a professional association as provided for by the last paragraph of 3° of IV of Article D. 533-16-1. Failing that, a table of correspondence of the information provided with this plan is demanded.

Information in funds' prospectuses
(5) The provision of "ESG information" simply on a written request is not considered as complying with the requirement of mentioning "Article 173" information documents as provided for in the second paragraph of Article L. 533-22-1 of the Monetary and Financial Code.

Good practice 5

Legibility of the information
(1) Insert a lexicon or glossary listing the terms used and defining the main concepts addressed (ESG criteria chosen, in particular metrics relating to climate change).
(2) In order to comply with the obligations of publication of the fund's "Article 173" information on the AMC's website, publish the fund's annual report on the AMC's website.
(3) In cases where the fund has no specific feature compared with the general ESG framework of the AMC, certain AMCs indicate this in the annual report and indicate the major principles of this system before referring to the information available at the AMC level, making it easier for the investor to read.

Poor practice 5:

Legibility of the information
(1) In the funds' annual reports, certain AMCs merely make references to the AMC's website without any other comment, which very adversely affects the legibility of the information.

Consistency of the information
(2) One AMC asserted in the "Article 173" information of a fund not taking ESG criteria into consideration that it was not possible to calculate the fund's carbon footprint, for want of available data. The same AMC publishes elsewhere the carbon footprint of another fund, labelled, which invests in a far broader universe than that of the first fund. The information provided is not consistent overall.

5.4. OVERALL CONSISTENCY OF THE INFORMATION

The transparency of the AMCs and funds regarding non-financial aspects will soon be governed by a dual regulatory framework, consisting of, on the one hand, the Disclosure Regulation together with its level-2 normative components, and, on the other hand, a specific national framework which supplements it. For funds marketing themselves as "SRI" or "responsible", a third requirement may possibly be added to these two frameworks, that of producing a standardised Transparency Code prepared for members of the AFG. This document is currently presented in two parts, one relating to the AMC and the other relating to the funds covered by the document.

In line with the recommendation expressed in section 5.2.3 regarding the publication of information relating to the AMC in a single document, in order to limit the number of documents and ensure clarity of information, the AMF invites the professional associations to work again, once the regulatory context has stabilised, **on new**

harmonised models of presentation of information which will take into consideration all the applicable regulatory requirements regarding ESG.

5.5. CONCLUSION

The work carried out by the AMF for preparing and complementing the application review of Article 173 concerned, on the one hand, the "Article 173" information produced at the AMC level and, on the other hand, the "Article 173" information produced at the level of each fund having AUM exceeding €500m. It took place in a changing context due to the introduction of the Disclosure Regulation on the European level. However, as shown in section 5.1.2, the "Article 173" and "Disclosure" systems show similarities in their principles. The observations made (information expressed both at the level of the AMC and of each CIU, "explain" principle), therefore remain relevant.

Hence, following the work performed, **progress in terms of publication** was noted at the AMC level by comparison with the previous AMF report, especially following the reminders sent out to the AMCs which, after instructive discussions, allowed the establishment of "Article 173" information. Thus, in August 2019, only two AMCs were identified by the AMF as having still not published "Article 173" information. Moreover, this first inventory operation carried out at the fund level was able to show that on the whole the funds complied with the requirements of publication in the fund's annual report (19 funds, i.e. 4% of the number and 3% of AUM, did not produce the required regulatory information in their annual reports). Publication on the website is globally complied with (15 funds, i.e. 3% of the number and 2% of AUM did not produce the required regulatory information).

Despite this progress, the AMF notes **residual major problems**. For example, for information at both the AMC level and the fund level, when there is no consideration of ESG criteria it is noted that in many cases the information provided does not explain the reasons for this, which could be considered as **contrary to the requirements of Article D. 533-16-1 II-4° of the Monetary and Financial Code**. The AMF therefore gives a reminder of the regulations on this point. Furthermore, the model plans stipulated by this article for information relating to the AMC (1° of II) and for information relating to the fund (2° of II) respectively are seldom respected, while the practice of the table of correspondence mentioned in the previous AMF report is seldom complied with. Given this situation, the AMF cannot effectively assess the information's compliance with the regulatory requirements, **and this adversely affects the comparability of frameworks** between AMCs on the one hand and between funds on the other hand. The AMF therefore recalls the need to respect the model plans provided for by the decree, or failing that establish a table of correspondence.
Moreover, probably driven by the need to be operationally efficient, certain AMCs produce industrialised information which does not always reflect with sufficient precision the framework applicable, either to the AMC in the group to which it belongs, or to the fund in the AMC's general framework. The AMF therefore gives a reminder of **the need to produce information relevant to the scope considered**. In particular:

- An AMC acting within a group must describe the ESG framework which is applicable to it.
- The information relating to a fund must describe faithfully and clearly the framework which is applicable to it: in particular, the information must describe any additional frameworks applicable to a fund by comparison with the general approach of its AMC, while conversely the information relating to the fund should not be weighed down by information relating to the AMC which is not applicable.

Moreover, despite a lack of formal consideration of ESG criteria, some AMCs want to communicate concerning their initiatives, approaches and thinking on the subject. In such cases **the communication shall remain proportionate**, to ensure that the information remains clear, accurate and not misleading. In any case, the information must be subordinated to clear, accurate and non-misleading information relating to the fact that ESG criteria are not taken into consideration by the AMC, and the reasons explaining this choice.