June 2023

SPOT INSPECTIONS

Summary of SPOT inspection on compliance with non-financial contractual commitments by portfolio asset management companies

AUTORITÉ DES MARCHÉS FINANCIERS

AMF

INTRODUCTION

As announced by the Autorité des Marchés Financiers (AMF) in the presentation of its supervisory priorities for 2022, it has conducted a study and a SPOT inspection campaign (Supervision des Pratiques Opérationnelle et Thématique - operational and thematic supervision of practices) on compliance with non-financial contractual commitments by funds (UCITS and AIFs) managed by portfolio asset management companies (AMCs). In practice, the AMF (i) reviewed the systems for defining, managing and controlling these commitments, in a representative sample of AMCs, (ii) assessed the level of compliance of these practices with the AMCs' regulatory obligations and (iii) identified good and poor practices in this field.

The review was carried out via two parallel workflows. The first involved analysing the answers given by 707 AMCs to a questionnaire sent out in Q2 2022 and targeting solely open-ended funds managed directly or under delegation at 31 March 2022. It followed the SPOT inspection campaign conducted in 2019 on the SRI management systems of AMCs and the incorporation of ESG criteria.[1] The analyses of the answers as presented in this summary, focus on the 176 non-specialised AMCs[2] (out of the 299 who responded to the questionnaire) who defined at least one non-financial contractual commitment for at least one of their funds.

The second workflow consisted of a SPOT inspection campaign targeting five of the 176 AMCs mentioned above whose ESG/SRI[3] funds represent between 20% and 90% of their total assets under collective management. The selection process for these AMCs targeted participants whose ESG/SRI funds included numerous and varied non-financial commitments,[4] in order to provide sufficient material to test the system for controlling compliance with these commitments. Furthermore, in the tests of samples of the ESG/SRI funds managed by these participants, the inspection task force mainly chose funds with the SRI label.

The consolidated scope of these workflows covered the following themes:

- organisation and resources implemented for ESG/SRI management;
- ESG management and rating methodology;
- process for selecting and controlling external suppliers of ESG data;
- investment/divestment system of the ESG/SRI funds;
- process for defining and reviewing the initial investment universe of the ESG/SRI funds;
- mapping of the commitments in force, in particular in terms of exclusion of issuers;
- conducting of (pre-trade and post-trade) controls of compliance with commitments;
- information supplied to investors regarding non-financial contractual commitments;
- compliance and internal control system relating to compliance with non-financial contractual commitments;
- role of depositaries in inspecting the non-financial commitments of the funds.

Works performed did not conduct the AMF to inquire upon the pertinence of non-financial contractual commitments used by the asset managers under analysis. These works only targeted internal processes regarding these commitments.

---

1 A summary of this campaign was published on 12 July 2019 on the AMF website: https://www.amf-france.org/sites/institutionnel/files/resource/20190712_synthese_spot_ISR_VF%20pdf.pdf

2 I.e. that carry out traditional management.

3 Cf. glossary below. For the sake of simplicity, the funds with this label in this document are funds categorised as Article 8 and Article 9 under the Sustainable Finance Disclosure Regulation (SFDR) (cf. glossary below) as well as funds that have an ESG/SRI label.

4 Cf. Section 5.2.1 below.

This summary presents the findings of the two workflows mentioned above.

This document is **neither a position nor a recommendation**. The practices identified as either “good” or “poor” highlight approaches identified during the controls and analysis carried out that may facilitate, or hinder, compliance with the regulations on defining, managing and controlling non-financial contractual commitments.

GLOSSARY

Term	Meaning
Audit trail	Probative and exploitable elements allowing to retrospectively chart the running of a process.
Best-in-class	Approach that involves assessing the ESG characteristics of the issuers and retaining those with the best ESG rating with regard to the practices of their peers in the same business sector (approach that does not favour or exclude one sector compared with another).
Best-in-universe	Approach that involves assessing the ESG characteristics of the issuers and retaining those with the best ESG rating regardless of their business sector (approach that adopts a sector bias, as sectors seen as virtuous as a whole will be favoured).
Breach	Proven non-compliance with a non-financial contractual commitment, of which there are two types. An active breach stems from a deliberate decision by the AMC, for example to invest deliberately in an issuer that is on an exclusion list. A passive breach is linked to changes outside the AMC, for example a deterioration in the ESG rating of an issuer by a supplier (following a controversy), below the minimum rating required for inclusion in the investment portfolio.
Transparency Code	Document providing, for each fund or group of funds in the ESG range, general data on the AMC and the target fund(s), the associated management process, the ESG controls in place and the ESG impact and reporting measures implemented.
Key aspect of communication	Notion introduced by AMF Position-Recommendation 2020-03 defining the minimum criteria for funds to be able to present their non-financial characteristics as a key aspect of communication. They are deemed to be a key aspect of communication if they are presented in the name of the collective investment scheme and/or in the KIID/KID, and/or in the marketing material, with more than a brief mention.
Reduced communication	Notion introduced by AMF Position-Recommendation 2020-03 defining the minimum criteria for funds to be able to provide reduced communication of their non-financial characteristics. Communication on the inclusion of non-financial criteria is deemed reduced if it is not central and is carried out in a brief and balanced manner in the KIID/KID regarding the limits for the inclusion of non-financial criteria in the management, and in the “other information” section and/or briefly in the marketing material.
Communication limited to the prospectus	Notion introduced by AMF Position-Recommendation 2020-03. Communication on the inclusion of non-financial criteria is deemed limited to the prospectus if the non-financial aspects are not referred to in the name of the fund, in the KIID/KID, or in the marketing material, and the communication in the prospectus remains proportionate.
Controversy	Incident regarding ESG aspects affecting an issuer in a fund’s investment universe likely to prevent the fund from complying with its ESG commitments (and lead to its exclusion from the universe concerned if the controversy is not resolved).
Non-financial commitment/non-financial requirement	Contractual commitment regarding ESG aspects made by an investment fund in its legal documentation (prospectus or KIID/KID). These commitments must be respected at all times and be monitored and subject to appropriate controls by the AMC.
Non-financial score/rating	Score awarded to the participants (e.g. companies) based on their environmental, social and governance practices, commitments or impacts. It may be calculated by the AMC or by an external third party (e.g. rating agency, external data supplier) and is often based on data published by the participants themselves.
ESG	Environmental, Social, Governance.
Override	Operation intended to manually revise upwards or downwards the ESG rating of an issuer calculated automatically by the rating algorithm. It may be carried out on the basis of potentially

	subjective criteria. This is not specific to ESG fund management and can be used for example within assets valuation process.
SRI	Socially responsible investment: approach aimed at applying the principles of sustainability to investment (investment that takes ESG aspects into account).[5]
Sustainable/Sustainability	Relating to environmental, social or governance aspects.
SRI Label[6]	Label awarded by the State that enables investors (in particular retail investors) to identify investment funds that adopt a significant SRI/ESG approach (https://www.lelabelisr.fr/)
Greenfin Label	Label awarded by the French state that enables investors to identify investment funds significantly committed to environmental aspects.
PAI	Principal Adverse Impact: concept mentioned in the SFDR Regulation (EU) 2019/2088, concerning the adverse impacts of investment decisions on sustainability factors (environmental, social and personnel issues, respect for human rights and combating corruption).
PRI	Principles for Responsible Investment: the following principles promoted by the United Nations: (1) We will incorporate ESG issues into investment analysis and decision-making processes, (2) We will be active owners and incorporate ESG issues into our ownership policies and practices, (3) We will seek appropriate disclosure on ESG issues by the entities in which we invest, (4) We will promote acceptance and implementation of the Principles within the investment industry, (5) We will work together to enhance our effectiveness in implementing the Principles, (6) We will each report on our activities and progress towards implementing the Principles.
Article 8 (A8) fund	Notion introduced by the SFDR. Means funds that promote environmental and/or social characteristics.
Article 9 (A9) fund	Notion introduced by the SFDR (more demanding than the one above). Means funds that have a sustainable investment objective i.e. investing in an activity that contributes to an environmental or social objective.
Article 6 (A6) fund	Notion introduced by the SFDR that has become part of the language of the market. Although SFDR A6 concerns the consideration of sustainability risks by funds, this term is commonly used to refer to funds that do not promote environmental and/or social characteristics, do not have a sustainable investment objective and are therefore neither A8 nor A9.
Investment universe	Grouping of assets on the basis of common sectoral, geographic or capitalisation characteristics. An investment universe is linked to each investment fund and represents the assets that the fund can invest in.
Taxonomy enabling activities	Activities that enable the development of sustainable sectors/activities that contribute to one of the six environmental objectives of the Taxonomy Regulation: climate change mitigation, climate change adaptation, water, circular economy, pollution prevention and biodiversity.
Taxonomy transitional activities	Activities that make it possible to reduce the environmental impact of sectors for which there are no sustainable alternatives.
ESMA	European Securities and Markets Authority: independent EU authority that helps to maintain the stability of European financial systems.[7]
SFDR	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019, known as the Sustainable Finance Disclosure Regulation: cf. Section 4 below. It targets the publication of information regarding ESG within framework of financial services.

[5] Definition from the official website of the SRI Label.
[6] https://www.ecologie.gouv.fr/label-greenfin/
[7] https://www.esma.europa.eu/about-esma/esma-in-brief

Supervisory Briefing	Document published by the ESMA aimed at helping national supervisors in each European country to implement and supervise specific issues.
Taxonomy	Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020: cf. Section 4 below.
CSR	Corporate social responsibility.

SUMMARY

1. CONTEXT OF THE INVESTIGATIONS: A FAST-CHANGING REGULATORY FRAMEWORK

Most of the non-financial approaches of French managers are traditionally based on methods that involve i) excluding from the investment universe of their fund issuers with the lowest rating from a non-financial point of view (e.g. best-in-class or best-in-universe approaches) or ii) improving the average non-financial rating of the fund's portfolio compared with that of its investment universe.

In view of this, **the French legal framework for sustainable finance** was developed with the national doctrine 2020-03,[8] Article 29 of the Energy and Climate Change Law (LEC),[9] the SRI label and to a lesser extent the Greenfin label. They require market participants to make contractual commitments in their funds' legal documentation regarding the non-financial requirements underlying these rules.

At European level, the SFDR[10] and Taxonomy (levels 1 and 2)[11] regulations result in several new non-financial requirements for different categories of funds (in particular A8 and A9 funds) which must undertake to include them in their legal documentation.[12] Furthermore, Commission Delegated Directive (EU) 2021/1270 of 21 April 2021 (CDD) (transposed in the AMF General Regulation) resulted in an increase in the incorporation of sustainability risks and factors in the procedures of AMCs relating to the general investment policy, risk management, internal control and management of conflicts of interests. It is the same for Commission Delegated Regulation (EU) 2021/1255 of 21 April 2021 (CDR) (amending CDR No 231/2013)

The amendment to delegated regulation MiFID II,[13] applicable since 2 August 2022, requires investment service providers and financial investments advisers to assess and take into consideration the sustainability preferences of their customers in their investment advice, among other things. These sustainability preferences relate to non-financial commitments defined in particular by the SFDR and Taxonomy regulations.[14] This is likely to encourage managers to formalize this type of commitment by contract in an increasing number of managed funds in order to increase their chances of distribution in view of the preferences expressed by their customers. **In practice, these requirements come in addition to the existing requirements without replacing them.** As a reminder, the laws and regulations in force **do not make a distinction between the funds' commitments according to their financial or non-financial nature**. Non-financial and financial requirements must be respected **at all times** and as such must be subject to a sufficiently ambitious control process.

2. SCOPE AND ORGANISATION OF THE INVESTIGATIONS

8 Cf. Section 4 below.

9 This Article which entered into force on 10 March 2021 and replaced Article 173 of the law on the energy transition for green growth (LTECV), amends Article L. 533-22-1 of the Monetary and Financial Code regarding the area of AMCs. It concerns informing subscribers to the funds and the public of the incorporation of ESG criteria in the investment strategy.

10 Cf. Section 4 below.

11 Level 1 corresponds to the European regulation and level 2 to its delegated acts.

12 Cf. recital 16 to the SFDR level 2 RTS in Section 4 below. The type of information targeted may concern for example, reaching a threshold, expressed as a percentage, for sustainable, social and/or environmental investment in the fund concerned, or under the investment taxonomy.

13 Cf. Section 4 below (Delegated Regulation (UE) 2021/1253). Since these regulations came into force after the inspection period (January 2019 - December 2022), they are mentioned for reference only in this document, and were not used to describe the findings of the inspections conducted in this SPOT campaign.

14 Investment taxonomy percentage, sustainable investment percentage, taking into consideration of PAIs (cf. glossary).

➢ Phase 1: assessment questionnaire sent to the AMCs

To assess the controls carried out by French participants to ensure compliance with the non-financial requirements included in the legal documentation of their funds, a questionnaire was sent in Q2 2022 to all of the AMCs active in the market in Q1 2022. **Out of 707 AMCs questioned, 655 (i.e. 93%) responded** to the questionnaire; they comprised **299 AMCs carrying out traditional management**, 225 private equity AMCs (including in the field of infrastructure), 99 mainly real-estate AMCs and 32 specialised AMCs (in particular in the securitisation and private debt businesses).

> Limitations of the summary
>
> The summary of the feedback received from the questionnaire is solely based on the answers received from the 299 non-specialised AMCs for open-ended funds, managed directly[15] or under delegation[16] at 31 March 2022.
> Furthermore, this summary does not address commitments linked to the European texts that were not in force on 30 June 2022 (closing date of the questionnaire). It also does not cover the general commitments that are not included in the legal documentation of the funds, **such as the commitment and voting policies**.

The questionnaire sent to AMCs was composed of three sections:

I) Funds characteristics:
   - Funds breakdown regarding SFDR regulation and AMF Position-Recommendation 2020-03 respective categorization;

II) Controls:
   - Typology of non-financial commitments in effect upon funds analysed;
   - Pre-trade and post-trade controls in place in order to check continuous respect with above commitments;
   - Volume of active and passive breaches registered between 2021 and 2022 regarding the above commitments;
   - Procedure in place regarding escalation process and potential compensation with regards to breaches;
   - Interactions between AMCs and depositaries regarding control of respect of non-financial commitments.

III) Investment universe:
   - Processes for defining investment universe and continuously controlling its consistency with investment policy;

➢ Phase 2: Preparing and conducting the SPOT inspections

The sample of AMCs to be reviewed was formed on the basis of the 299 AMCs mentioned above.

at 30 June 2022 (€bn)	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Total assets under management (€bn)	100 < x	50 < x < 100	50 < x < 100	20 < x < 30	20 < x < 30
Assets under collective management/total assets	46%	66%	62%	98%	29%
ESG assets/assets under collective management	49%	70%	21%	90%	79%
Assets with a label/ESG assets	64%	94%	45%	27%	57%

[15] Funds managed directly by the owner AMC, or for which management is delegated to another AMC.

[16] Funds managed on behalf of other AMCs.

Except for AMC 4, all of the AMCs in the sample **belong to a group**. All carry out diversified management via funds and mandates invested in shares, money market instruments and bonds.
The period under review was from **January 2019 to December 2021**.

3. SUMMARY OF THE MAIN FINDINGS

As regards the general ESG/SRI system, this was organised in the same way[17] in all of the AMCs in the SPOT inspection campaign sample. An initial investment universe is defined for each ESG/SRI fund. This universe is successively reduced by taking into consideration exclusions (thematic or linked to the ESG rating of the issuers) and controversies. In addition, the ESG rating system is based on a proprietary algorithm using non-financial data provided by several external suppliers. The ratings are calculated and updated automatically, and can be subject to a manual, one-off and conditional override, upwards or downwards, to determine the final rating. Finally, the managers make investment/divestment choices regarding the securities in the reduced universe.
The method of ESG selection of issuers is the so-called best-in-class method[18] for most (4/5) of the AMCs in the sample reviewed during the SPOT campaign. Moreover, this type of best-in-class or best-in-universe approach is used by 137 of the 299 non-specialised AMCs who responded to the market questionnaire (about 46%).

Analysis performed revealed that AMCs inside the SPOT sample adopted important human and technical resources in order to ensure respect of the non-financial commitments of their ESG / SRI funds. The conclusion is more diverse concerning the AMCs capacity in continuously adapting this control system with regards to the evolution of these commitments and the associated regulation.

Regarding the organisation and resources assigned to this system, the workforce dedicated exclusively to deploying the ESG/SRI strategy represents on average 7% of the total workforce of the five AMCs in the sample. They increased considerably (+80%) in the period under review. These resources benefited from a sustainable finance training programme in three of the five AMCs reviewed.
Furthermore, **the information system (IS)** used to deploy the ESG strategy of the AMCs in the sample is highly integrated. Firstly, all of the AMCs have developed an internal ESG rating system that includes the results of the ESG research carried out. Secondly, in four of the five AMCs reviewed, compliance with non-financial commitments is checked via the application for placing orders.
Finally, specialised committees **manage the deployment of the strategy**, either by a dedicated manager for 100% of his/her working time (for AMCs 3 and 5), or by a senior manager of the AMC for an average of 40% of his/her working time (for AMCs 1, 2 and 4). Each of these decision-makers reports directly to an executive manager of the AMC.

Regarding the non-financial data collected from external suppliers, the process for ESG rating of issuers is highly dependent on them. The average number of issuers covered by this data increased by 67% during the period under review (from 5580 to 9320 on average for the sample reviewed in the SPOT campaign), as did the average cost of acquiring it (+90%, amounting to €1.3m on average in 2021 per AMC reviewed).

17 This finding is linked to the fact that the funds that were tested in the SPOT campaign are mainly labelled funds. Furthermore, there are other significant approaches that the funds can adopt (for example aimed at improving the ESG rating or the percentage of investment in green bonds) that do not only involve reducing the investment universe.
18 Cf. glossary.

In this connection, three of the five AMCs in the sample (1, 2 and 4) have formalised **operational mapping of this data and of the associated suppliers**. Although most of them (four[19] out of five) have introduced a formal process in addition to this mapping, making it possible to resolve problems of contradictory non-financial data, only AMC 2 carries out **quality control of the non-financial data** before its inclusion in the algorithm for ESG rating of issuers. The low proportion of AMCs, within the SPOT sample, having put in place this type of control contradicts the guidelines issued by the AMF on data quality control in connection with the monitoring reports on non-financial commitments already published.[20]

The process for selecting and checking suppliers of non-financial data remains opaque. Only two of the five AMCs (1 and 4) include criteria for that type of service provider in their outsourcing procedure. Furthermore, a sample test (of four to five suppliers per AMC) conducted on the sample revealed that the process was adequately formalised for only two of the five AMCs (4 and 5). The supplier turnover rate was not significant for the period under review (2%). However, the inspection task force did not note an excessive level of concentration among the same suppliers in the sample group of AMCs.

Regarding the process for defining and reviewing the initial investment universe, it is generally a key component of numerous non-financial components. For example, of the 176 AMCs that responded to the questionnaire and had given an undertaking on at least one non-financial requirement in the legal documentation of at least one of their funds, 78% undertake to reduce their investment universe by excluding issuers with the lowest ESG rating, and 58% undertake to have an average ESG rating for the portfolio that is higher than that of the investment universe.

The process for defining the universe is subject to a full and operational procedure for most[21] of the AMCs in the SPOT sample. Although the managers propose the initial universe for the five AMCs reviewed (based on one or more market indices), **a team that is independent of the managers is responsible for validating this proposal**[22] (this practice is however less common among the AMCs who responded to the market questionnaire).[23] This process of gradual definition is adequately formalised.

On the other hand, the inspection task force noted that only two of the five AMCs had put in place regular, operational and formalised ex post controls of **the consistency of the initial investment universes with the investment policy of the funds**, to ensure there is no ESG bias due to sectoral, geographic or capitalisation inconsistencies (this control is carried out by a dedicated quarterly committee managed by the Management Director for AMC 2 and by the team of ESG/SRI experts for AMC 4). Analysis of the questionnaire led to the same finding, with only half of the AMCs in which the managers define the investment universe having actually deployed a control of this type.

Regarding the updating of the universe,[24] the responses to the questionnaire reveal a wide range of frequencies, from monthly to annual; these frequencies may be explained by the low volatility of certain indicators underlying

---

[19] Only AMC 5 did not formalise this process.

[20] For example, it is stated in Section 3.1.6 of the third joint report by the AMF/ACPR on the monitoring and evaluation of the climate commitments of Paris financial market participants (published on the AMF website on 25 October 2022) that "In order to have reliable data at their disposal, AMCs that have defined policies applicable to fossil fuels shall put in place a control mechanism to check the quality and consistency of such data, in a manner that is proportionate to the degree of significance of such data's uses and to the level of risk associated with mistakenly continuing to hold exposures to an issuer that should be excluded in application of the policies" (source: https://www.amf-france.org/en/news-publications/publications/reports-research-and-analysis/amf-and-acpr-have-published-their-third-report-monitoring-and-evaluation-climate-commitments-paris).

[21] I.e. four of the five AMCs. AMC 2's procedure omits the frequency of review of the universe defined.

[22] I.e. the Risk Department for AMCs 1 and 2 and the ESG Department for AMCs 3 to 5. This separation of duties also applies to the override process for ESG ratings.

[23] Half of the 176 AMCs that have a non-financial commitment linked to an investment universe allow their management teams to define the universe and only 50% of them have the universe validated by an independent team.

[24] Defining an adequate frequency for updating the investment universe is central to guaranteeing effective and continuous compliance with the funds' non-financial commitments.

the non-financial commitments (e.g. the ESG ratings of issuers which rarely change). Although daily or weekly updating appears difficult to implement for technical reasons, annual updating nevertheless appears inadequate to ensure that the universe is always representative and consequently to ensure compliance with the associated commitments.

Regarding the process for defining the reduced universe, this involves successively excluding issuers who were part of the initial investment universe. These exclusions may be thematic (e.g. targeting the tobacco or coal industry), caused by a severe controversy, or due to a decline in the ESG rating of an issuer below a procedural threshold. The inspection task force noted that the rules for ESG rating (including overrides), exclusion and management of controversies are specified operationally in the procedures of the five AMCs in the sample under review.

On the other hand, the quality of the audit trail[25] (comprising proof of the scores and ESG analysis of the issuers) retrospectively justifying the investments carried out by the ESG/SRI funds was inadequate. The average failure rate noted in this area in connection with a sample test conducted on five funds of the AMCs in the SPOT sample amounts to 44%. The result was better (test failure rate: 7%) for proof of rating overrides carried out in the period under review.

As regards the incorporation of ESG criteria in the investment/divestment process, this is only described in the AMC's procedures in two out of five cases (AMCs 1 and 4). Furthermore, only two out of five AMCs (AMCs 2 and 4) formalise full and operational mapping of their non-financial contractual commitments.

Compliance with these commitments is managed via (automatic and/or manual) pre-trade and post-trade controls carried out by the Risk Department (for four of the five AMCs) and by the Operations Department in AMC 3. The associated control plan is formalised in a dedicated policy. **Furthermore, for all five AMCs in the sample, the managers can simulate the impact of an investment on all types of orders before they are carried out.**

Of the 176 AMCs mentioned above, 77% have put in place (pre-trade or post-trade) manual controls, and 74% (131 participants) have put in place automatic controls (blocking for 65% of them). However, the combination of pre-trade and post-trade controls is not applied to all of the commitments, as 48% of the 176 AMCs mentioned above have at least one non-financial requirement not associated with a pre-trade control and 25% have a non-financial requirement not associated with a post-trade control. However, it is still necessary to combine the pre-trade controls (even if they are configured and blocking) with regular post-trade controls to strengthen the control mechanism and guarantee the identification of any non-compliance that the pre-trade approach alone may have failed to detect.

Regarding the supervision of commitments based on low-volatility underlying data, there is generally a combination of pre-trade and post-trade controls. This is the case for at least 70% of the AMCs that responded to the questionnaire who rely on this type of commitment.

Regarding the supervision of high volatility commitments,[26] they are mainly subject to post-trade controls, as is the case for 93% of the AMCs that responded to the questionnaire who made a commitment to improve their score. The low number of pre-trade controls put in place (43% of the AMCs who made this commitment) may be due to the difficulty in estimating future variations in underlying data, such as the ESG ratings of the universe and the portfolio and the valuation of the issuers.

---

[25] Cf. glossary

[26] I.e. commitments assessed at the level of the fund's portfolio and based on the issuers' capitalisation (e.g. average ESG ratings of the portfolios), in particular those linked to European regulations (e.g.: percentage of sustainable investment).

AUTORITÉ DES MARCHÉS FINANCIERS
AMF

After a sample test of five commitments for five funds per AMC, the inspection task force notes the existence of a robust audit trail for pre-trade and post-trade controls carried out for four of the five AMCs.[27]

The definition of and process for dealing with breaches detected by the controls are described in the risk management policy of the AMCs in the SPOT sample. The process sets the time limit for the manager of the fund concerned to be informed on the same day, and (failing resolution) for escalation to the senior managers after a time limit[28] of one (for AMC 5) to five days (for AMCs 1, 2 and 4). A regular review of the unresolved/resolved breaches is also carried out at least once a quarter by a dedicated committee. A sample test of the resolution process for 77% of the breaches recorded in the period under review for the five AMCs of the SPOT sample assessed the audit trail for the handling process as satisfactory.
The number of active breaches[29] remains limited for the period under review (2.6 on average on the inspection date, up by 6.5% since January 2019) possibly due to the existence of pre-trade controls blocking investment in ineligible securities for four of the five AMCs. **The average number of passive breaches** recorded in the period was higher (160.6) and increasing rapidly (+ 135%). None of these breaches led to the payment of significant compensation[30] to the unitholders of the funds concerned.[31] Nevertheless, only one of the five AMCs formalised the maximum time limit after which an unresolved passive breach must be reclassified as an active breach (i.e. five days).
The analysis was different after review of the responses to the questionnaire. Of the 176 AMCs mentioned above, 55% did not identify any breach in 2020 or 2021. Furthermore, **the proportion of non-financial breaches reported to the AMF between January 2021 and March 2022 only amounted to 0.4% of the total number of breaches reported to the AMF in that period**. It appears all the more desirable to continuously reinforce the control process in a situation where non-financial contractual commitments are increasing (in particular due to the European regulations) and there is the risk of misleading promises to investors if they are not respected.

Finally, the role of the funds' depositaries in the process for checking compliance with non-financial contractual commitments remains limited and mixed. Only 30% of the 176 AMCs who responded to the questionnaire and have at least one non-financial commitment state that they have already discussed the issue with the funds' depositaries. Within the scope of the SPOT campaign, only one (17%) of the six depositaries of the ESG/SRI funds managed by the five AMCs in the sample intervenes directly in ex post control of the commitments of AMCs 2 and 3 relating to the coverage rate of the ESG analysis of the portfolio and the sector-based exclusions. The AMF reminds depositaries of their responsibilities in controlling compliance with these commitments, and the AMCs of the need to make the data required for these controls available to depositaries.

As regards the information supplied to investors concerning the non-financial commitments of ESG/SRI funds, this was analysed for a sample of five ESG/SRI funds for each of the AMCs in the SPOT sample. In the sample, 65% of the funds are Article 8 funds (including 57.6% as a key aspect of communication), 5% are Article 9 funds

27 Retention of the audit trail for the pre-trade controls conducted by AMC 4 required IT developments that had not yet been carried out at the time of the control for budgetary reasons.
28 The time limit is the same for active and passive breaches, except for AMC 1 where the time limit is increased to 12 days for passive breaches.
29 Cf. glossary.
30 The compensation procedures making it possible to compensate investors who may have been harmed by any breaches of the non-financial commitments of the funds. They guarantee compensation of the losses suffered by unitholders, hence the need to formalise them so they are applied clearly, consistently and systematically regardless of the breaches that caused the losses.
31 No compensation was paid in this connection by AMCs 2 to 5 during the period under review. AMC 1 paid an immaterial consolidated amount of compensation (€250).

(including 80% as key aspect of communication) and 30% are Article 6 funds (including 94% as communication limited to the prospectus).[32]

Three of the five AMCs in the sample (2,3 and 5) have formalised an operating procedure for the process of drawing up, validating and distributing the regulatory documentation of the funds, including the specific characteristics for presenting non-financial commitments. There is the same proportion for the marketing material, but for AMCs 1, 3 and 4.

First-level control of the documentation is the responsibility of the Legal Department in AMCs 1 and 2, the Products Department in AMC 3 and the Compliance Department in AMCs 4 and 5. The tests carried out by the inspection task force on the information produced by the five funds in the sample tested above **reveal the shortcomings of this system**. The commitments tested are in fact not presented in the period under review in a complete, intelligible and balanced manner in an average of 62% of the materials consulted. Furthermore, 15% of the external suppliers of the ESG data used are not mentioned in these documents.

As regards the internal control system for non-financial contractual commitments, only three of the five AMCs (1, 2 and 4) have formalised risk mapping on the subject.[33] On the other hand, the compliance and internal control plan (PCCI) of the five AMCs reviewed provides for specific controls in this area.

The inspection task force notes however, following the tests carried out, that **a low rate of AMCs in the SPOT sample conduct these controls satisfactorily**. It amounts to 40% for control of compliance with the non-financial contractual commitments of the funds (AMCs 1 and 2) and control of the override process for the ESG scores of issuers (AMCs 2 and 4). The lack of second-level control for the latter process is particularly awkward for AMC 5 since it makes intensive use of it. The AMCs with satisfactory controls (1, 2 and 4) benefited from an **internal audit** of compliance with non-financial contractual commitments.

On the other hand, the permanent and periodic control system for the presentation of non-financial commitments in the documentation of the funds proved nonexistent for AMCs 1 and 3, and was limited to an ex ante review for AMC 2 and a partial review for AMCs 4 and 5. This situation is worrying in view of the shortcomings noted in this area by the inspection task force during the tests conducted.

4. APPLICABLE REGULATIONS

The analyses carried out were based on the following regulations:

- the Monetary and Financial Code (MFC);
- the AMF General Regulation (AMF GR);
- Commission Delegated Regulation (EU) No 231/2013[34] (CDR No 231/2013);
- Regulation (EU) 2019/2088, the Sustainable Finance Disclosure Regulation (called SFDR level 1);[35]
- Commission Delegated Regulation (EU) 2022/1288 supplementing SFDR level 1 (called SFDR level 2);[36]

---

32 As a reminder, there is no strict correspondence between firstly the concepts of Article 8/9/6 funds resulting from the SFDR, and secondly the concepts of "key/reduced aspect of communication/communication limited to the prospectus" resulting from AMF Position-Recommendation 2020-03 (cf. glossary).

33 This type of mapping has the advantage of formalising the risk analysis carried out by the AMC for the system for controlling the non-financial contractual commitments of its funds, as well as the estimate of the level of effectiveness (at a given time) of the control resources intended to ensure continuous compliance with these commitments.

34 Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision.

35 Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector.

36 Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation

- Taxonomy Regulation (EU) 2020/852[37] classifying activities deemed virtuous from an environmental point of view;
- Commission Delegated Regulation (EU) 2016/438 with regard to obligations of depositaries;[38]
- Supervisory briefing of the ESMA on "Sustainability risks and disclosures in the area of investment management";[39]
- AMF Position-Recommendation DOC-2011-24;[40] and
- AMF Position-Recommendation DOC-2020-03.[41]

Reminder: The table below includes all the regulations that the AMF used in its work. However, the regulatory articles listed in the shaded boxes at the end of each section below correspond to the regulatory articles specifically used to describe the findings of the inspections conducted during the SPOT campaign.

REGARDING THE ORGANISATION AND THE RESOURCES IMPLEMENTED
Article 321-23 of the AMF GR (UCITS) and Articles 318-1 of the AMF GR, 22 (1) (2) and 57 (1) CDR No 231/2013 (AIF) on the use of appropriate and adequate material, technical, financial and human resources, and the establishment of decision making procedures and a clear and documented organisational structure. **Articles 321-96 (II) (1) (2) (5) (UCITS) and 318-61 (II) (1) (2) (5) (AIF) of the AMF GR)** on outsourcing a critical or important task or function.
REGARDING POLICIES AND PROCEDURES
Articles 318-4 (AIF), 321-30 and 321-35 (UCITS) of the AMF GR, 60 and 61 (1) of CDR No 231/2013 (AIF) on establishing and maintaining appropriate operational policies, procedures and measures to detect any risk of non-compliance with professional obligations and the responsibility of governing bodies.
CONCERNING THE ESG MANAGEMENT AND RATING METHODOLOGY
Article L. 533-22-2-1 of the MFC regarding the obligation of AMCs to act honestly, fairly and professionally, in the best interests of investors. **Articles L. 533-22-1 (II) and D. 533-16-1 of the MFC** regarding 1/ presentation of the methodology, and 2/ description of the how the results of the ESG analysis are incorporated in the investment policy of the CIU and information on the contribution to compliance with the international objective to limit global warming and achieving the objectives of the energy and ecological transition.[42]

to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports. As this CDR entered into force after the inspection period (January 2019 - December 2021), i.e. on 1 January 2023, it was not used to describe breaches in connection with the inspections carried out during this SPOT campaign.

37 Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

38 Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 supplementing Directive 2009/65/EC of the European Parliament and of the Council with regard to obligations of depositaries.

39 https://www.esma.europa.eu/sites/default/files/library/esma34-45-1427_supervisory_briefing_on_sustainability_risks_and_disclosures.pdf

40 A Guide to drafting collective investment marketing materials and distributing collective investments.

41 Information to be provided by collective investment schemes incorporating non-financial approaches.

42 This article concerns both the reports required under Article 173 of the LTECV and those (which replaced them) required under Article 29 of the LEC. These two types of report were reviewed by the inspection task force.

REGARDING THE INVESTMENT AND RISK MANAGEMENT SYSTEMS

Articles L. 533-22-1 (I) and D. 533-16-1 of the MFC regarding the presentation of the ESG management approach in the investment policy and where appropriate in the risk management procedure.
Articles 321-30 of the AMF GR (UCITS) and 61 (1) of CDR No 231/2013 (AIF) mentioned above.
Articles 318-6 (AIF), 321-35 (UCITS) of the AMF GR and 60 (2) (f) of CDR No 231/2013 (AIF) regarding the adoption and regular review by the AMC's governing bodies of the **risk management policy**, and the arrangements, processes and techniques for implementing that policy.
Article 321-75-1 (UCITS) and 318-37-1 (AIF) of the AMF GR on **non-compliance** by AMCs with investment and asset structure rules laid down by legal and regulatory provisions and the investor disclosure documents for the funds they manage.
Articles 321-78, 321-79 (UCITS), 318-40, 318-41 of the AMF GR and Article 40 of CDR 231/2013 (AIF) regarding the establishment, implementation and maintaining of an adequate and documented **risk management policy and systems** that make it possible to detect, assess, manage and monitor the risks that the AIFs are or may be exposed to.
Article 321-101 (6) (8) of the AMF GR (UCITS) and Article 18 of the CDR No 231/2013 (AIF) regarding the establishment, implementation and application of policies and written procedures on due diligence during the **selection and ongoing monitoring of investments**, and the introduction of effective arrangements for ensuring that investment decisions on behalf of the AIFs are carried out in compliance with the objectives, the investment strategy and the risk limits.

REGARDING THE ROLE OF DEPOSITARIES IN THE CONTROL MECHANISM FOR NON-FINANCIAL CONTRACTUAL COMMITMENTS

Articles L. 214-10-5 (UCITS depositaries) and **L. 214-24-8** (AIF depositaries) **of the MFC** on the role of depositaries.
Articles 323-19 (UCITS depositaries) and **323-40** (AIF depositaries) **of the AMF GR** on the controls to be carried out by depositaries.
Commission Delegated Regulation (EU) 2016/438 of 17 December 2015 defining the specific obligations of depositaries.
Chapter IV, Section 3 of CDR No 231/2013, on the depositary functions and due diligence duties.

REGARDING THE METHODS OF INFORMING UNITHOLDERS OF THE NON-FINANCIAL CONTRACTUAL COMMITMENTS

Recital 16 to the SFDR level 2 RTS[43] (SDFR level 2 Commission Delegated Regulation) indicating that certain statements regarding the non-financial aspects of funds may recommend "*a financial product as environmentally friendly or sustainable, when in fact that financial product does not meet basic environmental or other sustainability-related standards*" and that to "*prevent mis-selling and greenwashing... financial market participants should confirm any commitment in terms of excluded investments, in particular as binding elements of the investment strategy*".
Articles L. 533-22-1 of the MFC regarding the content of the policy relating to sustainability risks of the document presenting the policy for incorporating environmental, social and quality of governance criteria in the investment strategy, and for declaring the non-financial performance.

[43] As the SFDR level 2 RTS entered into force after the period under review (January 2019 - December 2022) i.e. on 1 January 2023, they are mentioned here for reference only.

Article D. 533-16-1 of the MFC regarding the methods of presenting, in the information supplied to unitholders, the methods of incorporating environmental, social and quality of governance criteria in the management of ESG/SRI funds. **Article L. 533-22-2-1 of the MFC** relating to the obligation to only give investors information that is accurate, clear and not misleading (including in a promotional context). **Article 321-131 of the AMF GR (UCITS) and Article 103 of CDR NO 231/2013 (AIF)** on the content of the funds' annual report. **AMF Position-Recommendation DOC-2020-03** defining the information to be provided by collective investment schemes incorporating non-financial approaches. **AMF Position-Recommendation DOC-2011-24** on drafting advertising messages and marketing collective investment schemes.
REGARDING THE COMPLIANCE, RISK CONTROL AND INTERNAL CONTROL MECHANISM
Articles 321-23 (IV), 321-27 and 321-31 (I) of the AMF GR (UCITS) and Articles 57 (1) (c), 57 (6) and 61 (2) (a) of CDR No 231/2013 (AIF), regarding the introduction of an effective compliance function which operates independently, responsible for regularly checking the efficiency of the internal control mechanisms. **Articles 321-85, 321-86, 321-90 (UCITS), 318-50, 318-51, 318-55 (AIF) of the AMF GR**, concerning the monitoring system. **Articles 321-76 to 321-81 (UCITS) and 318-38 to 318-42 (AIF) of the AMF GR**, regarding risk control. **Articles 321-83 of the AMF GR (UCITS) and 62 of CDR No 231/2013 (AIF)** regarding periodic control. **Article 321-36 of the AMF GR (UCITS), Articles 60 (4) and 61 (3) (b) of CDR No 231/2013 (AIF)** regarding periodic disclosure to the governing bodies of the results of the work carried out by the compliance, internal audit, risk control and periodic control teams.

5. ANALYSIS OF THE ANSWERS TO THE QUESTIONNAIRE AND MAIN FINDINGS

5.1. ORGANISATION AND RESOURCES IMPLEMENTED AS REGARDS ESG/SRI

5.1.1.General ESG/SRI system

The main stages of deployment of the ESG strategy are similar[44] for the five AMCs in the sample:

- Stage 1: An initial investment universe is defined for each ESG/SRI fund. This universe is successively reduced by taking into consideration exclusions (thematic or linked to an ESG rating below the procedural thresholds) and/or controversies;[45]
- Stage 2: the AMC acquires raw data from external suppliers for its ESG rating system;

[44] This similarity is due to the process for selecting the AMCs in the sample. As was explained in the introduction, in connection with the sample tests carried out on the ESG/SRI funds managed by these participants, the inspection task force mainly chose funds with the SRI label.

[45] Cf. glossary.

- Stage 3: the ESG score of each emitter in the investment universe (ranging for example from 0 to 20) is calculated using an internal formula to weight the scores transmitted by the external suppliers for each of the E, S and G assessment criteria[46] (or pillars);
- Stage 4: a correspondence scale within the AMC is used to convert the mathematical score obtained in stage 3 above into a final ESG score for the issuer, that is more meaningful for the management teams and commonly presented in the form of a letter (e.g. "A" representing the best score and "E" the worst);
- Stage 5: the ESG analysts may propose to modify (override)[47] this score based on recent information in their possession (e.g. in the event of controversies);[48]
- Stage 6: the analysis universe of each ESG/SRI fund is obtained by applying to the initial investment universe the restrictions associated with the non-financial contractual commitments. These restrictions, which include the exclusion policies, apply to the issuers that have been rated;
- Stage 7: the managers can carry out investments/divestments in the ESG/SRI funds, in securities in the analysis universe.

Within this framework, most (four out of five) of the AMCs in the sample have adopted a best-in-class ESG assessment approach.[49] Only AMC 4 applies a best-in-universe strategy.[50] The parent company was involved in defining this strategy for 50% (two[51] out of four) of the AMCs in the sample belonging to a group. Although its role was minor for AMC 2 (as it concerned a request to overweight the "regional job creation" criterion in the method of assessing the issuers' social pillar), it was major for AMC 3 whose ESG/SRI strategy is managed directly by the group research manager in this field.

Regarding the rating process alone, the differences identified between the five AMCs in the sample are technical. They mainly concern the volume and origin of the external ESG data acquired, the number and nature of the ESG assessment criteria used and the formula for calculating the ESG score (including the weightings of each of the E, S and G indicators adopted).

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Number of criteria taken into consideration for the ESG rating of issuers[52]	38	13	34	31	20

Finally, all of the AMCs in the sample have joined several international ESG/SRI initiatives, including the PRI,[53] Net Zero Asset Managers[54] and Climate Action 100+.[55]

5.1.2. Human resources involved in the ESG/SRI system of the AMCs in the sample

46 For example, the criteria may be: energy consumption/turnover ratio for the environment component; difference between the salary of the managing director and the average salary for the social component, gender parity ratio within the board of directors for the governance component.
47 Cf. glossary.
48 Cf. glossary.
49 Cf. glossary.
50 Cf. glossary.
51 I.e. AMCs 2 and 3. As a reminder, AMC 4 is independent.
52 The presentation described above concerns the method of ESG rating of corporate issuers (as opposed to sovereign issuers for example) which constitute the majority of the entities receiving an ESG rating in the AMCs in the sample. As a reminder, the final ESG score will be influenced by the number of indicators and their weighing in the calculation formula.
53 Cf. glossary.
54 http://www.netzeroassetmanagers.org
55 http://www.climateaction100.org

The workforce dedicated exclusively to deploying the ESG/SRI strategy represents on average 7% of the total workforce of the five AMCs in the sample (from five FTEs for AMC 3 to over 50 for AMC 1). The level ranges from 2% (for AMC 3)[56] to 16% (for AMC 5). **The workforce has increased by 80% on average since 2019.**

The **teams dedicated to deploying the ESG/SRI strategy** are responsible for choosing the non-financial contractual commitments of funds in the ESG range, carrying out ESG research, selecting and monitoring external suppliers of ESG data, defining, deploying and monitoring the internal ESG rating method and dialogue with the issuers (in connection with monitoring their commitments). They also manage the configuration of non-financial contractual commitments in the AMC's IS.[57] On the other hand, control of compliance with these commitments is carried out by a team that is independent of the managers, i.e. the Risk Department for four of the five AMCs in the sample, and the Operations Department for AMC 3.

Regarding the managers, only AMC 3 has managers specialised in ESG/SRI management.[58] For the four other AMCs, ESG/SRI management is incorporated in the standard management activity.

Finally, most of the AMCs in the sample (three[59] out of five) have introduced a structured and recurring **training programme** on sustainable finance for all employees[60].

5.1.3.Technical resources used for ESG/SRI management by the AMCs in the SPOT sample

The IS used to deploy the ESG strategy of the AMCs in the sample is **highly integrated**. All of these AMCs have developed an **in-house proprietary rating system** that also includes monitoring of the results of (internal and external) ESG research activities, and makes it possible to make ESG ratings available to the managers. Furthermore, for most of the AMCs in the sample (four[61] out of five), controls of compliance with non-financial contractual commitments are carried out via the same application that is used to place orders.

5.1.4.ESG governance of the AMCs in the sample

For AMCs 3 and 5, deployment of the ESG strategy of the AMCs in the sample is managed by managers dedicated to that area for all of their working time. For AMCs 1, 2 and 4, management is carried out by a manager from the AMC for a percentage of work ranging from 20% for AMC 4 to 60% for AMC 1. On the other hand, each of these decision-makers reports to a senior manager of the AMC.[62]
The management mentioned above is based on a **similar committee procedure for the five AMCs in the SPOT sample**. An umbrella committee led by the senior manager mentioned above defines the AMC's ESG strategy and monitors its deployment. The committee meets twice a week for AMC 3, monthly for AMC 1 and quarterly for AMCs 2, 4 and 5. More frequent operational committees complete the system in order to validate changes in the methodology for ESG rating of issuers, define the non-financial commitments of each fund and regularly control compliance with them.

---

56 AMC 3 makes up for the smaller dedicated workforce by relying on the resources devoted to the group's ESG/SRI strategy.

57 Cf. Section 5.1.3 below.

58 This concerns 42% of the total workforce of the management front office, i.e. 21 FTEs.

59 Only AMCs 3 and 5 have not introduced such a programme.

60 The AMF reminds having created in 2021, on proposal of the High Certifier Council in Paris financial centre, a certification aiming to check professional knowledge about ESG / SRI. The AMF instruction n° DOC 2021-03 provides the description of the exam, the content of the certification request and duties of certified bodies (https://www.amf-france.org/en/regulation/policy/doc-2021-03).

61 Only AMC 2 uses two different tools as it merged with another company during the inspection period, following which it included the application for placing orders of the other company.

62 This reporting line is hierarchical for AMCs 1, 2, 4 and 5, but functional for AMC 3.

Finally, regarding the process for structuring ESG/SRI funds, this is combined with that of the other funds for most of the AMCs in the sample (three out of five). On the other hand, AMCs 3 and 5 have set up a dedicated committee on this topic for funds intended to join the ESG range.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Committee responsible for **defining, developing and managing deployment** of ESG/SRI funds (frequency)	Committee meeting on an ad hoc basis led by the Marketing Department.	Bimonthly committee led by the Marketing Department.	Committee meeting on an ad hoc basis led by the ESG Research Manager.	Weekly committee led by the Chief Investment Officer	Quarterly committee led by the Chairman of the AMC.

Good practices

- In addition to the pre-trade controls that may be carried out by the managers themselves, assigning control of compliance with non-financial contractual commitments to a team that is independent of the managers.
- Deploying a regular training programme in sustainable finance for the entire staff.
- Setting up a committee responsible for structuring ESG/SRI funds (separate from the committee in charge of the other funds).

5.2. ESG MANAGEMENT AND RATING METHODOLOGY

5.2.1.Procedure and mapping for non-financial contractual commitments

All of the five AMCs have formalised (and kept up-to-date) structured procedures describing the ESG/SRI strategy, the resources for the strategy[63] and the process for monitoring the non-financial contractual commitments of the funds. On the other hand, only two of the five AMCs in the sample (2 and 4) have formalised full, up-to-date and operational mapping of their non-financial contractual commitments. The mapping is centralised for AMC 4 and separate for each ESG fund for AMC 2. Although it requires a significant amount of work to draw up and update this document, mapping of this kind is very useful for departments responsible for managing and checking compliance with non-financial contractual commitments in force for the ESG/SRI funds.
After analysing the mapping, the following table provides a comparison of them, between on the one hand the AMCs in the SPOT campaign sample, and on the other those who responded to the questionnaire.[64]

[63] Described in Section 5.1 above.
[64] Cf. Section 2 above.

No.	Commitment	nature	Proportion of AMCs including this requirement in at least one of their funds	
			Basis: questionnaire (299 AMCs)[65]	Basis: SPOT inspection (five AMCs)
1	Coverage rate of the ESG analysis of the portfolio	generic	50%	100%[66]
2	Reduction in the investment universe of the fund by excluding issuers with the lowest ESG rating (e.g. 20% reduction in the universe)	generic	46%	100%
3	Improvement in the ESG score of the fund compared with the score of its investment universe	generic	34%	80%
4	ESG sector-based exclusions (e.g. tobacco)	generic	50%	100%
5	Minimum investment commitment in green, social or sustainability bonds	generic	9%	80%
6	Exclusion of issuers subject to significant non-financial controversies	specific	33%	60%
7	Requirements[67] associated with the Greenfin label	specific	8%	40%
8	Requirements associated with the SRI label (e.g. outperformance commitment for at least two non-financial indicators)	specific	14%	60%

5.2.2.Use of non-financial data provided by external service providers

This data includes in particular the characteristics of the (private and public) issuers, as well as information on the impact of their activity on the climate, natural resources (e.g. water, gas), consumption of fossil fuels and carbon dioxide (CO2) emissions. All of the AMCs in the sample also use a supplier for information on controversies[68] affecting issuers in the investment universe.

This data is used to show that the funds comply with their non-financial commitments. It is therefore important that the AMCs check their quality and reliability. To do so, they must put in place procedures that enable them to review the service provider's methodology (in particular for estimated data) and ensure that the data bought is consistent with the non-financial commitments made. The procedure must be proportionate to the use made of the data by the AMC.

In the course of the SPOT campaign, the inspection task force noted that three of the five AMCs in the sample[69] have formalised and kept up-to-date **operational mapping of the non-financial data** used for the analyses required for ESG management. For each data item (or data family) the mapping indicates the suppliers who produce it, the associated content and how the AMC uses it.[70]

The inspection task force did not note an excessive concentration of the same suppliers in the sample of AMCs, except for the specialised service provider for data on controversial weapons (used by four of the five AMCs).[71]

[65] I.e. the 299 non-specialised AMCs mentioned in Section 2 above, given that only 176 of them have at least one non-financial commitment in at least one of their funds.
[66] The difference noted in terms of the commitment coverage rate between the total sample and the SPOT sample is due to a desire to select, in the SPOT sample, participants who collectively have a higher coverage rate in order to be able to test in situ compliance with these commitments by the five companies reviewed.
[67] These requirements depend on the type of fund.
[68] Cf. glossary.
[69] AMCs 3 and 5 have not formalised such mapping.
[70] For example it may be used for the rating system or to collect information on controversies.
[71] Only AMC 5 uses a different supplier in this field from the four other AMCs.

At the time of the inspection, the average number of issuers covered by suppliers of non-financial data to the AMCs in the sample was 9,320. This number varied between 3,179 for AMC 5 and 14,600 for AMC 3. **It has increased by 67% on average since January 2019**, linked to extensions to subscriptions that the AMCs requested from the suppliers, or widening of the existing cover by the suppliers themselves.

Most of the AMCs in the sample (four[72] out of five) have put in place a formal process for resolving issues relating to contradictory non-financial data supplied by two different service providers on the same theme. These contradictions are dealt with by (i) using a combinatorial method for AMCs 1 and 2, (ii) using a separate supplier for each ESG topic[73] used by the rating algorithm for AMC 3 and (iii) asking the suppliers involved to check and reach a consensus for AMC 4.

On the other hand, only AMC 2 carried out effective control of the quality of the non-financial data before inputting it in the ESG rating system for issuers. This consistency check is carried out when required by a dedicated team which provides feedback to the suppliers (by email) to investigate any cases of data supplied that clearly contradicts the latest information available to the ESG analysts and the managers. In this case the suppliers concerned are encouraged to review the process for producing the data concerned.
Although this control is also carried out beforehand for AMCs 3 and 4, it is inadequately logged for AMC 3 and not exhaustive (in terms of the suppliers covered) for AMC 4. On the other hand, it is carried out after[74] the input process for AMC 1 (which only makes it possible to detect incorrect incoming data after calculating the resulting changes in the ESG scores). Finally, it does not exist for AMC 5.

- **External contractors involved in the ESG management system of the AMCs in the SPOT sample**

Three[75] of the five AMCs in the sample have formalised and kept up-to-date operational mapping of these service providers. This mapping shows that suppliers of ESG data are in the majority in this mapping, as is shown in the table below.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Total number[76] of external service providers that the AMC has active relations with in connection with its ESG system	27	12	10	13	5
% of external suppliers of ESG data	52%	83.3%	100%	69.2%	80%

Finally, the average consolidated price exclusive of tax paid by AMCs[77] 1, 2, 4 and 5 in 2021 to the suppliers cited amounted to €1.3m. **This cost has increased by 90%** on average since January 2019.

For financial year 2021, the ratio of the price paid in 2021 to external suppliers of ESG data, to the collective management fees received by the AMCs was as follows.

2021 financial year	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5

72 Only AMC 5 did not formalise this process.
73 e.g.: CO2 emissions, biodiversity.
74 AMC informed the inspection task force that a prior control was currently being introduced by the Operations Department (this team is also responsible for the processes for acquiring external non-financial data, managing the associated contracts, relationships with suppliers and input of the data received in the AMC's information system).
75 Only AMCs 3 and 5 have not formalised such mapping.
76 Apart from the suppliers of data used by the ESG rating system, this category includes for example, publishers of the external tools used by the ESG management system and ESG management consultancies.
77 AMC 3 declared to the inspection task force that it is unable to isolate this type of cost in its cost accounting.

Ratio of the price paid to external suppliers of ESG data, to the total amount of collective management fees received by the AMCs[78].	0.3%	0.4%	N/A	0.1%	0.3%

It is striking to note that the financial burden of ESG data suppliers is the same in the biggest and smallest AMCs in the SPOT sample.

- **Process for selecting and inspecting external suppliers of non-financial data**

A minority (two out of five) of the AMCs have formalised and kept up to date a procedure for selecting and regularly controlling external suppliers of non-financial data. Only AMCs 1 and 4 have completed their existing procedures for outsourcing with selection and control criteria[79] specific to these service providers. To analyse these processes, the inspection task force therefore relied on the declarations of the AMCs in the sample, in addition to the existing procedures.

Selection of external suppliers of non-financial data must be carried out **by invitation to tender** (for all of the sample). This process is carried out by the internal team of ESG experts for the five AMCs reviewed. In addition, AMCs 1 and 3 have a dedicated team from the Operations Department for the purpose, in particular, of checking the technical suitability of the format of the data tested for the AMC's IS.
Regarding the process to control the quality of the services provided by active suppliers, it is carried out by the ESG research team for four of the five AMCs and by the Compliance and Internal Control Officer for AMC 1. This process did not lead to significant renewals of active contracts at the time of the inspection. **The turnover rate[80] of the suppliers cited was zero for four of the five AMCs** in the period under review[81] and amounted to 10% for AMC 2 (i.e. one supplier replaced out of 10[82] during the inspection period).

<u>Test carried out by the inspection task force on a sample of external suppliers of ESG data</u>
The inspection task force wanted to check the robustness of the processes described above via a test. For that purpose, a sample of four to five active suppliers was chosen at random for each of the AMCs in the sample, ensuring that there was a minimum level of representativeness of over 25%.[83]
Regarding the supplier selection process in the sample, the inspection task force noted that a robust audit trail was only provided **for two of the five AMCs (40%)**. The audit trail proved incomplete for AMCs 1 and 3 and nonexistent for AMC 2.
On the other hand, regarding the quality control process for the services provided, the success rate was 60%, the audit trail supplied proving inadequate for AMCs 2 and 3.

5.2.3. Implementation of the ESG strategy

- **Process for defining and reviewing the initial investment universe of the ESG/SRI funds**

---

78 ESG data which costs have been used for the calculation cover both collective and discretionary management. Nevertheless, AMCs within the SPOT sample were not able to provide the AMF with an analytical breakdown of these costs by management type. That is why, in order to simplify, only collective management fees were used for the denominator of ratios calculated into the dashboard above.
79 These criteria include the extent of the coverage offered, the historical depth of the data available, the transparency of the methodology used, the simplicity of the user interface, the technical compatibility of the data flow with the AMC's IS, the quality of the customer support service, the supplier's reputation and the price.
80 Number of external suppliers of non-financial data who changed during the period under review/total number of external suppliers of non-financial data.
81 January 2019 – December 2022.
82 I.e. 83.3% x 12 as indicated in the table above.
83 This level (equal to the number of suppliers selected divided by the total number of suppliers) amounted to 28% for AMC 1, 40% for AMCs 2 and 4, 50% for AMC 3 and 100% for AMC 4.

FOCUS 1: position of the investment universes in the non-financial commitments

The investment universe of a fund comprises a set of issuers that the fund can invest in, in accordance with its investment policy. It is generally defined in terms of sector, location, capitalisation and types of assets.

Due to the requirements of the SRI label, the investment universe constitutes a key component of many non-financial commitments. For example, of the 176 AMCs that responded to the questionnaire and had committed to at least one non-financial requirement in the legal documentation of at least one of their funds, 78% undertake to reduce their investment universe and 58% undertake to have an average ESG rating for the portfolio higher than that of the investment universe. **It is essential to define the investment universe objectively and consistently, to guarantee effective compliance with the non-financial commitments and avoid any bias and circumvention.**[84]

To do so, it appears preferable to entrust the validation of the universe to a team that is independent of the managers. If it is up to the managers to validate it, there is in fact a risk that they will try to extend the universe at their own discretion, to have greater flexibility in managing the fund. However, **half of the AMCs cited above who have a non-financial commitment linked to the investment universe allow their teams of managers to define and validate the universe.**

Furthermore, the AMCs concerned have not deployed an ex post control system to check that there is no bias in the proposed investment universe.

Universe update frequency

It is also essential to define an appropriate frequency for updating the investment universe to guarantee effective and continuous compliance with the funds' non-financial commitments. **The answers to the questionnaire sent to the market show monthly or annual updating.** These frequencies may be due to the low volatility of certain indicators underlying the non-financial commitments. Although daily or weekly updating of the universe appears difficult to implement at this stage for technical reasons, updating it once a year nevertheless appears inadequate to ensure that the universe is always representative and consequently to ensure compliance with the associated non-financial commitments.

Most of the AMCs in the sample reviewed in the SPOT campaign (four[85] out of five) have formalised their process for defining and reviewing the initial investment universe[86] of the ESG/SRI funds in a dedicated procedure. The inspection task force noted that these procedures specified the two possible sources for defining this initial universe. The first source is a benchmark index in line with the geographic zone, the type of capitalisation of the issuers and the types of securities of the fund's investment policy. The second possible source involves selecting several indices if a single index is not sufficient to cover all of the attributes of the required fund.

Furthermore, the procedures consulted state the role of the different teams involved in this process. The initial investment universe is proposed by the managers for all five AMCs in the sample. On the other hand, **validation of the universe proposed is assigned to a team that is independent of the managers** (i.e. the Risk Department for AMCs 1 and 2 and the ESG Department[87] for AMCs 3 to 5). Finally, configuration of the validated universe in the

[84] The lack of bias is intended to i) ensure that the universe defined is continually consistent with the fund's strategy, ii) identify potential inconsistencies and iii) check that they do not lead to artificially achieving the funds' non-financial commitments.
[85] AMC 2's procedure omits the frequency of review of the universe defined.
[86] Cf. glossary.
[87] This generic term refers to the teams responsible for defining and deploying the ESG/SRI strategy (cf. Section 5.1.2 above).

AMC's IS is carried out by the same ESG department in AMCs 2, 4 and 5, whereas it is performed by a specialised team outside that department[88] for AMCs 1 and 3.

For all five AMCs in the sample, the process of defining the investment universe is formalised via reports by dedicated committees for AMCs 2 to 5, and on an Excel file for AMC 1. At the time of the inspection the average number of active initial investment universes[89] in the field of ESG/SRI management was 44[90] for an average of 133 ESG/SRI funds. The definition process provides an opportunity to carry out an ex ante control of the consistency of the investment universe with the fund's non-financial commitments.

On the other hand, the inspection task force noted that only two of the five AMCs (40%) had introduced ex post, regular, operational and formalised control of the consistency of the initial investment universes with the investment policy, for example to check that there is no sector, geographic or capitalisation bias. This control is carried out by the Risk Department and by a dedicated quarterly committee in AMC 2, and by the ESG Department in AMC 4. It is not formalised for AMC 3 and nonexistent for AMCs 1 and 5.

- **Methods of ESG rating of issuers used by the AMCs in the sample**

All of the AMCs in the sample have defined a formal, operational and up-to-date procedure indicating the rules for ESG rating of issuers. However, the inspection task force noted that the procedure had not been updated since September 2014 for AMC 1, which involves a risk that changes in the regulations (and the guidelines) after that date will be inadequately taken into consideration.

The range of ESG scores used[91] by the AMCs in the sample varies from five (for AMC 4) to 11 (for AMC 3). The scores are updated monthly by most of the AMCs (four out of five) and half-yearly by AMC 2.

The methods of rating used varied for three of the five AMCs in the sample (60%) during the period under review. These three AMCs ensured the consistency of the ESG scores awarded before and after the implementation of these changes, as is shown in the table below.

[88] I.e. for AMC 1, the team responsible for the investment standards, and for AMC 3, the team responsible for products.
[89] This is the arithmetic mean of the investment universes existing at the time of the inspection for the five AMCs in the sample, within the scope of their ESG/SRI funds.
[90] AMC 4 has 8 universes (minimum number in the sample) and AMC 2 has 105 (maximum number).
[91] I.e. the maximum number of ESG scores that can be issued.

	AMC 1	AMC 2	AMC 4
Significant changes in the method of ESG rating carried out during the period under review	Development of a specific method of ESG rating[92] for issuers of sovereign debt (in October 2020) and supranational debt (in April 2021).	Addition in 2021 of further ESG assessment criteria in the calculation scale.	Change in October 2020 from a method based on the ESG ratings allocated by a single external supplier to the implementation of a proprietary algorithm updated by several suppliers.
Controls carried out by the AMC to ensure the consistency of the ESG scores awarded to the issuers before and after making the changes mentioned above[93]	By carrying out simulations after each change.	By producing, before the change, a dedicated comparative report[94] issued by the Risk Department and validated by an ad hoc committee in October 2021.	By displaying in the current system the scores from the former system alongside those from the new system.[95]

The inspection task force did not identify an obvious structural bias in the methods of ESG rating of the AMCs in the SPOT campaign sample, except for AMC 4. For AMC 4, the inspection task force noted[96] that the ranges of the scores (out of 10)[97] for the “worst” scores produced by the algorithm (i.e. D and E) were 50% smaller than those leading to “good” scores (i.e. A, B and C).[98] The inspection task force concluded from this that AMC 4’s ESG rating algorithm in its current configuration had more chance of allocating a favourable ESG score to an issuer than an unfavourable score. However, this characteristic is not presented sufficiently clearly in the documentation of the ESG/SRI funds managed by that participant.

➢ **Override process[99] for scores produced by the automated ESG rating system**

Four[100] of the five AMCs in the SPOT sample (80%) specify in their procedures that it is possible to override the ESG score calculated automatically by the rating algorithm.

ESG analysts of the four AMCs are allowed to suggest (subject to justification)[101] overriding the ESG score (AMC 2 extended this option to the managers). **All proposed overrides are subject to formal validation by the ESG research manager.** The audit trail for this process is stored in the ESG rating system of each of the AMCs concerned. In the course of the tests presented below, the inspection task force noted that the overrides included in the sample were solely used to improve (by one level) the ESG score of the issuer calculated by the algorithm. However, none of the overrides analysed resulted in an issuer becoming eligible who would have been excluded by its initial ESG score. The formal justifications provided for the overrides analysed show that the level of information of the

92 These developments did not lead to a change in the rating scale.
93 The anomalies identified during these controls were progressively corrected until ratings were achieved that were considered consistent.
94 This report presents in detail the changes in the rating criteria used and the calculation formula for the ESG score. It also provides the IT modifications required to change the code to set the formula in the AMC’s IS.
95 It is the scores from the new system that are used operationally by the managers.
96 This finding is underlined in Section 5.4.3 below regarding the first-level control mechanism for the content and form of the regulatory and commercial documentation of ESG/SRI funds.
97 Scores are allocated according to the AMC’s in-house scale for the correspondence between the numerical ESG score and the final ESG score transmitted to the management teams (cf. Stage 4 in Section 5.1.1 above).
98 In fact, in AMC 4’s rating algorithm, the marks out of 10 resulting in the score D range between 1 and 2.4, i.e. a difference of 1.4. The marks out of 10 resulting in the score E range between 0 and 0.9, i.e. a difference of 0.9. On the other hand, the marks out of 10 resulting in the scores A, B or C range respectively between: 7.5 to 10 for the score A; 5 to 7.4 for the score B and 2.5 to 4.9 for the score C, i.e. an average (bigger) difference of 2.4.
99 Cf. glossary.
100 The exception is AMC 3 whose ESG rating methodology does not allow override.
101 This justification may involve knowledge by the analyst of information on an issuer that is more recent than that used by the algorithm to calculate the score.

manager is declared to be more up-to-date (regarding the issuer concerned) than the data present in the rating system.

Test carried out by the inspection task force of the method of ESG rating of issuers

The inspection task force carried out a sample test to check that the ESG rating (and override) processes presented in the procedures of the AMCs in the sample were properly applied. The test was conducted according to the following three stages:

- Stage 1: for each of the five AMCs, a sample of five (Article 8 and Article 9)[102] open-ended funds managed directly and representing at 30 June 2022, a share of the total ESG/SRI assets under collective management varying between 1.2% (for AMC 1) and 52% (for AMC 5);
- Stage 2: for each of the funds selected, the inspection task force chose two securities[103] continually included in the inventories of the funds in the period under review;
- Stage 3: for each security selected, the inspection task force asked the AMC to give it the ESG scores and analyses that justified their continuous presence in the inventories mentioned (in view of the non-financial contractual commitments of the funds).

After analysing the documents supplied, the inspection task force noted that **the result of the test was not effective for four of the five AMCs**.

	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Result of the test	EFFECTIVE	PARTLY EFFECTIVE	NOT EFFECTIVE	PARTLY EFFECTIVE	NOT EFFECTIVE
Failure rate	0%	20%	100%	20%	80%
Explanation	The ESG scores awarded are consistent with the presence of the issuers tested in the inventories of the funds. Each of the issuers had been subject to a detailed ESG analysis that accompanied the score awarded.	The audit trail justifying the presence of two of the 10 issuers tested was not provided for financial years 2020 and 2021.	No audit trail was provided, even though four of the 10 issuers tested were included at least once in the exclusion lists of the AMC for the period reviewed.	The audit trail justifying the presence of two of the 10 issuers tested was not provided.	The audit trail justifying the presence of eight of the 10 issuers tested was not provided.

On the other hand, the result of the test was effective overall for the override process for ESG scores.

	AMC 1	AMC 2	AMC 4	AMC 5
Result of the test	EFFECTIVE	EFFECTIVE	EFFECTIVE	PARTLY EFFECTIVE
Failure rate	0%	0%	0%	30%
Explanation[104]	One issuer out of the 10 tested was concerned by an override for the period under review. The override was formally justified via an explanatory report on the basis of which it was validated by a dedicated committee.	Scores were overridden for three issuers out of the 10 tested during the period under review. The overrides were formally justified via an explanatory report.	Same as for AMC 2.	Scores were overridden for six issuers out of the 10 during the period under review. A formal audit trail was not provided for two of the six overrides noted.

102 Cf. glossary.
103 I.e. a total sample of 10 securities tested per AMC (two per fund).
104 None of the overrides noted in the scope tested resulted in the exclusion of the issuer concerned from the investment universe.

- **Process for managing exclusions of issuers in place in the AMCs in the SPOT sample**

A dedicated (and updated) description is provided in the procedures of the five AMCs in the sample. This description specifies the (generic[105] and specific)[106] families[107] used by the AMC, the exclusion rules resulting from the non-financial contractual commitments[108] of the funds, the sources used to create the exclusion lists and the process for implementing (and updating) these lists in the AMC's IS. The inspection task force noted that only **AMC 2's procedure does not specify the maximum time limit allowed for selling securities once their exclusion from the universe has been decided**.

The exclusions identified in the sample of AMCs can be divided into several groups. For example, there were exclusions targeting the coal or tobacco industries. The inspection task force also noted exclusions linked to the SRI label relating to the production of non-conventional weapons[109] and violations of international principles;[110] In addition, exclusions were identified triggered by identifying a (severe and unresolved) controversy regarding an issuer, as well as exclusions linked to the decline in an ESG score (possibly after override) below the exclusion threshold[111] formalised in the procedures. Finally, the inspection task force noted the existence of exclusions specific to each AMC in the sample, i.e. for example activities linked to the mining of uranium for AMCs 1 and 3, pornography for AMC 4 and intensive exploitation of forest resources for AMC 2.

As regards controversies, the inspection task force noted the existence of an operational and substantiated process for monitoring their impact on compliance with non-financial contractual commitments for each of the AMCs in the sample. This process is specified in the transparency codes and the AMC's commitment (or responsible investment) policy. In addition, it is based on the alerts issued over time by a dedicated specialised external supplier.[112]

Finally, the inspection task force checked, in all of the procedures and a sample of the regulatory documentation of the funds[113] of the five AMCs in the sample, that their exclusion process **took into consideration the PAIs**[114] for some or all[115] of the funds in the ESG range.

Regulatory reminders

- **Articles 321-23 (IV) of the AMF GR (UCITS):** "*[AMCs] shall establish and maintain effective and adequate internal control mechanisms designed to* ***secure compliance with decisions and procedures*** *at all levels of the AMC.*" **(and Article 57 (1) (c) of CDR No 231/2013 (AIF))**;
- **Article 321-30 of the AMF GR (UCITS):** "*AMCs shall establish and maintain appropriate operational policies, procedures and measures to* ***detect any risk of non-compliance*** *[with these] professional obligations... and the subsequent risks and to attenuate those risks. [Within this framework] AMCs shall take into account the*

105 Valid for all of the ESG/SRI funds in the range.
106 Valid only for certain ESG/SRI funds in the range.
107 Cf. explanations later in this Section.
108 Cf. Section 5.2.1 above.
109 Concerns companies whose activity is linked to anti-personnel mines, fragmentation, biological and chemical weapons.
110 I.e. the principles of the United Nations Global Compact, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, and of the Organisation for Economic Co-operation and Development (OECD).
111 This threshold is usually the last score in the range described above in the section "Method of ESG rating of issuers"
112 Cf. Section 5.2.2 above.
113 Cf. Section 5.4 below.
114 Cf. glossary.
115 For AMC 4 they were only taken into consideration for 10 funds managed by the AMC under delegation from one of its subsidiaries representing assets of €7.5bn at 30 June 2022.

nature, scale, complexity and range of the businesses that they engage in." **(and Article 61 (1) of CDR No 231/2013 (AIF))**;

- **Articles 321-96 (II) (1) (2) (5) (UCITS):** *"II. c* ***contract*** *for critical or important operational tasks or functions. In particular, AMCs must take the necessary steps to ensure that the following conditions are satisfied: (1) The service provider must have the ability, capacity, and any authorisation required to perform the outsourced tasks or functions reliably and professionally; (2) the service provider must carry out the outsourced services effectively.* ***For this purpose, AMCs shall define methods for evaluating the service provider's level of performance****... (5) AMCs must retain the necessary expertise to supervise the outsourced tasks or functions effectively and manage the risks stemming from outsourcing, and must supervise those tasks and manage those risks. For the purposes of this provision, AMCs shall maintain the resources and expertise necessary* ***to effectively integrate sustainability risks";***[116] **(and Article 318-61 (II) (1) (2) (5) of the AMF GR (AIF))**;
- **Article 321-101 (8) of the AMF GR (UCITS):** AMCs shall *"establish written policies and procedures on due diligence and implement effective arrangements for* ***ensuring that investment decisions on behalf of the UCITS are carried out in compliance with the objectives, investment strategy*** *and risk limits of these UCITS*"; these policies and procedures "*shall be periodically* ***revised and updated***." **(and Article 18 (3) (4) of CDR No 231/2013 (AIF))**.

Good practices

- Formalising, and keeping up to date, the operational mapping of active non-financial contractual commitments for each of the ESG/SRI funds managed.
- Formalising, and keeping up to date, the operational mapping of the non-financial data used, providing for each data item (or data family) the suppliers who produce it, the associated content and how the AMC uses it.
- Putting in place a formal process for resolving issues of contradictory non-financial data between different suppliers.
- Including clear rules in the procedures for ESG/SRI management on the process (i) for defining and updating (several times a year) the initial investment universe, (ii) for ESG rating of issuers, (iii) for validation (and traceability) of overrides of ESG scores produced by the rating algorithm and (iv) for excluding issuers (types of exclusion, creating and updating of exclusion lists in the IS, links to controversies, maximum time limit authorised for selling securities once they have been excluded).
- In the event of a significant change in the method of ESG rating of issuers, introducing formal controls to check the consistency of the ESG scores awarded before and after the change.
- Ensuring clear and complete disclosure, via the regulatory documentation of the funds, of the correspondence rules applied to change ESG scores (usually in the form of a decimal number) produced by the rating algorithm into the score transmitted to the management teams (usually in the form of a letter).
- Entrusting the validation of the initial investment universe of the ESG/SRI funds to a team that is independent of the managers.

Poor practices

- Not conducting prior logged controls of the quality of the non-financial data input into the system for ESG rating of issuers.

116 As the provision specified in the last sentence entered into force on 1 August 2022, i.e. after the inspection period (January 2019 – December 2022), it is mentioned here for reference only.

- Failing to define and use in the existing procedure for choosing and controlling external service providers, specific criteria for suppliers of non-financial data (including the level of cover and historical depth proposed, the transparency of the methodology used - in particular for estimated data - and the technical compatibility of the data flow with the AMC's IS).
- Failing to keep a robust and formal audit trail of the ex ante and ex post first-level controls carried out, in order to check that the initial investment universes always comply with the investment policy and strategy of the ESG/SRI funds (to ensure there is no sector, geographic or capitalisation bias).
- Failing to keep a robust audit trail in the IS justifying the presence of issuers in the inventories of the ESG/SRI funds, in line with the non-financial contractual commitments of the funds (ESG score awarded, any overrides, associated ESG analyses).
- Making intensive use of the practice of overriding the ESG scores of issuers produced by the rating algorithm.

5.3. INVESTMENT/DIVESTMENT SYSTEM OF THE ESG/SRI FUNDS

Only two of the five AMCs in the sample[117] have a formal and up-to-date investment/divestment procedure taking into consideration the objective of incorporating ESG criteria in the management. This procedure is currently being drawn up by AMC 5 and does not exist in AMCs 2 and 3.

5.3.1.Pre-trade and post-trade controls

To guarantee continuous compliance with the contractual commitments made by collective investment undertakings, an (ex ante and ex post) monitoring and control process is deployed by the investment management companies of these collective investments.

The operational teams (in particular the senior managers) are responsible for the ex ante control system. It is intended to ensure compliance with all of the (financial and non-financial) contractual commitments of the funds during investment decisions. This system often takes the form of **so-called pre-trade controls**, which are manual or configured in the fund management tools. The configured pre-trade controls can be triggered more regularly than manual controls, as they are carried out automatically. Furthermore, when they are also blocking, they prevent any investment in assets likely to lead to a breach of the fund's contractual commitments.

The ex post control system is intended to ensure that the ex ante controls have been carried out. To ensure that they are objective and high-quality, it is important that the teams responsible for these controls are independent of the management teams. They take the form of **so-called "post-trade" controls**, can be manual or configured, and are carried out after the investment decisions have been made. If they are configured, these controls can be carried out very frequently and immediately generate alerts if a breach is identified (for transmission to the managers and initiation of the required remediation).

Of the 299 AMCs who responded to the questionnaire, a majority (176 out of 299, i.e. 59%) stated that they had given a commitment on at least one non-financial requirement in the legal documentation of at least one of their funds. The AMF has underlined the following findings regarding control of compliance with non-financial contractual commitments.

117 I.e. AMCs 1 and 4.

➢ <u>Lack of control</u> of compliance with non-financial contractual commitments

Only 16% of the 176 AMCs have not introduced a robust control mechanism for these requirements, raising the question of their ability to guarantee continuous compliance with the non-financial commitments of their funds.

➢ <u>Manual</u> controls of compliance with non-financial contractual commitments

Of the 176 AMCs mentioned above, 77% (i.e. 135 AMCs) have put in place **manual** pre-trade or post-trade controls. These controls are linked to a higher risk of error and consequently may lead to breaches not being identified and corrected in time.

This risk is all the more real in the 103 AMCs (out of 135, i.e. 76%) that have a score improvement requirement. Achieving this requirement depends to a significant extent on the proportion of the assets in the portfolio and the variation in their market value.[118] As their market value may vary regularly, frequent checks are required to ensure that the commitment is complied with. Manual controls cannot meet this need for very frequent checks.

Several solutions would help to mitigate this risk:
- firstly, replace manual controls with **configured blocking controls** in the AMC's management tools;
- secondly, **combine** the pre-trade controls with post-trade controls;[119]
- thirdly, enable the managers to carry out portfolio **simulations** in their management tool so that they can identify, before the investments, any potential breaches that would be caused by their investment decisions;
- fourthly and finally, carry out manual controls **often enough** to guarantee their effectiveness.

➢ <u>Configured</u> control of compliance with non-financial contractual commitments

Of the 176 AMCs mentioned above, 74% (i.e. 131 AMCs) have put in place **configured** pre-trade or post-trade controls. As a result, these AMCs maximise their ability to identify breaches of the non-financial ratios of the funds managed. The automatic alerts linked to these controls regularly notify the managers (and the control teams) of the breaches identified.

To be more precise, half of the 176 AMCs mentioned above (i.e. 86 AMCs) stated that they had introduced configured and **blocking** pre-trade controls. This approach significantly reinforces the system by automatically reducing the number of potential breaches.[120]

To ensure the long-term effectiveness of these controls, a regular second-level review of the configuration must be carried out.[121] **Of the 131 AMCs mentioned above, 45% (i.e. 59 AMCs) stated that they had carried out this type of review and identified shortcomings, while the remaining 72 AMCs stated that they did not identify any areas for improvement following these controls.**

➢ Types of controls carried out with regard to the types of commitment

As regards commitments based on low volatility non-financial criteria (e.g. lists of sector-based exclusions, ESG scores of the issuers, analysis of controversies affecting issuers) the analyses conducted reveal that they are usually subject to configured pre-trade controls, **combined** with post-trade controls.

118 As the average ESG scores of the portfolio and the investment universe are calculated by weighting the market value of the securities.
119 To ensure that any breaches not identified by the pre-trade controls are identified afterwards.
120 Any investment decisions by the managers that would make it impossible to comply with the non-financial requirements of the funds concerned are directly blocked by the management tool.
121 To ensure that they target the specified requirements and identify actual breaches.

No.[122]	Non-financial contractual commitments	Number of AMCs applying this commitment for at least one fund (out of 176)	controlling compliance with this commitment via a pre-trade control	controlling compliance with this commitment via a pre-trade control **combined with a post-trade control**
2	Reduction in the investment universe of the fund by excluding issuers with the lowest ESG rating	137 (77 %)	107 (78 %)	101 (74 %)
4	ESG sector-based exclusions	149 (84 %)	127 (85%)	115 (77 %)
6	Exclusion of issuers subject to significant non-financial controversies	100 (57 %)	74 (74 %)	69 (69 %)

The combination of pre-trade and post-trade controls proves beneficial for this type of commitment as is shown by the following example.

FOCUS #2: control of fossil fuel commitments by AMCs

Since 2019, the AMF has monitored the non-financial commitments of AMCs, and in particular their commitments to exclude fossil fuels (coal, oil, gas).[123] These studies make it possible to show the importance of a combination of pre-trade and post-trade controls to ensure compliance with these commitments.

Discussions by the AMF with certain AMCs with sector-based exclusion policies made it possible to identify cases of breaches where issuers on the exclusion list were in fact present in the portfolios of certain funds. These breaches were due to the lack of blocking pre-trade controls by the AMCs concerned, as well as, where these controls did exist, failure to combine them with post-trade controls. Indeed, **although configured pre-trade controls are necessary, they are not sufficient**. For example, errors in the ISIN code (that do not correctly link the securities to be excluded with the issuers on the exclusion list) are liable to prevent the pre-trade controls from detecting the securities to be excluded. Post-trade controls make it possible to identify that type of breach.

The frequency at which these controls are carried out depends on the level of risk associated with the breaches and the type of pre-trade controls conducted. **Automatic and blocking pre-trade controls are likely to justify less frequent post-trade controls.**

However, **this combination is not common practice for all of the other commitments** since, of the 176 AMCs mentioned above:

- 48% have at least one non-financial requirement not linked to a pre-trade control;
- 25% have at least one non-financial requirement not linked to a post-trade control.

For commitments that are assessed at the level of the fund's portfolio and are based on the issuer's capitalisation (e.g. average ESG scores of the portfolios), **or those linked to European regulations** (minimum percentage of

[122] With reference to the commitments table shown in Section 5.2.1.
[123] https://www.amf-france.org/sites/default/files/private/2022-10/Rapport%202022%20AMF-ACPR_0.pdf

alignment by the fund with the Taxonomy,[124] percentage of sustainable investment, calculation of PAI indicators), post-trade controls are conducted instead.

For example, 44 of the 103 AMCs (43%) who made a score improvement commitment[125] have not carried out pre-trade controls (which are more difficult to implement as it is necessary to estimate future variations in the average ESG score of the universe and the portfolio, as well as changes in the valuation of the issuers) but 93% of these 103 AMCs carried out post-trade controls in this area.

As regards commitments based on volatile non-financial criteria, to overcome the technical difficulties in implementing pre-trade controls mentioned above, it appears advisable to **include a simulation function** in the management tools, for the impact of these commitments on investment decisions. As regards post-trade controls, it appears appropriate to conduct them **at least as often as the calculation of the net asset value (NAV)** of the funds, as this type of commitment is heavily dependent on the market value of the issuers and variations in it.

- **Specific system for pre-trade and post-trade controls of the SPOT sample**

The controls are carried out by the Risk Department (for four of the five AMCs in the sample) and by the Operations Department for AMC 3. The results of the controls are presented to the Risk Committee. Within this framework, the general risk management policy[126] of the AMCs reviewed specifies the operational implementation of non-financial contractual commitments (and in particular of exclusions), the pre-trade and post-trade control plan and the process for handling breaches[127] (maximum time limits for resolution and methods of exemption possible). In addition, **for all of the AMCs in the sample, the managers can simulate the impact of pre-trade controls on all types of orders before they are carried out**.

As regards supervision of pre-trade and post-trade controls carried out on the funds **for which management was delegated** to a third party AMC, this applies to two of the five AMCs in the sample, for a limited scope.[128] For pre-trade controls, supervision is based on the delegation agreement (which defines the scope and content of the controls to be carried out) and for post-trade controls, on the periodic reports on the result of the post-trade controls that the delegatee submits to the delegator's Risk Department.

[124] The formula for calculating alignment with the Taxonomy is specified in Article 17(1) of the SFDR RTS and is equal to *the market value of all the investments of the financial product in environmentally sustainable economic activities* divided by the *market value of all the investments of the financial product*.

[125] This commitment is that the average ESG score of the portfolio will be higher than that of the investment universe.

[126] The commitment control process is the same for non-financial and financial commitments for all five AMCs in the sample.

[127] Cf. glossary

[128] I.e. two dedicated funds (assets: €525.3m) for AMC 1 and 30 funds (€4.6bn) for AMC 2.

Overall mapping of the pre-trade and post-trade controls of the AMCs reviewed

The mapping shows the list of non-financial contractual commitments presented in Section 5.2.1. Blocking pre-trade controls are shown **in bold type**. The abbreviations used are "auto." for automatic and "man." for manual.

#	Commitment	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
1	Coverage rate of the ESG analysis of the portfolio	Post-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)**	Post-trade (man.)	Pre-trade (man.)
2	Reduction in the investment universe of the fund by excluding issuers with the lowest rating	Post-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)**	Pre-trade (auto.)	Post-trade (auto.)
3	Improvement in the ESG score of the fund's portfolio compared with the score of its investment universe	Post-trade (auto.)	**Pre-trade (auto.)**	Post-trade (man.)	Post-trade (man.)	Post-trade (auto.)
4	ESG sector-based exclusions	**Pre-trade (auto.)** Post-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)** Post-trade (auto.)	**Pre-trade (auto.)**	Pre-trade (auto.)
5	Minimum investment in green, social or sustainability bonds	Pre-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)**	Post-trade (man.)	Pre-trade (man.)
6	Exclusion of issuers subject to significant controversies	**Pre-trade (auto.)** Post-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)** Post-trade (auto.)	**Pre-trade (auto.)**	Pre-trade (auto.)
7	Requirements associated with the Greenfin label	Pre-trade (auto.)	Post-trade (auto.)	Post-trade (auto.)	Post-trade (man.)	Pre-trade (man.)
8	Requirements associated with the SRI label.	Post-trade (auto.)	**Pre-trade (auto.)**	**Pre-trade (auto.)**	Post-trade (man.)	Post-trade (auto.)

Test carried out by the task force on the pre-trade and post-trade control system of the AMCs reviewed

The inspection task force chose an average sample[129] of five non-financial contractual commitments applied, for each AMC, to the five funds used in the test of the method of rating described above.[130] The aim of the test was to check, for each commitment in the sample, the existence of a robust audit trail for the pre-trade and post-trade controls carried out in one of the quarters in the period under review.

The test was "effective" for most of the AMCs in the sample (four out of five). Only AMC 4 was unable to provide the audit trail for the pre-trade controls conducted. However, the IT developments required to store the audit trail were approved in AMC 4's budget at the end of financial year 2022.

5.3.2. System for managing breaches identified by the controls

Once the pre-trade and post-trade control process has been put in place, it is necessary to add a remediation process that makes it possible to remedy the breaches identified as quickly as possible. This process involves (i) classifying the breaches as passive or active,[131] (ii) notifying the alert to the manager concerned for remediation (and then to a senior manager if it is not resolved within the time limit set in the procedure), (iii) initiating the potential compensation of unitholders if losses are identified and (iv) declaring to the AMF the breaches identified pursuant to Articles 321-75-1 (UCITS) and 318-37-1 (AIF) of the AMF GR.[132]

In the course of the SPOT campaign, the inspection task force noted that the five AMCs in the sample had formally defined, in their procedures, the breaches and the associated control, remediation and compensation rules. On the other hand, **only AMC 2 has defined in its procedures the maximum time limit beyond which an unresolved passive breach is redefined as an active breach**.

The team in charge of handling these breaches is the Risk Department for four out of five of the AMCs. On the other hand for AMC 3 it is carried out by a dedicated team from the Operations Department.

All breaches detected are immediately reported for resolution to the manager of the fund concerned for four out of the five AMCs (AMC 4 specifies a maximum time limit of 24 hours to inform the manager). If it is not resolved within a time limit[133] of one (for AMC 5) to five days (for AMCs 1, 2 and 4) it is escalated to the senior managers of the AMCs in the sample. In addition, the senior managers receive consolidated information on unresolved/resolved breaches at a dedicated committee, at least on a quarterly basis.

Of the 176 AMCs who responded to the questionnaire and had made at least one non-financial commitment for one of the funds managed, 128 (72%) have formalised this escalation procedure and 58 (33%) have automated it. The time limits before escalation vary between zero and five days.

As regards the number of breaches of non-financial contractual commitments recorded, when analysing the answers to the questionnaire, of the 176 AMCs who declared at least one non-financial requirement, **98 (55%) did not identify any breaches in 2020 or 2021**, which raises questions but could be partly due either to the existence (for 36 out of 98, i.e. 36%) of automatic and blocking pre-trade controls (which make it possible to reduce the number of breaches) or else, on the contrary, to the lack (for 57 out of 98, i.e. 58%) of (configured or manual) pre-trade or post-trade controls, which reduces the chance of identifying breaches. On the other hand, 37 AMCs (out

129 I.e. seven commitments for AMC 5, five for AMCs 1, 2 and 4, and three for AMC 3.
130 Cf. Section 5.2.3
131 Cf. glossary.
132 Cf. Section 4 applicable regulations.
133 This time limit is the same for active and passive breaches, except for AMC 1 where the time limit is increased to 12 days for passive breaches.

of 176, i.e. 21%) declared a total of 106 active breaches between January 2021 and March 2022, compared with 3,124 passive breaches declared by 64 AMCs (36%).

This trend in favour of passive breaches was also confirmed among the AMCs in the SPOT sample, as shown in the table below for the period under review (January 2019 – December 2021).

Breaches	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
Active	7	5	0	1	0
Passive	639	97	18	1	48

None of the breaches mentioned above required the payment of significant compensation[134] to the unitholders of the funds concerned. Concerning the questionnaire sent to the market, it does not allow to identify participants who have formalised a specific compensation procedure for breaches of non-financial contractual commitments (compared with breaches of financial requirements). As for financial requirements, development of such a procedure is important event if estimation of the financial impact of non-financial requirements may prove difficult due to the lack of a record of the impact of ESG breaches and the lack of links to quantitative financial indicators for some of the non-financial commitments (making isolation of the impact more complex in the event of a breach).

Test carried out by the inspection task force of the breach handling process

For a total sample covering on average 77% of the active and passive breaches identified during the period under review, the inspection task force checked that each of them was subject to a formalised investigation (in the AMC's IS) until its resolution, in accordance with the procedural time limits.

On the other hand, whereas 106 active breaches were declared via the questionnaire between January 2021 and March 2022, **about 14[135] were reported to the AMF** in connection with campaigns relating to breaches of ratios. Furthermore, these 14 non-financial breaches only represent 0.4% of the total number of (financial and non-financial) breaches reported to the AMF in the period mentioned.

These differences and the small proportion of non-financial breaches reported, raise questions about the handling by the AMCs of the funds' non-financial commitments compared with their financial commitments.

5.3.3.Actions by depositaries linked to the non-financial contractual commitments

The lack of distinction in the laws and regulations between financial and non-financial requirements (and the associated controls),[136] shows the role of the depositaries in controlling the non-financial commitments and justify the fact that there is no need for additional regulatory details on this topic. This point is also mentioned in a Supervisory Briefing by the ESMA.[137]

134 The compensation paid in this connection was around €1,000 for AMCs 1 and 3 and zero for the three others. When they are sufficiently significant, compensations related to breaches upon financial/non-financial requirements can be reported by statutory auditors within annual account certification report.

135 As the ratio campaign only covers the period from Q3 2021 to Q4 2022 in which 24 active non-financial breaches were reported, an extrapolation was made from this report to cover the same period as the questionnaire (the whole of 2021 and Q1 2022), making it possible to identify the 14 active non-financial breaches.

136 Cf. Section 4 Applicable regulations above (subsection depositaries). This section provides regulatory texts references regarding expectations and requirements upon depositaries concerning controls to be performed in order to check respect of investment rules and funds' assets composition. These references also target requirements upon *ex-post* monitoring and control targeting procedures and processes of AMCs regarding funds' assets and operations.

137 Cf. Section 4 Applicable regulations above (Supervisory Briefing by the ESMA). Control frequency may change depending on type of requirement controlled.

Nevertheless, **at this stage the depositaries have not yet introduced a complete and standardised approach for incorporating non-financial commitments into their control process**. Only 54 (about 30%) of the AMCs who responded to the questionnaire and have at least one non-financial commitment, state that they have already discussed this topic with their respective depositaries, but without providing further details on the content of the discussions.

From 2021, after several discussions between the associations representing the depositaries, the AMCs and the AMF, the AMF asked the market participants to set up a task force to define the controls of the funds' non-financial commitments to be carried out by depositaries.
At this stage, the AMF has strong reservations about the proposals of the task force, in particular regarding the lack of sufficiently granular and frequent risk-based control of each non-financial requirement.

In the course of the SPOT campaign, the inspection task force noted that the ESG/SRI fund depositories of four[138] of the five AMCs in the sample had introduced measures linked to non-financial contractual commitments. Firstly, the common depositary of AMCs 2 and 3:

- informs AMC 2 in the event of breach of the prospectus ratio requiring an investment in ESG/SRI CIUs of at least 90% of the net assets;
- informs AMCs 2 and 3 if it identifies, in the inventories of the funds deposited, issuers linked to the non-conventional weapons industry (included on the exclusion lists).

Secondly, the same depositary checks the compliance of the prospectuses of the AMC 4's ESG/SRI funds with the SFDR and Taxonomy regulations (before they are published on the AMC's website).
Thirdly and finally, a survey was conducted of the depositaries of AMCs 1 and 3 regarding the relevant means of controlling the commitments for the funds deposited in their accounts.

The AMF reminds depositaries of their responsibilities in controlling compliance with the non-financial commitments of the funds, and the AMCs of the need to make available to the depositaries the data required for their controls.[139]

5.3.4. Process for discussion with labelling organisations noted in the AMCs in the SPOT sample

This process is identical for all five AMCs in the sample. The label is awarded after an initial audit.[140] An annual review is carried out to check that the conditions for awarding the label still apply. A further audit is then carried out every three years. Remediation following the findings of the post-labelling reviews/audits is managed by the Risk Department. The inspection task force did not identify, in the audit reports reviewed, major deficiencies or unusually long time limits for resolving the anomalies detected.
These audits are carried out by external service providers authorised by accreditation organisations. **None of these audits resulted in refusal (or withdrawal) of a label for one of the ESG/SRI funds managed by the AMCs in the sample.**

Regulatory reminders

- **Articles 321-23 (IV) of the AMF GR 57 (1) (c) of CDR No 231/2013:** cf. above.

138 This is not the case for the depositary of AMC 4's funds.
139 As mentioned in the Supervisory Briefing of the ESMA (cf. Section 4 Applicable regulations).
140 The audit grid concerns in particular the transparency of the rating and pre-trade and post-trade control process, publication of the updated commitment policy and commitment report, as well as of the impact report, and finally the involvement of the compliance and internal control officer in the control of compliance with the ESG strategy.

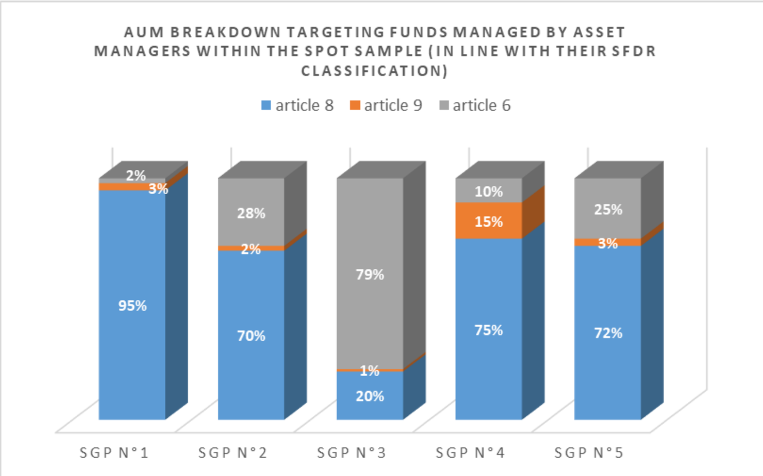
- Articles 321-30 of the AMF GR (UCITS) and 61 (1) of CDR No 231/2013 (AIF) *mentioned above.*
- **Article 321-35 (a) (d) of the AMF GR (UCITS)** on the responsibility of managers and, where appropriate, of the supervisory body, in the assessment and periodic review of the effectiveness of the policies, systems and procedures put in place by the AMC to comply with its professional obligations, and in the adoption of appropriate measures to remedy any deficiencies **(and Article 60 (2) (a) (e) (f) of CDR No 231/2013 (AIF))**;
- **Articles 321-101 (6) of the AMF GR (UCITS):** "*AMCs... ensure a high level of diligence in the selection and ongoing monitoring of investments, in the best interests of UCITS and the integrity of the market*" (and **Article 18 (1) of CDR No 231/2013 (AIF))**;
- **Articles 321-101 (8) of the AMF GR (UCITS) and 18 (3) (4) of CDR No 231/2013 (AIF):** cf. above;
- **Paragraph 46 of the Supervisory Briefing of the ESMA on "sustainability risks and disclosures" on the role of depositaries with regard to non-financial requirements:** "*NCAs should further ensure, through appropriate actions, that **all relevant information and data are provided by the UCITS management companies and AIFMs to the appointed depositary to enable it to perform effectively the relevant depositary functions**. In particular, **depositaries should include all ESG-related investment restrictions in the monitoring of the compliance of the instructions** coming from the management company or the investment manager.*"

Good practices

- Including in the risk management policy a section on ESG risks indicating the method of operational implementation of the non-financial contractual commitments, the associated pre-trade and post-trade control plan and the process for handling breaches, including the usual time limits (for informing the managers, before escalation to the senior management, and before reclassifying passive breaches as active) and the planned remediation and potential compensation (specifying for the remediation and compensation the methods applied for estimating the impact of the breaches identified for the funds holders).
- Putting in place blocking pre-trade controls.
- Adapting the controls implemented to the type of non-financial contractual commitment to be supervised:
    - for commitments based on low volatility non-financial criteria (e.g. sector-based exclusions, controversies) use a combination of configured pre-trade controls and post-trade controls;
    - for commitments based on volatile non-financial criteria (e.g. minimum percentage of alignment of the fund with the Taxonomy, percentage of sustainable investment), deployment by the managers of tools to simulate the impact of these commitments on the investment decisions and carry out the post-trade controls at least as often as the calculation of the NAV.
-

5.4. INFORMATION PROVIDED TO INVESTORS CONCERNING NON-FINANCIAL CONTRACTUAL REQUIREMENTS

A breakdown is provided below of the assets of the AMCs in the SPOT sample at the time of the inspection according to their SFDR classification.



In the sample, it is a key aspect of communication for 57.6% of Article 8 funds, compared with 79% of Article 9 funds. Communication is limited to the prospectus for 94% of Article 6 funds.[141]

5.4.1.Procedures relating to ex ante and ex post informing of investors

Three of the five AMCs in the sample (60%) have formalised an up-to-date operating procedure for the process of drawing up, validating and distributing the regulatory documentation of funds relating to the ESG/SRI range. On the other hand, the procedure of AMC 1 does not mention specific controls for information on the ESG approach that should be included in that type of document. Regarding that of AMC 4, it does not refer to the specific AMF guidelines on informing unitholders of ESG/SRI funds.[142]

There is the same percentage for the implementation of a procedure relating to marketing material.[143] On the other hand, the procedure of AMC 2 does not deal with the method of presenting and controlling the non-financial contractual commitments described in the documentation. As regards AMC 5, it has not formalised a specific procedure for this area.

5.4.2.Information materials provided to investors concerning ESG/SRI funds

These are summarised in the table below. These materials are provided in a relatively homogeneous form in the sample group of AMCs reviewed, and are made available on their websites.

141 As a reminder, there is no strict correspondence between firstly the concepts of Article 8/9/6 funds resulting from the SFDR, and secondly the concepts of "key/reduced aspect of communication/communication limited to the prospectus" resulting from AMF Position-Recommendation 2020-03 (cf. glossary). The information above is provided in order to describe the overall scope of the work of the SPOT inspection campaign.

142 Position-Recommendation 2020-03 (cf. Section 4 above).

143 This concerns in particular the documents presenting the ranges of funds, detailed product data sheets, sales brochures, advertising inserts, documents given to customers at forums, direct mail advertising to customers, sales enablement kits, documents reserved for distributors, information published on websites, periodic sales reports to the customers and marketing literature.

<table>
<tr><th colspan="2">Doc.</th><th>AMC 1</th><th>AMC 2</th><th>AMC 3</th><th>AMC 4</th><th>AMC 5</th></tr>
<tr><td>Regul.</td><td rowspan="5">Ex ante</td><td colspan="5">KIID/prospectus</td></tr>
<tr><td rowspan="2">Com.</td><td colspan="2">Brochures presenting the characteristics[144] of each fund</td><td>-</td><td colspan="2">Same as for AMCs 1 and 2</td></tr>
<tr><td colspan="2">-</td><td colspan="3">Presentation of the investment process of the ESG/SRI funds</td></tr>
<tr><td rowspan="2">Other</td><td colspan="5">Presentation of the method of incorporation of sustainability risks in the investment process</td></tr>
<tr><td colspan="5">Transparency codes[145]</td></tr>
<tr><td>Regul.</td><td rowspan="3">Ex post</td><td colspan="5">Annual and half-yearly reports of the funds</td></tr>
<tr><td>Com.</td><td colspan="5">Monthly reports of the funds[146]</td></tr>
<tr><td>Other</td><td>ESG integration report[147]</td><td>Quarterly SRI letter and non-financial report[148]</td><td>Impact report on funds with the SRI label</td><td>-</td><td>-</td></tr>
</table>

In addition to the documents described in the table above, which concern the scope of the products (i.e. of the funds), the inspection task force noted the existence, at the level of the entity (i.e. AMC) of:

- the report on Article 173-VI of the law on the energy transition for green growth (LTECV)[149] in all five AMCs in the sample;
- the report required under Article 29 of the Energy and Climate Change Law (LEC)[150] in all five AMCs in the sample;
- a CSR[151] report in AMC 1
- an annual report on compliance with PRI in AMC 4.

[144] I.e. past performance, risk/return statistics and non-financial commitments

[145] Cf. glossary. AMC 1 formalised a transparency code for each fund with the SRI label, whereas AMC 3 drew up a code of that kind for all of the funds managed with that label. AMCs 2, 4 and 5 drew up this code for each strategy for funds with the SRI label.

[146] These specify the indices used to define the investment universe, the ESG score of the portfolio, any label it has and its SFDR classification.

[147] This report covers financial year 2021. It specifies the system implemented by the AMC to incorporate ESG criteria in its management and presents the results of this incorporation for the last financial year.

[148] This report, which completes the annual report of each ESG/SRI fund, presents the non-financial approach, the SRI score of the portfolio, and the comparative values of the SRI indicators for responsible governance, sustainable management of resources, development of territories and the carbon intensity of the portfolio.

[149] This report was made compulsory by the above-mentioned law, and (for AMCs) is intended to present to investors the methods of incorporation, in the last financial year, of criteria relating to ESG and climate issues in the AMC's investment policies and the resources deployed by the AMCs to support the energy and ecological transition. It also provides an exclusion list for each management strategy and the process for drawing up this list (including the incorporation of PAIs). It was replaced in 2022, for the same purpose, by the report required under Article 29 of the Energy and Climate Change Law (LEC), for which the implementation decree was published on 27 May 2021.

[150] This report retains and clarifies the requirements of Article 173-VI of the LTECV as regards AMCs, while increasing the requirements regarding transparency and reporting of climate and biodiversity risks. Article 29 also introduces a reporting requirement for funds with assets of over €500m which are required in particular to present their strategy for alignment with the objectives of the Paris Agreement and those linked to biodiversity.

[151] Cf. glossary. This report covers financial year 2021. It specifies the ESG commitments of the AMC as a company (regarding social cohesion, the quality of working life, inclusion, sponsorship and the environmental footprint), its climate strategy and the methodology used to calculate the responsible investment assets.

5.4.3. First-level control mechanism for the content and form of the regulatory and commercial documentation of ESG/SRI funds

The first level of control of the documentation mentioned above is the responsibility of the Legal Department in AMCs 1 and 2, the Products Department in AMC 3 and the Compliance Department in AMC 4. The inspection task force carried out the two tests described below to assess the strength of this mechanism.

<u>1. Test of information regarding external suppliers of ESG data</u>
The aim was to check that all of the external suppliers of ESG data used by the AMCs in the sample were mentioned in the documentation of the ESG/SRI funds as described in the table above. Based on the sample of five funds already used above,[152] the test result was **partly effective**. The average rate of suppliers not mentioned in the documentation reviewed was 15%.[153]

<u>2. Test of information regarding non-financial contractual commitments</u>
The aim was to check that the commitments of the sample mentioned above[154] were presented consistently and intelligibly in the regulatory documentation of the five funds included in the previous test. Based on the analysis carried out, the test result was **partly effective**. The commitments tested are in fact not presented in the period under review in a complete, intelligible and balanced manner:

- for an average of 44% of the sample of funds tested as regards the ex ante information;
- for an average of 60% of the sample of funds tested as regards the ex post information;

This finding has the following breakdown.

Regulatory documentation	AMC 1	AMC 2	AMC 3	AMC 4	AMC 5
ex ante (KIID/prospectus)	For 40% of the sample: the exclusions relating to non-conventional weapons were not mentioned in it in 2019 and 2020 (whereas the exclusions relating to coal are mentioned from 2019).	-	-	For 80% of the sample: the commitments tested were not mentioned in it in 2019 and 2020.	For 100% of the sample: the commitments tested were not mentioned in it in 2019 and 2020.
ex post (annual report)	For 20% of the sample: the commitment relating to the “minimum threshold of 90% of the issuers in the portfolio rated according to ESG criteria” is not specified in the 2021 version whereas it is present in the two previous versions.	For 20% of the sample: the commitments tested were not mentioned in it in 2019 and 2020.	For 100% of the sample: the commitments of the sample are not presented in a complete and intelligible manner.	For 60% of the sample: two of the five commitments tested were not mentioned in it in 2019 and 2020.	For 100% of the sample: *Same as above.*

[152] Cf. Section 5.2.3 (Test carried out by the inspection task force of the method of ESG rating of issuers)
[153] I.e. 3.7% for AMC 1, 15% for AMC 4, 17% for AMC 2 and 20% for AMCs 3 and 5.
[154] Cf. Section 5.3.1 (Test carried out by the task force on the pre-trade and post-trade control system of the AMCs reviewed)

Furthermore, for AMC 4 the inspection task force notes that in all of the documentation of the funds tested, there are no detailed scoring grids indicating the scores leading to the exclusion of issuers with the lowest scores, **even though the ranges of scores (out of 10) leading to the "worst" scores produced by the algorithm (D and E) are 50% smaller than those leading to "good" scores A, B and C)**.

Regulatory reminders

- **Article L. 533-22-2-1 of the MFC:**[155] "*I. In their policy on sustainability risks... AMCs shall include* ***information on the risks linked to climate change and risks linked to biodiversity****. II. AMCs shall make available to their subscribers and the public a document presenting their policy for incorporating environmental, social and quality of governance criteria in their investment strategy, and the resources deployed to contribute to the energy and ecological transition and a strategy for implementing that policy.* ***They shall indicate in it the criteria and methodologies used*** *and how they are applied... This information concerns in particular* ***combating climate change****. It concerns in particular the level of climate-related investments and the contribution to compliance with the international target for limiting global warming and the achievement of energy and ecological transition objectives... III. When AMCs draw up a declaration of non-financial performance... it shall include information on the implementation of the strategy mentioned in section II of this Article...*"
- **Article L. 533-22-2-1 of the MFC:** "*AMCs shall act in an honest, fair, and professional manner best serving the interests of investors. All information, including marketing literature, provided to investors by an AMC must be* ***accurate, clear and not misleading****. Promotional communications must be clearly identifiable as such...*"
- **Article D. 533-16-1 (II) (2) (e) (III) (1) (a) (4) (e) (V) of the MFC:**[156] "*II. Information regarding environmental, social and quality of governance criteria, known as sustainability factors... shall be presented as follows: 2. For each type of information that must be published according to this Article, the entity shall indicate...: e) If a quantitative analysis is required,* ***the methodologies and databases the analysis is based on****, indicating where appropriate whether the data is freely accessible,* ***the name of the supplier*** *of methodologies or data,* ***the risks of double counting*** *and the measures taken to avoid it... III. The information relating to environmental, social and quality of governance criteria mentioned in section II of Article L. 533-22-1 are as follows: 1. Information relating to the general approach of the entity: a)* ***Summary presentation of the general approach of the entity*** *for incorporating environmental, social and quality of governance criteria, in particular in the investment policy and strategy; 4. Information on the commitment strategy regarding issuers or investment management companies and how it is implemented; e)* ***Decisions made regarding the investment strategy****, in particular as regards withdrawal from sectors. V. The information mentioned in section III shall be presented in an* ***annual report*** *produced by the entity... published within six months of the end of the financial year. Where appropriate, this report shall mention the information specific to the inspected entities or the financial products published in periodic reports for the financial products mentioned in Article 11 of these regulations. It shall be published* ***on a page of the entity's website*** *dedicated to environmental, social and quality of governance information... Except as otherwise provided, this information shall be* ***updated each year****.*"
- **AMF Position-Recommendation (PR) DOC 2020-03, Position No. 2:** "*Only collective investment products which comply with the following characteristics can make non-financial characteristics a* ***key aspect of***

[155] This Article entered into force on 10 March 2021 and was amended by Article 29 of the LEC**.** The previous version of the Article is that of Article 173 of the LTECV. Given that the period under review ran from January 2019 to December 2021, the obligations of Article 173 of the LTECV and of Article 29 of the LEC were both taken into account in the analyses presented in this document.

[156] Same remark as above regarding Article L. 533-22-1 of the MFC. As this article was amended by the decree implementing Article 29 of the LEC (which entered into force on 29 May 2021) the analyses presented in this document took into account the versions before and after the amendment.

*__communication__: a) the approach adopted **is based on a commitment** in that it provides in the regulatory documents for measurable objectives concerning consideration of non-financial criteria; b) the commitment to take into account **non-financial criteria** must be significant... c) **the rate of analysis, non-financial rating or coverage of the non-financial indicator must be higher than 90%**... Regarding this, AMCs must make sure that the proportion of the fund's net assets which is not analysed, rated or does not have a non-financial indicator remains insignificant... d) In the specific case of approaches making the SRI aspect a key theme of communication, the non-financial analysis applied to collective investment assets takes into consideration criteria relating to **each Environmental, Social and Governance factor**..."*

- **AMF PR DOC 2020-03, Position No. 4:** *"In order to assess the significantly engaging nature of the approach in the regulatory documentation, at least the following information should be presented in the prospectus: - the minimum measurable objectives adopted in accordance with Position No. 2; - the portfolio's minimum rate of non-financial analysis. Moreover, **a presentation of the investment universe based on which non-financial analysis is performed**, if it is not produced in the KIID, and when the AMC uses such a measure to assess the significance of the approach employed, **should in any case be produced in the prospectus in order to report on the effective reduction in the initial universe** or the significant improvement in the portfolio's non-financial rating relative to said universe**..."***
- **AMF PR DOC 2020-03, Recommendation No. 2:** "*applicable to collective investment products making non-financial characteristics a key aspect of communication: The AMF recommends that the regulatory documents for collective investment schemes making consideration of non-financial criteria a key aspect of their communication should present: (i) an **investment objective** stating the non-financial aspect of their management strategy; (ii) the type(s) of approach practised (best-in-class, best-in-universe, etc.); (iii) information about the **investment management and selection methods** used."*
- **AMF PR DOC 2020-03, Recommendation No. 3:** "*applicable to collective investment products making non-financial characteristics a key aspect of communication: **In the KIID, the AMF recommends that a description of the non-financial strategy be given** via a presentation of: the type of approach(es) used... It is also recommended to define **the significance of these various strategies** to ensure that the document can be easily understood, and indicate whether the approach can lead to the selection of certain sectors or not;- a **summary of the process of consideration of non-financial characteristics**... - **a few examples of some of the most important non-financial criteria** analysed..."*
- **Articles 321-30 of the AMF GR, 61 (1) of CDR No 231/2013:** cf. above;
- **Article 321-131 of the AMF GR (UCITS):** "*... **Annual reports** of UCITS must contain, where relevant, information about the financial instruments in the portfolio that have been issued by the AMC or entities from its group. The annual reports must also mention, where relevant, collective investment schemes and third country investment funds managed by the AMC or entities from its group."*
- **Article 103 of CDR No 231/2013 (AIF):** "*All information provided in the **annual report**, including the information specified in this Section, shall be presented in a manner that provides materially relevant, reliable, comparable and clear information. The annual report shall contain the information investors need in relation to particular AIF structures*".

Good practices

- Including in the procedures for the process of drawing up the documentation for the funds, a section on the characteristics of the ESG/SRI range, stating in particular the applicable regulations and the method of presentation and control of the information on non-financial contractual commitments.

Poor practices

- Failing to keep, over the long term, in the documentation of the ESG/SRI funds, a presentation that is consistent, intelligible and well-balanced (between ex ante and ex post information) of:
    - all of the external suppliers of the non-financial data used;
    - and the grid for ESG rating of issuers (and associated exclusion rules).
- Failing to ensure that the level of information available on the non-financial contractual commitments in the ex post regulatory documentation is in line with that present in the ex ante regulatory documentation.

5.5. COMPLIANCE AND INTERNAL CONTROL SYSTEM RELATING TO NON-FINANCIAL CONTRACTUAL COMMITMENTS

5.5.1. Work carried out by the permanent control teams

Three of the five AMCs in the sample (1, 2 and 4) included the risk of breach of non-financial contractual commitments in the general risk mapping of the AMC (for 1 and 2) or in risk mapping for each fund (4). **However, this was not carried out by AMCs 3 and 5.**

The team responsible for this system is managed by one (or two) compliance and internal control officers, and comprises 13 FTEs on average for the sample group of AMCs reviewed. The work carried out is reported to the senior managers of the AMCs via a dedicated committee at least once each quarter. The work is governed by a compliance and internal control plan (PCCI) which is regularly updated (except for AMC 1)[157] that covered, for the period under review, compliance with non-financial contractual commitments and information for unitholders of ESG/SRI funds. Although they are not included in the PCCI (as they are carried out, if they exist, by a different team from the one responsible for compliance and internal control), second-level controls concerning the override process for ESG scores were also included in the analysis.

<u>Regarding the monitoring system for compliance with non-financial contractual commitments of the funds</u>, the inspection task force noted that **efficient controls were only carried out by two of the five AMCs in the sample** (1 and 2). On the other hand, no controls were formalised on this theme in the period under review by AMCs 4 and 5. For AMC 3, the work carried out showed a continuous increase in the level of compliance, contrary to the findings of the inspection task force presented above.[158]
On the other hand, the inspection task force noted, for all five AMCs in the SPOT campaign sample, the lack of a regular second-level review of the relevance of the configuration of the automated controls of non-financial contractual commitments.

As regards the monitoring system for presenting non-financial commitments in the documentation of the ESG/SRI funds, the controls carried out in the period under review were not satisfactory **for any of the AMCs in the sample**. These controls were in fact nonexistent for AMCs 1 and 3, were limited to an ex ante review for AMC 2[159] and were partial for AMCs 4 and 5.[160]

---

157 Which has not updated this plan since 2019 in the context of the covid crisis.

158 Lack of mapping of non-financial contractual commitments; mapping of non-financial data; an operational process to control the quality of the data entered in the rating system; formal control of the consistency of the initial universe with the investment policy, and formal ESG analyses for the sample of 10 issuers tested.

159 The compliance and internal control team of AMC 2 conducts a systematic ex ante control of the documentation of the ESG/SRI funds before they are published on the AMC's website. However, this control is not completed by a sample ex post control (in spite of the discrepancies noted in the documentation in Section 5.4.4 above).

160 For AMC 4, the work carried out did not identify the discrepancies presented in Section 5.4.4 above. As regards AMC 5, this work only started in 2021.

Finally, regarding the monitoring system for the override process for issuers' ESG scores, it is only effective for two of the five AMCs (2 and 4) and nonexistent for the three other AMCs.

5.5.2. Work carried out by the periodic control teams

The participants' answers to the questionnaire sent by the AMF show that **only 60 of the 176 AMCs (34%) who made at least one non-financial commitment for one of the funds managed, conducted periodic controls between 2020 and 2021 in the area of non-financial requirements**. Of these 60 AMCs, only 12 (20%) state that they implemented a plan to improve their system following these controls.

> Although periodic controls make it possible to ensure the smooth functioning of the monitoring system, they also give greater **credibility** to the claims by AMC's of compliance with the non-financial commitments of the funds, in particular those linked to recent changes in the European regulations.

For the AMCs in the SPOT campaign sample, periodic control is carried out by the general inspectorate of the parent company of AMCs 1, 2, 3 and 5 and by the internal audit department of AMC 4. Each of them implements an audit plan which the inspection task force consulted.

Three of the five AMCs in the sample (1, 2 and 4) conducted an audit of the control system for compliance with non-financial contractual commitments in the period under review. For AMCs 1 and 2, this audit resulted in a **satisfactory** score for the commitment control system. In AMC 1, it recommended formalising a specific control plan for the AMC's ESG/SRI system. For AMC 4, there were four findings, linked to the inadequate level of information in the documentation of the funds regarding the impact of sustainability risks on fund performance, compliance of the index chosen as the benchmark with the ESG characteristics of the fund, and the level of consideration of PAIs. The AMC gave the inspection task force proof of the remedial measures taken or completed in view of these recommendations.

Regulatory reminders

- **Articles 321-23 (IV) of the AMF GR (UCITS) and 57 (1) (c) of CDR No 231/2013 (AIF):** cf. above;
- **Article 321-27 of the AMF GR:** "*AMCs shall **monitor and, on a regular basis, evaluate** the adequacy and effectiveness of their systems, internal control mechanisms and arrangements... and take appropriate measures to **address** any deficiencies.*" **(and Article 61 (2) (a) of CDR No 231/2013 (AIF))**;
- **Article 321-30 of the AMF GR (UCITS) and Article 61 (1) of CDR No 231/2013 (AIF):** cf. above;
- **Article 321-31 (I) (1) of the AMF GR (UCITS):** "I. – *The AMC shall establish and maintain an effective compliance function that operates independently. Its role is to: (1) **Monitor and, on a regular basis, assess the adequacy and effectiveness of policies, procedures and measures** implemented for the purposes of Article 321-30, and actions taken to remedy any deficiency in compliance of the AMC and the relevant persons...*" **(and Article 57 (6) of CDR No 231/2013 (AIF))**;
- **Article 321-83 of the AMF GR:** "AMCs, where appropriate and proportionate in view of the nature, scale, complexity and range of their business, shall establish and maintain an effective **internal audit function** which is separate and independent from their other functions and activities and which has the following responsibilities: to establish and maintain an effective audit plan to examine and evaluate the adequacy and effectiveness of the AMC's systems, internal control mechanisms and arrangements; to issue

recommendations based on the result of work carried out...; to verify compliance with those recommendations; to provide reports on internal audit issues...” **(and Article 62 of CDR No 231/2013 (AIF))**.

Good practices

- Including in the general risk mapping of the AMC a specific case for potential breach of the non-financial contractual commitments of ESG/SRI funds.
- Conducting an audit periodically of the control system for compliance with non-financial contractual commitments.

Poor practice

- Not conducting a regular second-level review of the relevance of the configuration of automated controls of non-financial contractual commitments.