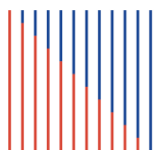


AUTORITÉ DES MARCHÉS FINANCIERS AMF

Towards a review of SFDR

AMF Position paper

Back in 2018-2019, the European co-legislators and the European Commission designed the Sustainable finance disclosure regulation (SFDR) as a non-financial disclosure regime applying to financial entities and products.

SFDR being intended as a disclosure regime, lawmakers have decided to refrain from offering a precise definition of concepts such as "sustainable investments", "environmental/social characteristics" or the "consideration of principal adverse impacts". That choice, which made sense in the context of a disclosure regime where the goal is to make sure that financial intermediaries and end investors find the information they need, implied that the interpretation of these concepts was left to the discretion of each financial market participant.

However, because SFDR has been used in practice as a labelling regime by market participants, this lack of clarity has confused investors even further.

Thus, the AMF welcomes the Commission's stated intention to undertake a review of SFDR and calls for a thorough recast of the Regulation. This paper provides a summary of the positions expressed by the AMF as part of its response to the SFDR targeted consultation of the European Commission.

In that context, the AMF's main messages are the following.

1. The new framework should provide clarity in terms of product categorisation, and thus include product categories based on objective minimum criteria.
2. Conversely, the review should preserve a wide range for disclosures, seeking simplification wherever possible to focus on relevant disclosures for investors and taking into account other developments in the sustainable finance agenda.

An objective, clear and simple EU product categorisation system

As part of the broader European Union (EU) sustainable finance strategy, which intends to channel capital to sustainable activities and transition, the AMF advocates for an EU categorisation system to enable, above all, end investors to identify and compare financial products that make contributions to sustainability factors.

These new product categories should rely on minimum criteria to ensure that products belonging to them attain a minimum level of contribution. Rather than attempting to design labels of excellence for top-of-the-crop environmental, social and governance (ESG) financial products[1], the establishment of an EU categorisation system should seek to create wide-ranging categories with criteria that act as entry points. Within such categories, financial market participants would be free to develop more ambitious strategies and practices, but because there may be multiple sustainable strategies that do not necessarily lend themselves to a simple ranking, there should be no hierarchy between categories.

All stakeholders, including financial market participants, distributors, end investors and national competent authorities (NCAs), should share a common understanding of what these categories are and require. To that end, the categorisation system should rely on <u>objective</u> minimum criteria that leave no room for interpretation.

Objective minimum criteria should echo existing regulatory tools (EU Taxonomy) and market practices (exclusions, non-financial screening) to limit the burden on manufacturers and distributors: the former would not need to develop internal methodologies from scratch, and the latter would have a robust common ground to understand and compare products.

Furthermore, compliance with the new categorisation system should be subject to national competent authorities (NCAs) supervision: a financial product claiming to belong to one category without meeting its minimum criteria should be considered in regulatory breach and be subject to NCAs enforcement action.

[1] And drawing the lessons from the failed endeavour to develop an EU Ecolabel for retail financial products.

In the AMF's view, a categorisation system that meets the aforementioned principles would have several benefits:

- the framework would remain flexible and compatible with existing national labelling schemes: as long as products comply with the minimum criteria of a category, their manufacturers could go further to differentiate their products from their peers', for instance by obtaining a label or developing tailor-made approaches for sophisticated clients;
- the new categories could serve as a basis for developing rules on product denomination and promotional communication. For instance, only a product belonging to the "climate transition" category could use terms like "Paris-aligned" in its name and marketing material. Financial products that do not belong to a category could still make sustainability-related claims, but only in their regulatory documents and in a proportionate manner;
- categories should also be used in the context of the distribution of financial products to redefine the notion of sustainability preferences laid down in the Markets in financial instruments directive (MiFID) and Insurance distribution directive (IDD);
- with clear and robust categories, it could be argued that sustainability disclosures would not need to be as detailed and extensive, thus opening the way for some much needed simplification and alleviation of SFDR product disclosures.

On the basis of these principles, AMF proposes four categories: "environmental solutions", "social solutions", "climate transition" and "non-financial filters"[2]. Other categories may be introduced over time, for instance "biodiversity transition". Those categories would make the current architecture based on Articles 9 and 8 of SFDR obsolete and replace it altogether.

Streamlined product disclosures

Manufacturers should disclose for all their financial products, subject to a 'comply or explain' approach, how they integrate sustainability risks in their investment decisions as well as an assessment of the likely impact of those risks on their products' return. The existing Article 6 of SFDR could be redrafted to become more specific, primarily by spelling out the types of risks to be considered and the expected disclosures relating to the methodology used to quantify their impact on product return.

Additional disclosure requirements should apply to products with sustainability-related claims, i.e. products belonging to a category as well as uncategorised products making such claims in their regulatory documents. Those disclosures should aim to foster comparability between products while being understandable to retail investors. They could consist of a mandatory reporting on a limited set of indicators[3] and on the implementation of the financial market participant's engagement and voting policies towards undertakings invested by the product. This could be complemented by voluntary disclosures on the decarbonisation targets of the product.

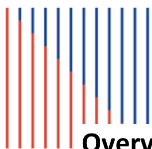
A refocusing of SFDR on product disclosures only

The sustainability information disclosed at product level represents the most useful information source for investors with sustainability preferences who search for a product to invest in. Therefore, it is doubtful that retail investors derive any substantial benefits from, let alone peruse, the sustainability information disclosed at entity-level. As regards sophisticated investors, they likely consider entity-level reporting as a "nice-to-have", but continue to request specific and tailor-made information on a bilateral basis from product manufacturers or advisors.

Under the Corporate sustainability reporting directive (CSRD) framework, financial undertakings will be subject to sector-specific reporting standards. As those standards will reflect the double materiality approach, they will likely encompass disclosures similar to those which SFDR provides for at entity level. For the sake of clarifying the EU regulatory landscape, there would be merit in focusing SFDR on product-level disclosures, and remove all entity-level disclosures from the regulation, provided those disclosures are adequately dealt with under CSRD.

[2] See pages 3 and 4 of this position paper for an overview of the AMF suggestions regarding categories and minimum criteria.
[3] Such as the proportion of investments made in Taxonomy-aligned activities or the proportion of exposures to fossil fuel activities.

As only the largest financial market participants and financial advisors fall under the scope of CSRD, should it be deemed relevant that smaller actors disclose entity-level information, then the scope and provisions of CSRD should be amended accordingly.



Overview of the AMF proposal at product level: the global architecture.

All financial products

- ❑ Disclosures on the integration of sustainability risks in accordance with Article 6 of SFDR (comply or explain).
- ❑ Redraft of the existing Article 6 to make it more specific (e.g. spelling out the types of risks to be considered).

Financial products that make sustainability-related claims

- ❑ Mandatory reporting on a limited set of indicators (e.g. % of Taxonomy-alignment, exposures to fossil fuel activities) and the implementation of the financial market participants' engagement and voting policies towards undertakings held by the product.
- ❑ Voluntary disclosures on the decarbonisation trajectory of the product (if any).

Financial products that belong to a category

- ❑ Products should meet a set of minimum expectations to belong to a category. Those minimum expectations should consist of objective minimum criteria that leave no room to interpretation.
- ❑ See next page for more details on the suggested categories and criteria.

Financial products that belong to a category

These products could make sustainability-related claims in their name, marketing material and regulatory documents. Claims would depend on the category they belong to.

Financial products that make sustainability-related claims

Without belonging to a category, products could still make sustainability-related claims, but only in their regulatory documents and in a proportionate manner.

Other financial products

These products could make no sustainability-related claims at all.

Overview of the AMF proposal at product-level: suggested categories and thoughts about their minimum criteria.

"Environmental solutions" product category

Target: Clients interested in environmental topics and seeking to identify products that invest in activities that are already environmentally sustainable.

1st criterion: minimum proportion of Taxonomy-aligned investments (x%).

- x% should find the right balance between ambition and the reality of the alignment of the economy;
- x% should be dynamic and evolve upwards over time to take into account the evolution of the Taxonomy-alignment of the economy.

2nd criterion: exclusion of companies active in the fossil fuel sector.

3rd criterion: exclusions common to all categories:

- companies involved in the manufacture or selling of controversial weapons;
- companies involved in the cultivation and production of tobacco;
- companies that do not follow practices of good governance, provided that objective, precise criteria and/or thresholds are defined.

"Social solutions" product category

Target: Clients interested in social topics and seeking to identify products that invest in activities that are already socially sustainable.

Such a category should be established, provided that objective, precise and simple criteria are developed.

"Climate transition" product category

Target: Clients interested in transition and seeking to identify products that invest in companies in climate transition.

1st criterion: three approaches could be explored based on (i) decarbonisation trajectory of financial products, (ii) transition plans of investee undertakings and (iii) Taxonomy-aligned investments.

Additional thoughts on those approaches:

- under approach (i), the use of absolute greenhouse gas (GHG) emissions for investments in larger undertakings could be considered;
- a minimum proportion of investments should be made in high impact climate sectors;
- approach (ii) should not be restricted to investments in undertakings subject to CSRD, yet it should be ensured that the disclosures relating to transition plans are aligned with the European sustainability reporting standards;
- under approach (ii), a minimum proportion of investments should be made in undertakings whose transition plan is aligned with the 1.5°C objective;
- approach (iii) could refer to the CapEx KPI, which should be dynamic and evolve upwards over time.

2nd criterion: exclusions common to all categories.

"Non-financial filters" product category

Target: Clients interested in applying some non-financial filters to the selection of the assets they invest in.

1st criterion: objective non-financial filters in the selection of the assets. For public equity:

- non-financial analysis, indicator or rating should cover at least 90% of the portfolio of the product;
- the weight of each of the three pillars of the non-financial rating, namely E, S and G, should represent at least 20% of the rating;
- the product should meet one of these two conditions:
  - the non-financial analysis should lead to a 30% reduction in the product's investment universe, at least; or
  - the weighted average of the non-financial rating of the portfolio should be at least 30% higher than that calculated for the investable universe;
- other assets classes like private equity, real estate and infrastructure should have their own criteria.

2nd criterion: exclusions common to all categories.