RESPONSIBLE INVESTING

Guide to the new regulatory framework

Confidence must be earned

Amundi
ASSET MANAGEMENT

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TOWARDS A
GREENER EUROPE

The 2015 Paris Agreement and the 2030 UN Agenda for Sustainable Development have prompted the European legislator to rethink the role of finance.

Since the 2018 Sustainable Growth Financing Action Plan it is clear the European Commission considers financial operators as one of the main players in the 10-point action plan aimed at:

- **Redirecting** capital flows towards sustainable investments
- **Integrating** sustainability into risk management
- **Promoting** transparency and encouraging a long-term vision

The European Commission's regulatory initiatives include four main measures:

DISCLOSE ESG INFORMATION

Disclosure of sustainability risks and of investment sustainable (SFDR[1])

EUROPEAN TAXONOMY

Shared system of definition and classification of sustainable economic activities (Regulation on the taxonomy[2])

SUSTAINABILITY BENCHMARK

Creation of two new benchmark categories with low-carbon emissions[3]

SUSTAINABILITY IN ADVISORY SERVICES

Amendments to the Markets in Financial Instruments Directive «Mifid II» and the Insurance Distribution Directive «IDD»

While some of the measures are already in place (such as the adoption of new sustainability benchmarks), the next two years are packed with deadlines that will oblige financial market players to adapt in full to the new regulations.

The first important date is **10 March 2021** when Regulation (EU) 2019/2088 on **sustainability related disclosures in the financial services sector** (Sustainable Finance Disclosure Regulation, or **SFDR**) comes into force.

[1]Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability reporting in the financial services sector.
[2]Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.
[3]Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU climate transition benchmarks, the EU-Paris aligned Benchmarks and sustainability-related disclosures for benchmarks

SFDR: SUSTAINABILITY RISKS IN THE SPOTLIGHT

The Regulation aims to establish a pan-European framework to facilitate sustainable investments and provides for a harmonised approach to transparency requirements for investors regarding sustainable investments in the financial services sector of the European Economic Space.

SFDR defines:

> **“harmonised rules for financial market participants and financial advisers on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability related information with respect to financial products.”**

Sustainability risk: an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact in the value of the investment (wording of the regulation)

The legislation requires financial market participants and financial advisors to publish on their websites information about their policies to integrate sustainability risks into their investment decision-making processes. It also required remuneration policies to be published on the website and explain how those policies are consistent with the integration of sustainability risks.

At a product level, financial market participants shall indicate in pre-contractual information (UCITS Prospectus) how sustainability risks are integrated into their investment decisions and should communicate how they assessed the likely impacts of sustainability risks on the performance of financial products (**Article 6**). If, on the other hand, financial market participants do not consider sustainability risks to be applicable, a clear and concise explanation should be provided.

Articles 8 and 9 of SFDR the Regulation concern financial products which, respectively, **promote environmental or social characteristics** or which have **sustainable investments** as their objective. For funds falling into these categories, the legislation indicates a set of additional information to be included in pre-contractual documentation and periodic reports.

The integration of the legislation will take place in four stages:

- **First, the integration of pre-contractual documentation of funds and websites (so-called first level measures) with the disclosure of principal adverse impacts on sustainability factors by financial products.**
- **this will be completed by the end of 2022 with an indication of the main negative effects on sustainability by individual financial product.**

AN OVERVIEW OF THE SFDR CATEGORIES

TAXONOMY:
CHECKMATE TO **GREENWASHING**

Establishing clear "green" European criteria for investors is the key to raising more public and private funding and allow the EU become "carbon neutral" by 2050, as set out in the European Green Deal, and to prevent "greenwashing".

This is the objective of the **Taxonomy Regulation** which came into force on 12 July 2020 with the publication in the Official Journal of the European Union of Regulation (EU) 2020/852, on **the establishment of a framework that promotes to facilitate sustainable investment (Taxonomy Regulation).**

The Regulation establishes the birth of the **first system in the world to classify sustainable economic activities**, establishing criteria for **determining whether an economic activity can be considered sustainable**.

Greenwashing: term indicating the practice of some companies or organisations to gain an unfair competitive advantage based on misleading or false claims in order to present as environmentally friendly a financial product that does not actually meet basic environmental standards.

→ **The taxonomy identifies six environmental and climate objectives:**

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

To be eco-compatible, an activity must meet the following criteria:

- ✓ contribute positively to at least one of the six environmental objectives;
- ✓ do not produce negative impacts on any other objective;
- ✓ be carried out in compliance with minimum social guarantees (for example, those provided for in the OECD guidelines and UN documents).

The Taxonomy Regulation also brought in the creation of the **International Platform on Sustainable Finance**, a permanent group of public and private sector experts to develop sustainable finance policies and tools.

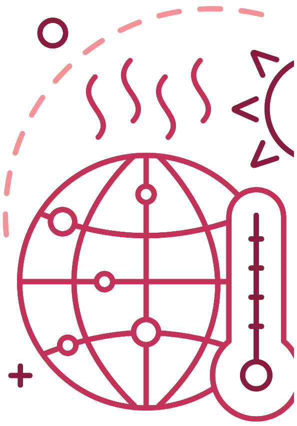
The mandate of the expert group includes: the development of technical screening criteria for the EU taxonomy; the revision of the taxonomy to potentially include criteria of significant social harm; the observation of capital flows towards sustainable finance and finally the development of policies on sustainable finance.

WHEN WILL THE TAXONOMY BECOME OPERATIONAL?

In December 2020, the consultation phase on the proposed Delegated Regulation containing the technical criteria of the activities to be considered sustainable for the achievement of the objectives of mitigation and **adaptation to climate change was closed**. Once approved by the European Parliament and the Council of Ministers, it will apply **from 1 January 2022**. For the other four objectives, the information required by the Taxonomy should be made known **from 1 January 2023**.

TWO NEW BENCHMARKS
TO HELP INVESTORS IN THEIR CHOICES

One of the legislator's initiatives to ensure greater clarity and transparency for investors is the introduction of two new categories of low-carbon benchmarks with similar objectives but different target levels:



EU Climate Transition Benchmark:
aiming to reduce the carbon footprint of a standard portfolio. More precisely this index type should be defined by taking into account the companies that follow a scientific and measurable decarbonisation objective; which takes into account the long-term global warming goal determined in the Paris Agreement

EU Paris-aligned Benchmark:
aiming to select only securities that contribute to the achievement of the 2°C objective established in the **Paris Agreement on climate change**

With the Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020, the legislator deemed necessary to define minimum requirements for the two indices including a list of companies to be excluded, such as those involved in controversial weapons or those active in the cultivation and production of tobacco.

This also requires administrators of all benchmarks to indicate the way in which environmental, social and governance factors (ESG factors) are reflected in each benchmark or family of benchmarks they provide and publish and which ESG factors they have taken into account in developing their benchmark methodologies.

Investors' ESG preferences matter

ESMA[5] also contributed to the sustainable finance issue by proposing to integrate clients' preferences on sustainability in the profiling phase.

Intermediaries will be called upon to review client profiling processes, provide advice and assessment of adequacy, integrating them with ESG factors.

The process of collecting information from clients must provide, in addition to what is already provided for by current legislation, for **the collection of the clients' preferences in the ESG spectrum**. Therefore the assessment of financial objectives can be extended to include environmental, social and governance preferences. This information will be useful to complement the advisory service defined by the intermediaries in order to **carry out a commercial proposition which is consistent with the investment objectives declared by their clients**.

They will also need to review the adequacy policies with the introduction of further controls to verify that **the investment product being advised is in line with the ESG preferences declared** by the client in the profiling phase (revision of the Mifid II Directive).

THE SHAREHOLDER RIGHTS DIRECTIVE II: AN OPPORTUNITY FOR ENGAGEMENT

SRD II

→ On 3 September 2020, the SRD II, Directive on the rights of shareholders issued by the European Union ("Shareholder Rights Directive II" or "SRD II") came into force with the following objectives:

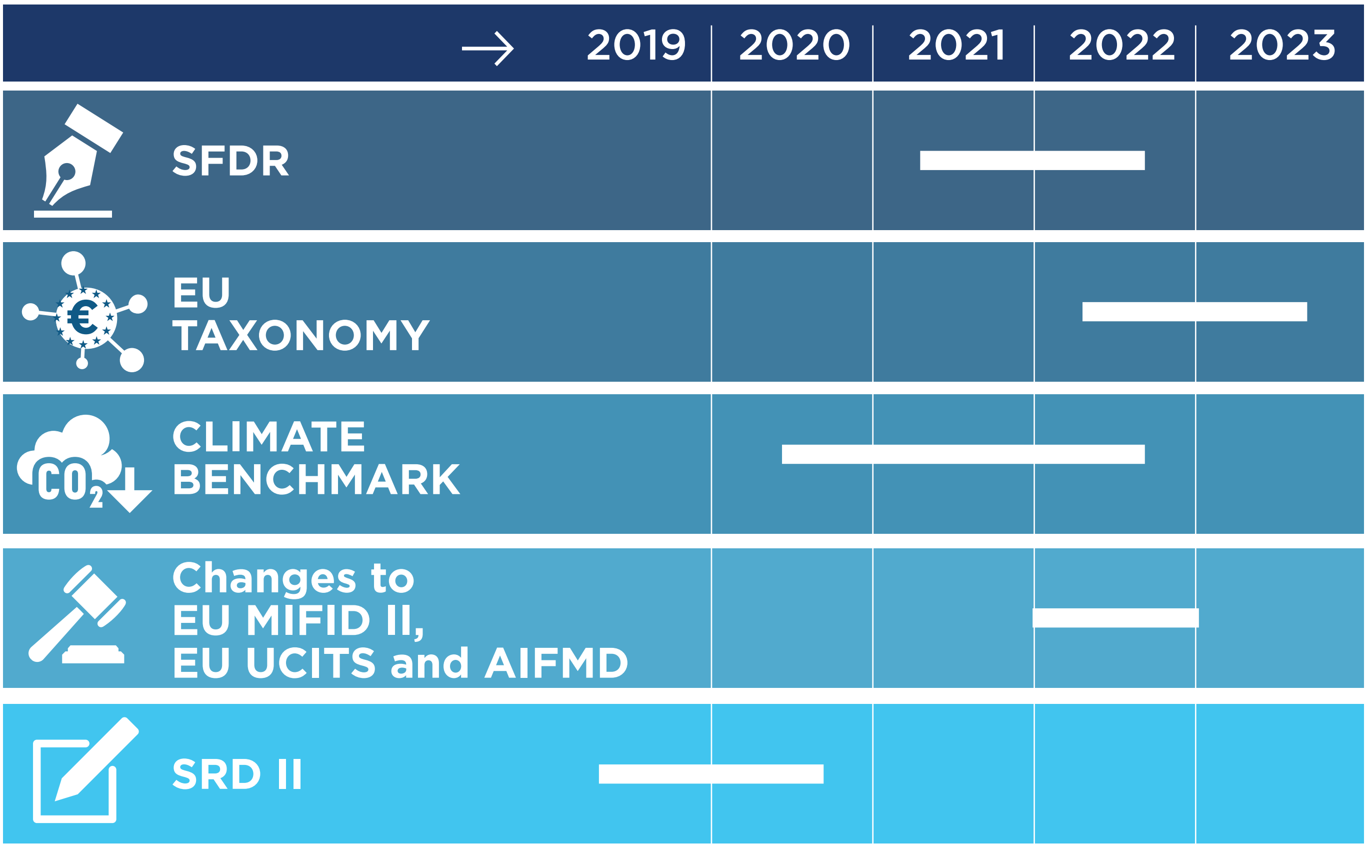
- → involve shareholders, encouraging them to participate more actively in corporate governance and giving them greater opportunities to control remuneration policy and transactions with related parties, also cooperating together;
- → strengthening the transparency of companies by providing more information about their corporate governance, to investors and in general, and allowing them to be able to know the identity of their shareholders and the voting policies of their institutional investors, so as to allow a more profitable dialogue on corporate governance issues;
- → foster business growth and competitiveness.

The Directive lays down new obligations for active managers to communicate how they have exercised **their voting rights; or to explain why they did not exercise them** (comply or explain engagement). Another objective of the Directive is **to promote long-term participation**, far from the short-term strategy that forces companies to achieve perfect quarterly targets.

[5]Established with effect from 1 January 2011 with EU Regulation 1095/2010, ESMA is a European supervisory authority that brings together the national financial market supervisory bodies of each EU Member State. Together with the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), it is an integral part of the European Supervisory System.

In summary

THE TIMETABLE OF **THE NEW REGULATORY FRAMEWORK**



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