AMF DETAILED POSITION ON THE CATEGORISATION SYSTEM FOR FINANCIAL PRODUCTS AND MINIMUM CRITERIA

1. INTRODUCTION

As mentioned by the European Commission in its targeted consultation document (introductory part of section 4.1), disclosure regimes laid down in Articles 9 and 8 of SFDR "are being used as de facto product labels". This advocates in favour of the definition of product categories at European level, based on minimum criteria.

As part of its consultation, the European Commission identifies two possible ways of establishing those categories, namely (i) keeping the current 9/8/6 architecture and clarifying their underlying concepts or (ii) creating new product categories.

In its position paper released on 10 February 2023 relating to the introduction of minimum environmental standards in SFDR, the AMF structured its thinking around Articles 9 and 8. Nonetheless, it carried out this work on its own initiative, aiming at providing an experimental "ready-to-use" solution within the current SFDR framework. Responding to this consultation launched by the European Commission as part of its comprehensive assessment of SFDR is a different exercise. It results that the position paper of February 2023 is a legacy position, and it is opportune to move away from it where necessary to clarify the regulatory framework as far as possible.

2. AMF COMMENT ON THE DESIGN OF THE CATEGORISATION SYSTEM

2.1. The starting point [questions 4.1.1 and 4.1.2]

The AMF considers that the establishment of product categories based on minimum criteria should aim to provide a common definition, at European level, of the expectations a financial product should satisfy to qualify as, for instance, a transition product.

The developed framework should be objective, that is to say that categories and their minimum criteria should not be prone to interpretation, to ensure that this definition is actually understood and implemented in the same way by stakeholders throughout the EU: manufacturers, distributors, investors, authorities.

Such an objective framework would (i) make it possible to compare products with each other, (ii) enable the national rules currently in force to be withdrawn and, therefore, (iii) contribute to cross border distribution.

Last but not least, this categorisation system should be simple and legible for all stakeholders, including retail investors and advisors.

For all these reasons, the AMFs deems necessary to create new product categories, and not reuse Articles 9 and 8 which would be deleted.

2.2. Four guiding principles [questions 4.1.1 and 4.1.2]

From this starting point, the AMF suggests four guiding principles in developing the product categories and their minimum criteria:

- the number of categories should be limited;
- the names of these categories should be evocative and easy to explain to retail investors;

- minimum criteria should be objective; and
- there should be no gradation within each category nor hierarchy between categories.

In the end, each category should be easy to identify, and even retail investors should be clear on what they may legitimately expect from each of those categories.

2.3. The role of minimum criteria, and what it implies [questions 4.1.1 and 4.1.2]

Those product categories should rely on minimum criteria: it means that developing these categories should not be an attempt to define what sustainable products are. On the contrary, the AMFs considers that those categories should identify precisely products that invest in environmental or social solutions/contributions or are transition products.

Minimum criteria should be a common ground for financial products belonging to the same category. Hence, the framework developed by the AMF in this note remains highly flexible: as soon as a product meets the minimum criteria of a category, the manufacturer is able to go further to differentiate its products from others. A product could for instance obtain a label, and/or the manufacturer could develop a tailor-made approach to meet a specific need expressed by a client.

As a result, it does not seem necessary nor appropriate to introduce a graduation system within each category: these graduations would not be sophisticated enough for professional and institutional investors that look for tailor-made solutions, and would be too complex for retail investors. It implies that minimum criteria should find the right balance between ambition and pragmatism, that is to say being accessible while ensuring that the categories are stringent enough to exclude less ambitious products and practices.

Furthermore, there would be no need for a hierarchy between the different product categories: each of them would be designed to meet different expectations expressed by investors.

These minimum criteria should be clear, accessible to all asset classes[1] and non-EU investments and, above all, objective. In our point of view, it is crucial not to develop criteria prone to interpretation by financial market participants. The establishment of categories based on criteria open to interpretation would severely hamper EU policy objective to provide clarity and channel private investments into sustainable activities and the transition.

In that respect, the concept of sustainable investment, too vague and on which the Article 9 relies, should disappear. The AMF advocates for the integration of the transition within the EU regulatory framework, and acknowledges the European Commission recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy. Nevertheless, it is key to provide through minimum criteria a clear and precise definition of what transition is, at the risk of encountering the same pitfalls at those arising from the definition of sustainable investment. [question 4.1.12]

2.4. The governance of the categorisation system [question 4.2.2]

National competent authorities (NCAs) should supervise the implementation of this categorisation system, including the respect of the minimum criteria by financial products. Three main reasons would justify it:

[1] Including derivatives. The role and treatment of derivatives should be clarified within the SFDR framework, for both long and short positions.

- Given the regulatory nature of these categories, the fact that a product claims to belong to one of them without meeting its minimum criteria should be considered as a breach. Hence, whether a product belongs to a category should be supervised by NCAs at its launch and, where applicable, throughout its life.
- As objective as the minimum criteria will be, it must be ensure that they are applied in a consistent manner throughout Europe. In this regard, NCAs will be able to work together where necessary to define at EU level a common way to supervise this categorisation system.
- Imposing a third party verification will increase the costs faced by manufacturers.

2.5. The use of the categories [questions 4.4.1 to 4.4.3]

Product categories should be used in the context of the distribution of financial products, hence replacing the current sustainability preferences laid down in MiFID and IDD Delegated Regulations 2021/1253 and 2021/1257. The advisor could asks its client whether he/she has interest for non-financial issues and, where applicable, could collect information on its appetence for one or several product categories.

Product categories based on objective minimum criteria would be an ideal basis for rules on product denomination and communication. The AMF suggests the following rules:

- Only products belonging to a product category could make sustainability-related claims in their denomination, marketing material and regulatory documents. Their denomination and communication should be consistent with the category they belong to. For instance, only a product belonging to the so-called “climate transition” category could use the word transition in its denomination and communication.
- Products that do not belong to a category could still make sustainability-related claims, but only in a proportionate manner and only in their pre-contractual and periodic documents listed in Articles 6(3) and 11(2) of SFDR.

Furthermore, the category a product belongs to should be included in the PRIIPS KID. [question 4.3.1].

3. AMF SUGGESTION FOR PRODUCT CATEGORIES AND MINIMUM CRITERIA

3.1. Suggested product categories [question 4.1.4 and questions 4.1.5 to 4.1.7]

The AMF suggests creating three product categories that would meet the expectations of the following three customer profiles:

- Clients interested in environmental topics and seeking to identify products that invest in activities that are already environmentally sustainable (a so-called “environmental solutions” product category).
- Clients interested in transition and seeking to identify products that invest in companies in climate transition (a so-called “climate transition” product category).
- Clients interested in including some non-financial filters in the selection of the assets they invest in (a so-called “non-financial filters” product category).

The AMF would welcome the development of a fourth category for clients interested in social topics and aiming to identify products that invest in activities that are already socially sustainable (a so-called “social solutions” product category). Yet, the introduction of such a category would be conditional on the development of objective, precise, simple criteria.

The list of product categories should be evolving in order to adapt over time to changes observed in the market. A new category could be added to the existing categories as soon as it could rely on appropriate criteria. This is the case, for example, with products relating to the transition on biodiversity issues. Changes could be made to this list by means of delegated regulation.

We do not suggest creating a category dedicated to impact, for the three reasons below:

- Impact is already embedded in the categories suggested. "Company impact" is implicitly part of the criteria suggested, such as the % of Taxonomy-alignment or the requirement to have a transition plan.
- "Investor impact" has no common, clear definition. At French level, stakeholders agreed in 2021 upon a principle-based definition. Nevertheless, this definition is very high level and remains highly subjective. Therefore, each financial actor has its own discretionary way to understand and implement it. Such a definition does not fit with the conditions set out above and cannot be used to develop appropriate objective, precise and simple minimum criteria.
- As impact investing remains a niche strategy, it does not seem relevant to design a dedicated category at European level. Suggested categories are destined to be large enough to cover several strategies. For manufacturers capable of implementing an impact investing strategy, and demonstrating their investor impact, this would remain a way to differentiate their products.

Those product categories should apply to all financial products. Nonetheless, further work would be necessary to assess the relevance of how multi-options products (MOPs) could be included in the categorisation system. Should the use of categories be relevant for those products, dedicated criteria taking into account the specific features of the MOPs could be developed. [question 4.2.3]

3.2. Suggested **minimum criteria [questions 4.1.10 and 4.1.11]**

As a first step, we present below some thoughts on how minimum criteria of these product categories may look. Further works would be necessary to set definitive minimum criteria.

<u>For clients interested in environmental topics and seeking to identify products that invest in activities that are already environmentally sustainable – so-called "environmental solutions" category.</u>
<u>1st criterion</u>: a minimum proportion of Taxonomy-aligned investment (x%). - x% should find the right balance between ambition and the reality of the alignment of the EU economy; - x% should be dynamic and evolve upwards over time to take into account the evolution of the EU economy towards sustainability; - once the categorisation system comes into force, a grandfathering clause would be provided for products such as closed-end funds:a product should commit to meet the minimum proportion in force at the time it is made available to investors[2]; - The KPIs to use could be turnover, CapEx or OpEx, and market value for real estate and infrastructures.

[2] For instance: the minimum proportion of Taxonomy-aligned investments is x% from 2030 to 2034 and y% from 2035 to 2039:

- A closed-end fund is made available to investors in 2030 and 2031: to belong to the "environmental-solutions" category, the fund should only meet the x% threshold. The y% threshold would not apply to this fund, as it would not be made available to investors from 2035.
- A open-ended fund is made available to investors from 2030: to belong to the "environmental-solutions" category, the fund should meet the x% threshold between 2030 and 2034, the y% threshold between 2035 and 2039, and so on.

2nd criterion: an environmental exclusion.

- Companies active in the fossil fuel sector, as defined in point (5), Annex I of the draft RTS amending the SFDR Delegated Regulation of the ESAs (published on 4 December 2023).

3rd criterion: exclusions common to all categories.

- Companies involved in the manufacture or selling of controversial weapons, as defined in point (18), Annex I of the draft RTS amending the SFDR Delegated Regulation of the ESAs.
- 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 (like female/male equality at board or the presence of independent administrators).

For clients interested in social topics and seeking to identify products that invest in activities that are already socially sustainable – so-called “social solutions” product category.

This category could be introduced subject to the development of objective, precise and simple criteria, which would establish a common understanding at EU level of what socially sustainable activities are.

For clients interested in transition and seeking to identify products that invest in companies in climate transition – so-called “climate transition” product category.

1st criterion: several alternative approaches could be explored :

Approach A: refer to a decarbonisation trajectory, with a year-on-year reduction of GHG emissions aligned on Paris agreement and inspired by Article 7 of Delegated Regulation (EU) 2016/1011.

Yet, there are several drawbacks to address:

- This approach should ensure that products actually invest in companies active in sectors relevant for the climate transition. The current provisions laid down in Article 3 of Delegated Regulation 2020/1818 would be an interesting starting point, but is not stringent enough to make sure that products belonging to this category would sufficiently invest in those sectors (it all depends on the investment universe of the product). Therefore, this approach should require a minimum proportion of investments in high impact climate sectors, as defined in point (9), Annex I of SFDR Delegated Regulation.
- Setting up a trajectory at portfolio level only would not be enough to make sure that investee undertakings do have a company impact on decarbonisation: the product could meet this requirement by a mere change in its portfolio composition. This should be addressed by more stringent requirement regarding asset selection.
- It would also be interesting to take a closer look at the metric used to monitor the decarbonisation trajectory: the use of absolute GHG emissions could be considered for investments in larger undertakings.

Approach B: refer to transition plans, which are accompanied by disclosures aligned with the requirements laid down in §16 of ESRS E1-1.

Yet, some issues deserves a special care: - As mentioned in *Approach A*, there should be a requirement to make a minimum proportion of investments in high impact climate sectors. - Moreover, this approach should allow investments in companies that fall out of the scope of CSRD, that is why we refer to disclosures aligned with the ESRS E1-1, and do not suggest limiting Approach B to companies reporting under Article 19a or 29a of Directive 2013/34. The notion of alignment would deserve further practical specifications. - The product should make a minimum proportion of investments in companies whose transition plan (both target and trajectory) is aligned with the objective of limiting global warming to 1.5°C above pre-industrial levels (y%). To ensure the robustness and comparability of the methodologies used, clear minimum expectations should be set. y% should be dynamic and evolve upwards over time (with a grandfathering clause for closed-end funds). *Approach C*: refer to a minimum proportion of Taxonomy-aligned investment (z%). - z% should find the right balance between ambition and the reality of the alignment of the EU economy; - z% should be dynamic and evolve upwards over time to take into account the evolution of the EU economy towards sustainability; - a grandfathering clause would be provided for closed-end funds (a product should commit to meet the minimum proportion in force at the time it is made available to investors); - The KPIs to use could be CapEx. 2nd criterion: exclusions common to all categories (see above).

For clients interested in including some non-financial filters in the selection of assets they invest in – a so-called "non-financial filters" product category.

1st criterion: the selection of the assets embeds objective non-financial filters.
 	
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 the two conditions below:
    o the non-financial analysis should lead to a 30% reduction in the product's investment universe, at least; or
    o the weighted average of the non-financial rating of the portfolio should be at least 30% higher than that calculated for the investable universe.
 	
We see strong merits in developing criteria specific to other asset classes like private equity, real estate and infrastructure.
 	
2nd criterion: exclusions common to all categories (see above).

3.3. Comment on the use of the EU Taxonomy [question 4.1.10]

The AMF acknowledges the operational challenges that may come with the implementation of the EU Taxonomy. Nonetheless, the AMF highlights that the EU Taxonomy is the most robust, credible standard currently available to define what is an environmentally sustainable activity and, as a result, an environmentally sustainable investment. Furthermore, this standard is common to all European stakeholders, from issuers to distributors and manufacturers.

Most of these challenges stem from investments in non-EU companies. Nonetheless, on these cases, the EU Taxonomy remains relevant and helpful:

- The criteria of the EU Taxonomy are science-based and defined at activity level. Therefore, non-EU companies may use them on a voluntary basis. The most salient difficulty lies in the implementation of criteria that refers to EU legislation.
- Yet, a refinement of those criteria could occur in the coming years. For instance, the Platform on sustainable finance recommends three options, namely
    - developing equivalence tables between EU legislation and third countries';
    - developing equivalence tables between EU legislation and international standards; or
    - translating criteria referring to EU legislations into quantitative and/or process based criteria (see pp.167-168 of its data and usability report released in October 2022).
- Given the number of years between now and implementation of a potential SFDR2, it is reasonable to deem that the methodologies of data providers will improve. This improvement should go along with additional regulatory specifications, ensuring that data providers duly refer to the existing criteria of the EU Taxonomy and use actual information or data on undertakings whose degree of alignment with the taxonomy they assess.
- Finally, in the long term, considering the coexistence of several Taxonomies globally and the current work of the International platform on sustainable finance, one could potentially envisage an equivalence mechanism between the EU Taxonomy and some other Taxonomies, provided they are close enough to one another and that there is reciprocity in equivalence.

3.4. Exclusive or cumulative categories [question 4.1.8]

As categories would not aim to identify sustainable products but products meeting common minimum expectations, we consider that some of those categories could be cumulative. In this regard:

- a product could belong to the so-called "environmental solutions" category as well as the so-called "social solutions" category (when the latter would be designed);
- the so-called "non-financial filters" category could not be cumulative with others, as products belonging to this category would give priority to obtaining financial returns;
- the relationship between the so-called "environmental solutions" and "transition" categories would depend on the minimum criteria designed for each of them. At first sight, a product should be able to belong to both of them, provided that it meets their respective minimum criteria. Nevertheless, the legibility of this combination for investors should be ensured.

Products belonging to at least one category

So-called "environmental solutions" product category

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

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

3rd criterion: exclusions common to all categories.

Disclosures: comply with the disclosure requirements applicable to products making sustainability-related claims.

So-called "social solutions" product category

Provided that objective, precise and simple criteria are developed.

So-called "climate transition" product category

1st criterion: approach based on decarbonisation trajectory, transition plans and/or Taxonomy-aligned investments.

2nd criterion: exclusions common to all categories.

Disclosures: comply with the disclosure requirements applicable to products making sustainability-related claims.

So-called "non-financial filters" product category

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

2nd criterion: exclusions common to all categories.

Disclosures: comply with the disclosure requirements applicable to products making sustainability-related claims.

Products that do not belong to a category but that make sustainability-related claims in their pre-contractual and periodic documents (Art.6(3) and 11(2) of SFDR)

Disclosure requirements applicable to products making sustainability-related claims:

- Mandatory reporting on (i) a limited set of indicators and (ii) engagement and voting policies.
- Voluntary reporting on decarbonisation targets.
- Comply or explain on the integration of sustainability risks.

Products that do not belong to a category and do not make sustainability-related claims

Only information : *comply or explain* on the integration of sustainability risks.