POSITION PAPER GROUPE BPCE –SFDR

As a preliminary thought, we would like to emphasize the beneficial contributions of the SFDR regulation in that **it has helped to make ESG investment much more mainstream** among the public through a deeper professionals' involvement.

A CLEARER, MORE DEMANDING ESG REGULATORY FRAMEWORK IN NEEDS

However, while flexibility was important at first, we now need to bring a more demanding but clear sustainable framework to maintain a demand. We need to **work within a more defined framework and simplify the technical terminology**. The risk of not being taken seriously by retail investors – already seen today – will increase as sustainability consideration gain ground among our customers.
The lack of clear and common definition of what means sustainable investment or the very broad scope of ESG products, the multiplicity of labels or terms of reference (ISR, Febelfin, Luxflag, ecolabel, MSCI ESG, green bonds, sustainability-linked bonds), the number of strategies complex to understand by new or occasional investors (screening, best in class strategies, thematic...), have been confusing retail investors. All in all, professional investors get in this battlefield, but retail investors remain more skeptical.

Client confidence is key to maintain the retail investors' confidence in EU ESG framework.

LINK BETWEEN IDD/MIFID ESG CLIENT's PREFERENCES AND SFDR

The MIFID/IDD ESG clients' preference is then becoming more appropriate as it does not refer to ESG products, to sustainable companies… but to a minimum %age of taxonomy alignment (defined and based on common definitions), and sustainable investment (not so well defined yet) or wide concepts like PAI, which we would recommend expanding to the notion of positive impact. Customers' preferences for ESG regulation are expressed in highly technical terms that are not properly understood by customers. Nevertheless, the ESG MIFID/IDD approach has the merit to better prevent investor from a greenwashing perception by requiring the expression of a minimum %age of sustainable investments, taxonomy alignments, PAI, more usable than the current SFDR framework.
From the observation of SFDR, both its current product's classification (art 6, 8 and 9), and its vague definition of what a sustainable investment is, are not able to give clarity to investors.
In addition, given the level of transition of our economies, it is currently very complicated if not impossible to offer products that only focus on sustainable activities (as defined by the taxonomy or equivalent) when performed by a set of multiple companies. In addition, for advised retail investors, financial preferences and risk appetite come first, before its ESG preferences, which reduces its possibilities. It is hence very difficult to propose to these clients a portfolio allocation only invested in sustainable activities, likely risky. This is also a reason to include the notion transition in the concept of sustainable investment.

We also need to maintain a certain level of consistency between SFDR and customers' preferences for ESG:

- All needed information in ESG client's preference must be included in SFDR pre and post disclosures' requirements: whether the minimum level of taxonomy alignment, the minimum of sustainable investment alignment and the PAI.

- All financial instruments are included in ESG clients' preferences, whereas SFDR scope does not include investment products like structured products, remains unclear like for derivatives. We should have a framework that is consistent across various asset classes for an average investor.

From this perspective, we welcome the consultation on SFDR level 1.

SFDR: LABELLING or CLASSIFICATION SYSTEM

SFDR is currently more used as a labelling system than a disclosure framework, as noted by the Commission. This might indicate the need for a categorization of ESG products to reflect strategy, which can be thematic, oriented toward financing the transition, promote best in classes to create the condition of change…. Since the categories are nonetheless useful for professional investors, we do not believe that a complete overhaul of the system would be beneficial for any of the stakeholders. Where a labelling system in our view would bring rigidity, we recommend to clearly transforming the current SFDR framework into a marketing tool, which categorize the products to reflect the investment strategy, to help customers better understand and compare the investment products.
We therefore believe that SFDR would be used to reflect a strategy-based approach.

REGULATORY LEVEL OF PRESCIRPTION: NEED MORE TIME TO BE WELL CALIBRATED

The current regulatory framework is perceived as arbitrary and can lead to greenwashing and reputational risk for financial institutions. We therefore call for more precise definitions and regulations to ensure that sustainable finance is accurately represented and properly incentivized.
The question remains to determine the level of flexibility granted to the industry when designing products that can be ESG or sustainable products to maintain the credibility of the ESG framework:

- Are we ready to give the flexibility to an asset manager to include in ESG or sustainable products, harmful companies targeting efforts on wasting, on carbon emission …
- Do we need factual minimum safeguards on the environmental or human aspects on ESG products or are these conditions limited to sustainable investments?

Obviously, transparency on such quite new and complex subjects will not be sufficient to address the green washing perception, as the different concepts are usually not well understood by average retail clients whose majority has limited financial and ESG knowledge. Therefore, **too much rigidity might discourage effort**s for transition even if they are not at the expected level to preserve the environment or human rights. On the other hand, **too much flexibility can undermine the credibility of the whole ESG framework**. This is a risk that would compromise our efforts to transition our economies and that would end up being very costly, if all ESG investments done by the regulators and the industry were to be thrown away and to be replaced by new requirements. In our view, this point needs to be carefully addressed with adequate testing **but can't be answered in a couple of weeks.**

IN THE INTERIM, IN OUR VIEW, WE NEED:

1. **To clearly define what a sustainable investment or an ESG product means.**

   SFDR delivers a great deal of confusion surrounding what constitutes sustainability, as not explaining:

   - **Different concepts behind the same word**: -
     - The purpose of the Taxonomy regulation as specified in its article 1, defines what a sustainable activity is to determine the % of sustainability of an investment. A sustainable activity must have a **substantial** contribution to an ESG objective (currently defined for 6 Environmental objective), complies with the Technical

Screening Criteria, the minimum safeguards and the Do Not Significantly Harm requirements (DNSH).

- SFDR article 2(17): a sustainable investment is an economic activity that contributes **[only]** to an environmental or a social objective, provided that it does not significantly harm' ("PAIs") any of those objectives and that the investee company follows good governance practices.
  Consequently, an activity aligned with the taxonomy criteria is de facto considered as environmentally sustainable under SFDR, but the reverse is not necessarily true.

  - **The content of a sustainable investment is also a source of confusion:**
    - Which level of PAI considered for a company are acceptable?
    - Is this level equal to the taxonomy when the company has only one activity covered by the taxonomy, or can it be different?
    - Shall sustainable investments include companies with a net-zero transition trajectory only, whether they are compliant or not with the DNSH or PAIs? Shall it capture all efforts to have a positive impact on E or S without considering all PAIs?...
    - The current taxonomy mixes activities with different source of sustainability: the green "GAR enabling" corresponds to activities not necessarily green but allowing others to become green. The green KPI capex can correspond to either activities in transition or developing already green activities. The French AMF (Financial Market Authority), confirms this lack of clarity in its taxonomy report, raising that there is no way for data end-user to distinguish the capex of a company that will increase the amount of green assets from the "greening" of its existing brown assets.

  - **Whether and to which extend a company with partial sustainable activities is itself a company eligible in a sustainable product, which also raises the relevance of the concept of sustainable product and the possible need for a clear definition**.
    - Can companies with only 25% alignment with taxonomy could be considered sustainable if the rest of their activities is neutral?
    - Can those with 50% alignment and 50% harmful activity in transition could be?
    - Can a sustainable investment be harmful on a portion of the product, if it is clearly disclosed?...
    - Shall we include the usual exclusions (although it is very hard to find a consensus on a standardized list)?

- **The same comment applies to article 8 products**: shall we set up minimum requirements to allow the name ESG product, like in Germany?

⇨ **Given the low level of sustainability in the economy we would prefer flexibility when applying in practices PAIs or DNSH, as well as a clear recognition of any effort to bring a positive contribution or mitigating harmful effects in ESG and sustainable products.**

We believe it is very important to recognize and value any efforts, whether substantial or more limited, which are undertaken by a company. A more small or medium improvement in ESG is always better than nothing. Given the emergency of the transition, discouraging companies by setting too ambitious goals does not seem the right approach. Furthermore, a strong focus on dark green assets, which are currently quite limited, presents also adverse consequences for investors: over pricing of assets, riskier investments and potentially less profitability for average clients whose main concerns remain the performance and or security.

On the other hand, the calibration of the flexibility when defining the notion of sustainable investment or of sustainable product **can be a powerful tool to direct the flow of financing towards the EU economy**. By choosing to be selective to determine eligible assets in sustainable products, EU will naturally favor more companies subject to higher standards, which might be more numerous in EU than in other zone; given the various green initiatives launched by the European Commission along these last years : Green deal, Fit for 55 package... The same reasoning might apply to social minimum safeguards along their value chain. Given the EU social standards, and also since the CSDDD will apply to EU companies only, this could also be easier for them to be more demanding on this area. This indirect preference to EU company could help them absorbing the costs of the implementation of all this ESG regulations. **There is also a tactic element:** depending on whether the EU wants to directly reach retail investors, mainly the less than 35 years old, they might need to consider the needs of this target. These investors want clear, demanding, and simple concepts. Including too much flexibility in sustainable investment might make them go away. Institutional clients might have a different perspective and consider for instance than compensate the flexibility by more disclosure can be sufficient, as observed in the Anglo-Saxon environment. But not considering all needs from the beginning, might be more complex to implement later.

⇨ **BPCE group considers this is yet premature to suggest a more precise recommendation on what it could consider as the optimum level of flexibility.**

2. **To determine easy language for a retail investor, currently far too technocratic**. The use of words like aligned with the taxonomy or with the notion of sustainable investment as defined by the article 2.17 of SFDR, even the PAI sounds awful for a client. The same is true with the multiple concepts behind the green ratio: transitional activities or enabling activities are green activities not green themselves. This far too complex to be explained in less than 30 minutes to a client which has several other appointments planned in its day. There is a need to be able to use more friendly concepts, like financing the green economy in the regulation itself to give more level certainty and comparability.

3. **To simplify & harmonize disclosures requirements**.
   - We would recommend using a standardized template for financial products, including ESG/sustainable investments, with specificities by nature of products. In our view, this should be SFDR's primary objectives.
   - We would delete the entity reporting not read and not used **as well as website product disclosures** if they are duplicating ex-ante and ex-post product disclosures. The entity reporting requirements are onerous, and their added values are questionable given the very low number of visits to the dedicated pages. Moreover, the entry into force of the CSRD is likely to make these reporting even more obsolete, as they will become redundant with the new requirements.
   - For products disclosures, we would request the ex-post disclosure of the existing 14 entity KPIs for all products further to potentially specific relevant KPIs to ease the comparison between products on ESG features.

- We would include proportionality and materiality concepts like in CSRD for SFDR and advise on the value that needs to be taken to maintain a neutral status of the non-material KPI.
- MOP should be able to use the pre contractual information et periodic information for each underlying.

4. **SFDR should not overstep the role that product labels have**. The fact that SFDR is now used as product categorization system is not the result of a market need, as has been suggested. It is rather the result of disparities in transparency requirements. Labelling introduces high costs, is not always credible for investors already lost in the number of existing and sometimes weak ESG labels. It also reduces understanding for retail customers compared to quantified and comparable data. The standardization induced by labels can also create speculative bubbles in labelled assets, while not encouraging financial players to push for more drastic changes in companies once the labelling threshold has been reached.

5. **Instead, we would rather use SFDR categorization as an additional information support to help the client understanding the different investment strategies. This should be complemented with an adequate naming rule, which has an impactful marketing tool**.
Several ideas are currently circulating transition, sustainable, impact (lighter than transition), ESG risk (best selection, exclusion…). ESMA suggest a category for transition in its proposal of guidance on naming rules published on the 14 December. It also request quite prescriptive minimum requirements for using the sustainability-related terms in funds' names: the fund should (1) apply the 80% minimum proportion of investments used to meet the sustainability characteristics or objectives, (2) apply the Paris-aligned Benchmark (PAB) exclusions with few change for the transition , and (3) invest meaningfully in sustainable investments defined in Article 2(17) SFDR, reflecting the expectation investors may have based on the fund's name. Some ideas are Interesting, but ESMA should not preempt the full review of SFDR undertaken by the Commission.

6. **To simplify and harmonize product disclosures.** It is yet premature to make a proposal on what could look like ex and post disclosure for SFDR. This should also be determined alongside PRIIPs review, as it would be welcome to centralize all key information on one single document. Whichever be the proposal, we would recommend **first** using testing with a significant panel of end-clients to ensure the disclosures meet their demand of information. We still find the new proposal of disclosure in the revised SFDR RTS proposal quite complex and would double check with end-clients that they are understandable, and it meets their needs (ex-ante and ex post SFDR templates).

7. **As much as possible standardized formula and thresholds** where relevant to calculate the PAI.
For derivatives, we recommend adopting the same calculation methodology in PAI (confirmed by the ESAs in recent report) and in sustainable investments. They should be considered **long delta x notional** when derivatives are meaningful for the ESG features/objective of the fund. Net short positions should not go below zero. Derivatives should be disregarded from the Numerator if it is not meaningful for ESG features/objective of the fund, for example if it is used for market risk hedging (Rates, Credit, FX, Equity, EPM). And finally, the denominator, representing the market value of all investment should be based on the net assets.
The new SFDR proposal suggest to possible methodology to calculate the level of sustainable activity in SFDR, one at the level of the corporate, the other at the level of activities, the asset

manager being responsible to publish in its website the chosen approach. It is not simple for end-clients. Like a couple of modifications suggested in the revised RTS proposal, we should ensure the comparability of the aggregation of PAI as much as possible.

8. An **evolution of MIFID and the IDD ESG client' preferences** by including positive impact alongside the PAI in the third question. We could clearly include the concept of transition within the sustainability questions as equally important as financing already green activities.

9. **We want to advise the European Commission <u>against</u> revising the SFDR RTS before concluding the revision of the SFDR regulation**. Changing the technical requirements constantly will surely challenge investors in their understanding of the framework and might lead to a crisis in confidence. **Similarly, we are deeply worried of ESMA's guidelines on fund names** considering the precedence it would take on the review of SFDR 1.0 engaged with the Commission's consultation, and the unlevel playing field it would create for management companies compared to other stakeholders like data providers or benchmark administrators.

CONCLUSION

The focus should be on requirements that bring value to investors, and if necessary to significantly revise the current SFDR framework. The disclosure framework should ensure clarity and simplicity for end client to ensure that investors will adhere to the system not perceived as a source of green washing.

Some of the requirements of the regulation offer little or no value to both professional and non-professional investors and should be eliminated. Conversely, other entity-level requirements, such as Article 3 on sustainability risks policies and Article 5 on remuneration policies, establish a common expectation in the market that is valuable and should be maintained.

It is crucial to streamline the requirements for the whole industry to both ensure its focuses on providing value to investors and meeting their needs, while contributing the funding of the transition of the EU economy.