March 2023

RESPONSIBLE INVESTING

Quick guide to the new regulatory framework

Confidence must be earned

Amundi
ASSET MANAGEMENT

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1 TOWARDS A GREENER EUROPE

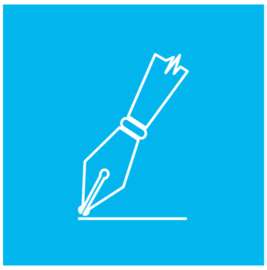
Following the 2015 Paris Agreement and the 2030 UN Agenda for Sustainable development, the European legislator started to rethink the role of finance can and should play in sustainable development.

In light of this, the European Commission developed the 2018 Sustainable Growth Financing Action Plan[1], setting a comprehensive strategy to better link finance with sustainability. The 10 key actions aim at:

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

[1] https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en

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

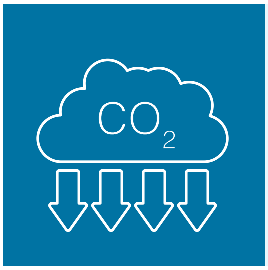


DISCLOSURE OF ESG

(Environmental, Social, Governance) information - Disclosure of sustainability risks and of sustainable investment (Sustainable Finance Disclosure Regulation or SFDR[2])

EUROPEAN TAXONOMY

Shared system of definition and classification of sustainable economic activities (Regulation on the Taxonomy[3])



SUSTAINABILITY BENCHMARK

Creation of two new benchmark categories with low-carbon emissions[4]

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 the new sustainability benchmarks and the SFDR level 1 and 2, the next years will be characterized by several deadlines that will **oblige financial market participants to adapt in full to the new regulations.**

[2] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability reporting in the financial services sectorRèglement (UE) 2020/852 du Parlement européen et du Conseil du 18 juin 2020 concernant
[3] 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
[4] 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.

2 SFDR: SUSTAINABILITY RISKS IN THE SPOTLIGHT

The aim of the SFDR regulation is to establish a pan-European framework to facilitate sustainable investments and providing a harmonised approach to transparency requirements for investors regarding sustainable investments in the financial services sector of the European Economic Space.

The SFDR level 1 came into effect on 10 March 2021, while the level 2 is effective from January 2023. The SFDR regulation 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:
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)

Financial market participants and financial advisors have to publish on their websites information about their policies to integrate sustainability risks into their decision-making processes. Remuneration policies will also need to be made public and market participants have to explain how those policies are consistent with the integration of sustainability risks.

Furthermore, financial market participants must 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 financial market participants do not consider sustainability risks to be applicable, a clear and concise explanation must be provided.

Financial products can be classified on the base of the fact they include ESG criteria in their risk integration, promote ESG characteristics or have sustainable investments as part of their objective. The legislation indicates a set of additional information to be included in pre-contractual documentation and periodic reports. The SFDR level 1 classifies the products in function of their degree of sustainability as follows:

- **Article 6 financial products:** do not promote sustainability characteristics
- **Article 8 financial products:** promote environmental or social characteristics among others
- **Article 9 financial products:** promote sustainable investment as one of its objectives

SFDR level 2, which came into effect in January 2023, states that Article 8 and Article 9 funds must commit to the achievement of a minimum level of Sustainable Investments that will need to be specified in their legal documentation. Further clarifications from the regulator mentioned that Article 9 funds should commit to being composed of 100% of Sustainable Investments.

To date, there is no common, standardised methodology for qualifying an asset as a "Sustainable Investment". Indeed, industry firms have each developed their own methodologies to define a Sustainable Investment under SFDR, according to the definition given by the text. These methodologies differ greatly and so far have led to inconsistencies in the percentage of Sustainable Investments reported by asset managers and data providers. Depending on the methods used, a world equity index, for example, can be reported as constituting anywhere from 10% of Sustainable Investments to over 70%.

These differences make it difficult for distributors and savers to understand and compare offers. Regarding Article 9 funds: so far, the market has mostly understood the legislation to say that Article 9 funds must be 100% invested in Sustainable Investments.

3 TAXONOMY: CREATION OF COMMON DEFINITIONS FOR SUSTAINABLE INVESTMENTS

The objective of the **Taxonomy Regulation** is to develop a clear framework to promote sustainable investments. It establishes the first system in the world for classification on economic activities which could be considered sustainable on an environmental level, which is the key to raising more public and private funding to allow the EU to become "carbon neutral" by 2050[5], as set out in the European Green Deal[6], and to prevent "**greenwashing**".

Greenwashing:
This indicates 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 Regulation establishes six environmental objectives

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition of a circular economy
5. Pollution prevention 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).

5 https://ec.europa.eu/clima/eu-action/climate-strategies- targets/2050-long-term-strategy_en
6 https://ec.europa.eu/info/strategy/priorities-2019-2024/ european-green-deal_en

WHEN WILL THE TAXONOMY BE OPERATIONAL?

The **first delegated act** on climate change mitigation and adaptation approved by the EU entered into force on 1 January 2022. In February 2022[7], the European Commission presented a **complementary act on climate** which, subject to objections from the co-legislators, will apply from January 1, 2023.

The **Taxonomy Regulation** also brought in the creation of the **International Platform on Sustainable Finance**[8], 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.

7 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32021R213
8 https://ec.europa.eu/info/business-economy-euro/ banking-and-finance/sustainable-finance/international- platform-sustainable-finance_en

4 TWO BENCHMARKS FOR A SUSTAINABLE PASSIVE MANAGEMENT

One of the legislator's initiatives to ensure greater clarity and transparency for investors is the introduction of two 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.

5 SUSTAINABILITY PREFERENCES OF INVESTORS

ESMA (European Securities and Markets Authority)[9] also contributed to the sustainable finance issue by proposing to integrate clients' preferences on sustainability when they are selecting financial instruments.

Financial Advisors have the obligation to collect and assess the sustainability preferences of their clients in order to recommend the investments most likely to meet their needs.

The key objective is to help create a dialogue between Financial Advisors and their clients around the clients preferences when it comes to incorporating sustainable products into their savings or pensions.

By asking the client about their preferences in this area it will naturally allow the Financial Advisor to advise the client on the different sustainable products that might match their needs and ultimately channel capital flows towards greener products.

9 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.

The regulator has defined the main criteria in the MiFID II delegated act[10], defining sustainability preferences as:

A client's or potential client's choice as to whether and, if so, to what extent, one or more of the following financial instruments shall be integrated into his or her investment:

a. a financial instrument for which the client, or potential client, determines that a minimum proportion shall be invested in environmentally sustainable investments as defined in Article 2, point (1), of Regulation (EU) 2020/852 of the European Parliament and of the Counci;

b. a financial instrument for which the client or potential client determines that a minimum proportion shall be invested in sustainable investments as defined in Article 2, point (17), of Regulation (EU) 2019/2088 of the European Parliament and of the Council;

c. a financial instrument that considers principal adverse impacts on sustainability factors where qualitative or quantitative elements demonstrating that consideration are determined by the client or potential client.

[10] https://ec.europa.eu/finance/docs/level-2-measures/mifid-2-delegated-act-2021-2616_en.pdf

SRD II

THE SHAREHOLDER RIGHTS DIRECTIVE II: AN OPPORTUNITY FOR ENGAGEMENT

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;
- strengthen 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 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.

6 PRINCIPAL ADVERSE IMPACT INDICATORS (PAIs)

One of the innovations included in the SFDR Regulation is the disclosure of Principal Adverse Impact Indicators (PAIs). All financial market participants will have to disclose 14 indicators, 2 indicators for investments in sovereigns and supranationals and 2 indicators for investments in real estate assets.

PAIs are defined as:
"Negative, material or likely to be material effects on sustainability factors that are caused, compounded by or directly linked to investment decisions and advice performed by the legal entity".

→ The indicators applicable to investments in investee companies are:

1. Greenhouse gas (GHG) emissions (Scope 1, 2, 3 and total[11])
2. Carbon footprint
3. GHG intensity of investee companies
4. Exposure to companies active in the fossil fuel sector
5. Share of non-renewable energy consumption and production
6. Energy consumption intensity per high impact climate sector
7. Activities negatively affecting biodiversity sensitive areas
8. Emissions to water
9. Hazardous waste ratio
10. Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines
11. Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles and OECD Guidelines

12. Unadjusted gender pay gap
13. Board gender diversity
14. Exposure to controversial weapons (antipersonnel mines, cluster munitions, chemical weapons and biological weapons)

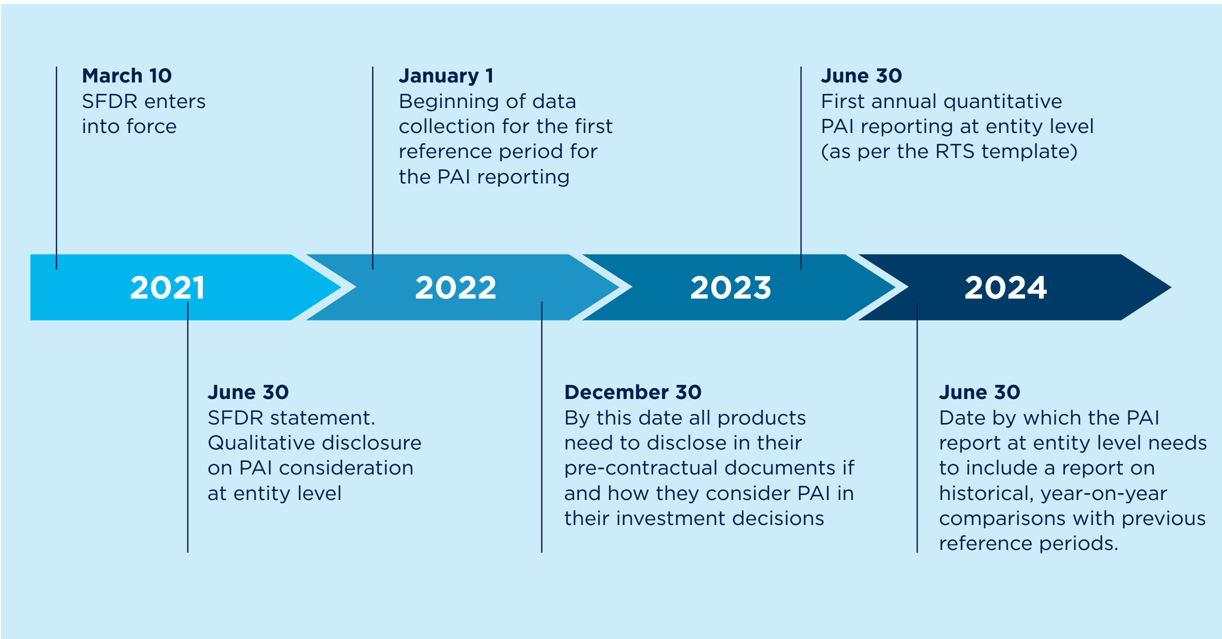
➔ While the indicators applicable to investments in sovereigns and supranationals are:

15. GHG intensity
16. Investee countries subject to social violations

➔ The indicators applicable to investments in real estate assets are:

17. Exposure to fossil fuels through real estate assets
18. Exposure to energy-inefficient real estate assets

The purpose of these indicators is to improve transparency on the sustainability of financial products and increase product and entity level requirements to mitigate the negative effects of greenwashing. The disclosure period of PAIs will take place between January and June 2023.



[11] The Greenhouse Gas Protocol defines scope 1 emissions as direct GHG emissions, scope 2 emissions as electricity indirect GHG emissions and scope 3 as other indirect GHG emissions

IMPORTANT INFORMATION

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