FACT SHEET

SUSTAINABILITY RISKS

UNDER REGULATION (EU) 2019/2088 ("DISCLOSURES" OR "SFDR")

JANUARY 2021

As of 10 March 2021, asset management companies are subject to Regulation (EU) 2019/2088 *("Disclosures" or "SFDR")*. To comply with the transparency requirements of this regulation, the AFG is publishing this fact sheet on sustainability risks. From 10 March 2021, Asset Managers will be required to disclose sustainability risks in each fund's prospectus and on their websites.

This fact sheet supplements the provisions described in the Sustainable Finance - Regulations guide published by the AFG in December 2020.

DEFINITIONS

(22) **Sustainability risk** means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.

(24) **Sustainability factors** mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

ARTICLE 3

Transparency of sustainability risk policies

1. **Financial market participants shall publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process.**

Asset Manager - Website

To comply with the transparency requirements on policies related to sustainability risks on the asset management company's website, the AFG has put together several approaches that could be considered good practice for management companies. For example, the asset management company may use one or more of the tools listed below:

- **Draw on assessments/reports in response to market standards** such as Article 173 reporting, the UN backed Principles for Responsible Investment's (UNPRI) annual assessment when the AM adheres to these principles, TCFD reporting, formalising a responsible investor policy or the voting and shareholder engagement policy and creating or identifying a section dedicated to risks;
  The AFG encourages its members to improve the transparency of their descriptions as sustainability risk management practices become more standardised.
- **Formalise a policy of exclusion**;
- **Formalise a controversy management policy**;
- **Formalise a Risk Committee that integrates ESG risks**;
- **Use indicators related to physical risks**, such as *Climate VaR*. However, this approach is still evolving, and the market indicators developed at this stage only relate to climate.

Taking into account the data and methodologies available at this stage, together with the approaches suggested by the European Commission in its letter of 20 October 2020, we realise that transparency regarding sustainability risk policies is currently primarily narrative in form. We emphasise that Article 3 of the SFDR only deals with transparency and not with risk management itself.

The level of granularity for each of the chosen approaches about which the asset management company will be transparent remains the choice of each asset management company. A good practice is to **proceed step by step**.

The AFG recommends that all information related to responsible investment used by the asset management company be grouped together in a dedicated section on its website.

This section may include links to the various reports or group together information specifically directly to sustainability risks. Information directly related to sustainability risks must be clearly identified as such, for example in a dedicated section.

It should also be noted that Article 3 of the SFDR is supplemented in France by Article L. 533-22-1 of the Monetary and Financial Code (see Article 29 of the French Energy and Climate Law): *"I. In their sustainability risk policy, made public pursuant to Article 3 of the Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, asset management companies shall include information on climate change risks and on biodiversity risks."*

ARTICLE 5

Transparency of remuneration policies in relation to the integration of sustainability risks

1. Financial market participants and financial advisers shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks, and shall publish that information on their websites.

2. The information referred to in paragraph 1 shall be included in remuneration policies that financial market participants and financial advisers are required to establish and maintain in accordance with sectoral legislation, in particular Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97 and (EU) 2016/2341.

Asset Manager - Website

As regards the adaptation of remuneration policies, in the absence of further clarification from the regulator, AFG members agree on the following points of interpretation:

a. There is notable scope for varying interpretations of the words "information on how those policies are consistent with the integration of sustainability risks".

b. The regulatory requirement focuses mainly on ensuring that remuneration policies take into account the need to integrate sustainability risks into investment strategies.

c. In practice, at the very least, the remuneration policy must be adapted to:
   - **cover members of the investment management teams (including decision-makers: investment committees, etc.);**
     For example, in terms of the overall annual variable remuneration pool for these employees, by taking into account "sustainability risks" as one of the criteria for determining this pool .
   - **include a feature that aligns the asset management company's incentive scheme with promoting the integration of ESG into its cross-functional processes.**
     For example, explicit consideration of "sustainability risks" as one of the criteria for determining the company's overall annual variable remuneration pool.

d. Depending on the individual strategies of each asset management company, **more targeted approaches** may be considered.
   For example:
   i. *Include criteria for the explicit consideration of "sustainability risks" in portfolio managers' individual objectives.*
   ii. *Extend the above individualised approach to other employees: directors, managers or even all employees (e.g. for smaller firms).*
   iii. *Include criteria for the consideration of "sustainability risks" in the malus criteria applied to deferred remuneration instruments, etc.*

e. The information published on the website may convey the principles set out in the policy without necessarily spelling out the more operational details (which relate to procedures, parameters, etc.).

ARTICLE 6

Transparency of the integration of sustainability risks

1. Financial market participants shall include descriptions of the following in pre-contractual disclosures:

- **the manner in which sustainability risks are integrated into their investment decisions; and**
- **the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available.**

Where financial market participants deem sustainability risks not to be relevant, the descriptions referred to in the first subparagraph shall include a clear and concise explanation of the reasons therefor.

Fund - Prospectus

The AFM recommends that its members use **a standard set of wordings for all the asset management company's funds**. The description of this standard set of wordings should be short, in accordance with AMF Position 2020-03, which permits proportionate language relating to the SFDR's requirements to be used in the prospectus. **The standard descriptions must be tailored to specific characteristics** in terms of geography or sector, for example.

The AFG suggests that its members base this standard set of wordings, for example, on a reference to the exclusion policies in force within the asset management company or on a reference to the monitoring of controversies.

The monitoring of controversies can be conducted without buying data from data providers, but instead, for example, by setting up an alert in search engines on the controversial topics being monitored by the asset management company.

Members are reminded that the description of risk monitoring in the SFDR provides an option to apply the "comply or explain" principle. An asset management company that does not integrate sustainability risks into its management decisions because they are not relevant may specify this in the prospectus, explaining the reasons.

CONTEXTUAL INFORMATION IN THE RECITALS THAT MAY HELP TO REFINE THE RESPONSE PROVIDED:

Recital	Text
5	Disclosures to end investors on the integration of sustainability risks, on the consideration of adverse sustainability impacts, on sustainable investment objectives, or on the promotion of environmental or social characteristics, in investment decision-making and in advisoryprocesses, are insufficiently developed because such disclosures are not yet subject to harmonised requirements.
8	As the Union is increasingly faced with the catastrophic and unpredictable consequences of climate change, resource depletion and other sustainability-related issues, urgent action is needed to mobilise capital not only through public policies but also by the financial services sector. Therefore, financial market participants and financial advisers should be required to disclose specific information regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts.
10	This Regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make precontractual and ongoing disclosures to end investors when they act as agents of those end investors (principals).
12	This Regulation maintains the requirements for financial market participants and financial advisers to act in the best interest of end investors, including but not limited to, the requirement of conducting adequate due diligence prior to making investments, provided for in Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013, as well as in national law governing personal and individual pension products. In order to comply with their duties under those rules, financial market participants and financial advisers should integrate in their processes, including in their due diligence processes, and should assess on a continuous basis not only all relevant financial risks but also including all relevant sustainability risks that might have a relevant material negative impact on the financial return of an investment or advice. Therefore, financial market participants and financial advisers should specify in their policies how they integrate those risks and publish those policies.
13	This Regulation requires financial market participants and financial advisers which provide investment advice or insurance advice with regard to insurance-based investment products (IBIPs), regardless of the design of the financial product and the target market, to publish written policies on the integration of sustainability risks and ensure the transparency of such integration.

Recital	Text
15	This Regulation should be without prejudice to the rules on the risk integration under Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013 and as well as under national law governing personal and individual pension products, including but not limited to the relevant applicable proportionality criteria such as size, internal organisation and the nature, scope and complexity of the activities in question. This Regulation seeks to achieve more transparency regarding how financial market participants and financial advisers integrate sustainability risks into their investment decisions and investment or insurance advice. Where the sustainability risk assessment leads to the conclusion that there are no sustainability risks deemed to be relevant to the financial product, the reasons therefor should be explained. Where the assessment leads to the conclusion that those risks are relevant, the extent to which those sustainability risks might impact the performance of the financial product should be disclosed either in qualitative or quantitative terms. The sustainability risk assessments and related pre-contractual disclosures by financial market participants should feed into pre-contractual disclosures by financial advisers. Financial advisers should disclose how they take sustainability risks into account in the selection process of the financial product that is presented to the end investors before providing the advice, regardless of the sustainability preferences of the end investors. This should be without prejudice to the application of provisions of national law transposing Directives 2014/65/EU and (EU) 2016/97, in particular the obligations on financial market participants and financial advisers as regards product governance, assessments of suitability and appropriateness, and the demands-and-needs test.
18	Where financial market participants, taking due account of their size, the nature and scale of their activities and the types of financial products they make available, consider principal adverse impacts, whether material or likely to be material, of investment decisions on sustainability factors, they should integrate in their processes, including in their due diligence processes, the procedures for considering the principal adverse impacts alongside the relevant financial risks and relevant sustainability risks. The information on such procedures might describe how financial market participants discharge their sustainability-related stewardship responsibilities or other shareholder engagements. Financial market participants should include on their websites information on those procedures and descriptions of the principal adverse impacts. In that respect, the Joint Committee of the European Banking Authority established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council (15) (EBA), the European Insurance and Occupational Pensions Authority established by Regulation (EU) No 1094/2010 of the European Parliament and of the Council (16) (EIOPA) and the European Securities and Markets Authority established by Regulation (EU) No 1095/2010 of the European Parliament and of the Council (17) (ESMA) (the 'Joint Committee'), and financial market participants and financial advisers should consider the due diligence guidance for responsible business conduct developed by the Organisation for Economic Co-operation and Development (OECD) and the United Nations-supported Principles for Responsible Investment.

Recital	Text
22	This Regulation is without prejudice to the rules on remuneration or the assessment of the performance of staff of financial market participants and financial advisers under Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, and Regulations (EU) No 345/2013 and (EU) No 346/2013, or to implementing acts and national law governing personal and individual pension products, including but not limited to the relevant applicable proportionality criteria such as size, internal organisation and the nature, scope and complexity of the activities in question. It is, however, appropriate to achieve more transparency, in qualitative or quantitative terms, on the remuneration policies of financial market participants and financial advisers, with respect to their investment or insurance advice, that promote sound and effective risk management with respect to sustainability risks whereas the structure of remuneration does not encourage excessive risk-taking with respect to sustainability risks and is linked to risk-adjusted performance.
23	To enhance transparency and inform end investors, access to information on how financial market participants and financial advisers integrate relevant sustainability risks, whether material or likely to be material, in their investment decision making processes, including the organisational, risk management and governance aspects of such processes, and in their advisory processes, respectively, should be regulated by requiring those entities to maintain concise information about those policies on their websites.
27	Even though this Regulation does not cover national social security schemes covered by Regulations (EC) No 883/2004 and (EC) No 987/2009, in view of the fact that Member States increasingly open up parts of the management of compulsory pension schemes within their social security systems to financial market participants or other entities under private law, and as such schemes are exposed to sustainability risks and might consider adverse sustainability impacts, promote environmental or social characteristics or pursue sustainable investment, Member States should have the option to apply this Regulation with regard to such schemes in order to mitigate information asymmetries.
28	This Regulation should not prevent a Member State from adopting or maintaining in force more stringent provisions on the publication of climate change adaptation policies and on additional disclosures to end investors regarding sustainability risks provided that the affected financial market participants and financial advisers, have their head offices in its territory. However, such provisions should not impede the effective application of this Regulation or the achievement of its objectives.

The French asset management association
(Association Française de la Gestion Financière – AFG)
represents and promotes the interests of third-party portfolio management professionals. It brings together all asset management players from the discretionary and collective portfolio management segments. These actors manage more than €4,000 billion worth of assets, i.e. a quarter of continental Europe's portfolio management market.

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