association française
des produits d'investissement
de détail et de bourse

European Commission Consultation on the renewed sustainable finance strategy

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French AFPDB position paper

On the occasion of the European Commission Consultation on the renewed sustainable finance strategy, the French association of retail structured product manufacturers (AFPDB) would like to share its views with the Commission.

The AFPDB's contribution to the consultation focuses on questions and topics targeted at experts (Section II) which get specific importance to the structured products industry:

- <u>Specific obstacles in current EU policies and regulations that hinder the development of sustainable finance</u> (question 7)

- <u>Strengthening the foundations for sustainable finance</u>
    - Company reporting and transparency (question 14)
    - Definitions, standards and labels for sustainable financial assets and financial products (questions 25, 29, 30, 33 & 34)

- <u>Increasing opportunities for citizens, financial institutions and corporates to enhance sustainability</u>
    - Mobilizing retail investors and citizens (questions 49 & 50)
    - Better understanding the impact of sustainable finance on sustainability factors (questions 52 & 53)

<u>**This AFPDB position paper provides additional information to the online questionnaire, and notably on the questions 7, 34, 50, 52 & 53.**</u>

Consultation document:
https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2020-sustainable-finance-strategy-consultation-document_en.pdf)

AFPDB Reply

Question 7: Overall, can you identify specific obstacles in current EU policies and regulations that hinder the development of sustainable finance and the integration and management of climate, environmental and social risks into financial decision-making?

While the EU Community has rightly identified the need to support sustainable finance, ***EU policies and (draft) regulations often suffer from a biased approach. All too frequently, they unduly favor one specific type of ESG strategy or one particular class of financial products over the other ones, failing to develop a global, balanced view of ESG issues***.

This bias is quite unfortunate. No one-size-fits-all approach of ESG is the appropriate approach to foster growth in this still-nascent sector.

In order to nurture a truly functional ESG ecosystem, a more holistic view is required that better acknowledges the variety of funding needs and the symbiotic interdependencies between the various related ESG strategies and instruments.

To this end, EU policies ought to better take into account the following principles:

- ***ESG projects may require diverse types of funding and hedging*** relying on an equally gamut of tools (i.e. debt or equity capital instruments, funds, structured notes...). Also these investments may need to be accompanied by tailor-made derivative hedging solutions, depending on the nature of risk involved (e.g. credit, forex, country or sectoral risk).

- ***Funding ESG projects involves both primary and secondary market solutions.*** While small size projects may be limited to a direct loan or an equity capital injection, larger-size infrastructure projects will require some form of pooling and repackaging in order to be ultimately distributed to a larger public. As for other economic sectors, ***the sustainability of the ESG funding will hinge upon the financial sector ability to establish a perennial transformation cycle connecting the diverse primary market needs to large secondary markets.***

- To this end **it is crucial to consider both, direct and indirect ESG investments as the two complement each other.** There will be no sustainable ESG investment market if one does not promote the various solutions that allow primary investors to exit their initial investments in order to free up their balance sheet capacity and allow to reinject their returned capital back into sustainable projects.

- But **a mature reflection upon the ways to scale up sustainable finance must also take a better account of the variety of investors' needs.** In the wake of the implementation of product governance regulations as part of the IDD and MIFID2 directives, it is important to favour ESG regulations that effectively permit to address the diversity of target markets, especially when addressing retail investors. Indeed, as an example, while some investors may choose to invest exclusively in small-scale impact -finance community project, others will prefer more mutualised approaches (e.g. ESG UCITS) or capital or coupon-protected ESG structured notes that better suit their risk appetite or their -limited- ability to bear losses.

In light of the above, the AFPDB would urge the EU to adopt a more balance view of ESG products and strategies. This balanced approach is already the one that ESG structured products manufacturers apply to their own products when they generally recommend that they should offered as part of a portfolio diversification strategy. This investor protection principle is key and, as part of sound risk mitigation practices, no ESG retail investor should be invited to invest his/her entire portfolio into one single class of assets.

The need to incorporate a broader product spectrum in EU ESG strategies should also be better reflected in the current draft ECOLABEL and Sustainable Finance Disclosure Regulations. At present, the EU reflection upon the various asset classes is unfairly restricted. Structured products are simply not included. This deficiency may result from a misunderstanding or an unduly biased perception of their characteristics, their functioning and their specific protective features (e.g. full or conditional capital protection). Ultimately, this exclusion presents **the risk of depriving both, retail investors and the economy at large from a very long-established tool that could usefully contribute to the achievement of a successful ESG agenda.** Indeed, structured product currently play a significant role in supporting the green transition of our economy notably through the various ESG-index strategies. By doing so, structured products channel important flows of investments towards ESG objectives and contribute to sustaining the liquidity of the underlying listed companies that implement this ESG agenda.

Consequently, the AFPDB hence wishes to stress that structured products should be strictly made part of the asset landscape potentially eligible for a positive sustainability assessment under the various EU regulatory frameworks.

Question 14: In your opinion, should the EU take action to support the development of a common, publicly accessible, free-of-cost environmental data space for companies' ESG information, including data reported under the NFRD and other relevant ESG data?

Yes.

The AFPDB strongly supports any efforts aiming at more coherence of data related to the ESG impact of business activity and taken as a basis for sustainability-related assessments, in both the regulatory and commercial context.
Given the current lack of standardisation of such information the AFPDB would be in favour of creating EU dataspace for such data which may serve as a central hub/ entry point to access it for third parties, including other private sector participants.
However, to avoid the current level of information inconsistency perpetuating within the newly created data source, the AFPDB would favour to combine the establishment of such dataspace with developing a **minimum data entry standard** that ideally should be based on existing legal ESG reporting requirements of private-sector financial and non-financial companies, and could go beyond. Ultimately, the data entry standard should allow for informed decisions on sustainability-related aspects in both the regulatory and commercial context.
The delivery of data into the hub should be done by way of using template formats, which could be developed by the industry falling back on existing platforms developed for exactly this purpose, such as FinDatEx (www.findatex.eu).

Question 25: In those cases where a prospectus has to be published, do you believe that requiring the disclosure of specific information on green bonds in the prospectus, which is a single binding document, would improve the consistency and comparability of information for such instruments and help fight greenwashing?
Please express your view by using a scale of 1 (strongly disagree) to 5 (strongly agree)

1 (strongly disagree).
The AFPDB clearly speaks out against adding (more) specific information on green bonds in the prospectus.

Currently, the prospectus describes the Green Bond Framework (GBFW) in general terms and makes reference to it by way of an external link. However, the GBFW is not formally made part of the prospectus. In our eyes, this is the better solution also from the investor´s perspective as updates to the Green Bond Framework, which are to be expected more frequently going forward in line with the ESG evolution, can better be followed than under a formal embedding of GBFW-rules into the prospectus. Furthermore, adding additional information would render the prospectus approval procedure more complicated thereby increasing the liability risks for the issuer.

Question 29: Should the EU establish a label for investment funds (e.g. ESG funds or green funds aimed at professional investors)?

No.
The AFPDB is very aware of the importance of minimum EU standards for the asset sustainability assessment. However, it does not support a centralised system in which the positive sustainability assessment of each asset is being conditioned upon its submission to one specific national or EU ESG label.
The AFPDB is rather supportive of an enhanced disclosure framework pursuant to which each financial institution clearly states its ESG methodology or criteria.
Also, the AFPDB expresses concerns over an EU approach of ESG labels that could unduly introduce biases towards certain product types and unfairly exclude others.

Question 30: The market has recently seen the development of sustainability-linked bonds and loans, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. This approach is different from regular green bonds, which have a green use-of-proceeds approach. Should the EU develop standards for these types of sustainability-linked bonds or loans?

1 (strongly disagree)

The AFPDB and its members have well taken note of the broad and evolving landscape in ESG-related financial instruments.
Given the existence of many incongruent standards/labels and diverging practices in the European markets of today, the AFPDB would speak out <u>against</u> the hasty introduction of further regulatory frameworks. Rather would we encourage the law-making institutions to exhaustively probe the market and carefully evaluating the costs and benefits of any effort to standardise financial instruments (This applies in general but with a particular draw on ESG aspects).

Question 33: The Climate Benchmarks Regulation creates two types of EU climate benchmarks - 'EU Climate Transition' and 'EU Paris-aligned' - aimed at investors with climate-conscious investment strategies. The regulation also requires the Commission to assess the feasibility of a broader 'ESG benchmark'. Should the EU take action to create an ESG benchmark?

No
The AFPDB does not support the creation of an ESG benchmark.
The ESG index landscape is a highly dynamic area whose constant evolution follows and also drives the ESG topic's further development in its single subdomains of environmental, social and governance evaluation criteria.
Within the business landscape of index providers, many private sector players, both traditional ones as well as specialised firms, have these days established their business model competing under free-market conditions for the best solutions that satisfies specific investor demands. An ESG benchmark created somewhat artificially by the EU institutional level would heavily impact this business landscape without adding any value. It would be near to useless in terms of catering for the highly diverging investor/buy-side requirements following the many specific/individual ESG-approaches used in the marketplace.

Question 34: Beyond the possible standards and labels mentioned above (for bonds, retail investment products, investment funds for professional investors, loans and mortgages, benchmarks), do you see the need for any other kinds of standards or labels for sustainable finance?

No.

The AFPDB would, outside the area of establishing a minimum data entry standard for private company related ESG-information to be collected and accessed through newly created EU dataspace (see above answer to question 14), not see the need for introducing further standards or labels.
More generally the AFPDB wishes to underline that the landscape of ESG-related labels and standards varies already in terms of origin, regulatory/legal referencing, product scope and applied technical methodology. It is highly complex and difficult to understand already for experts in the field, leaving alone the average retail investor.
Instead of adding to this red tape, the AFPDB would encourage lawmakers to engage in fostering coherence at least of ESG assessment criteria/standards used in the various EU rulesets. The EU Taxonomy Regulation, for example, surely has been a highly useful addition in that sense. However, divergences persist between other relevant EU rules and rulesets as, for example, the ECOLABEL, MIFID ESG rules relating to product information at the point of sale and the EU Disclosure Regulation, all of which differ in terms of their product scope, only to illustrate our argument by way of example.

Question 49: In order to ensure that retail investors are asked about their sustainability preferences in a simple, adequate and sufficiently granular way, would detailed guidance for financial advisers be useful when they ask questions to retail investors seeking financial advice?

No.

The AFPDB would not support detailed guidance for financial advisers. Against introducing such speaks already that the ESG landscape is under permanent evolution and features strong national market specific constraints that are of paramount importance in the distribution process, thereby making centralised EU-level guidance rather less adequate. Even more important though is that the individual preference and understanding of investors in terms of what ESG means to them are highly diverse thus making an overly detailed guidance of the financial adviser potentially also less relevant.

Question 50: Do you think that retail investors should be systematically offered sustainable investment products as one of the default options, when the provider has them available, at a comparable cost and if those products meet the suitability test?

No.

The AFPDB is strongly opposed to such an approach. Not only would such a default offering contradict current MIFID rules which do not give (nor allow for) a preference between ESG and non-ESG financial products.
A default offering of ESG products could further lead to a biased investment landscape in which an unduly high-risk exposure (in ESG assets) is allocated over time to a large part of the retail investor audience. This evolution is to be expected at least in case of a rather narrow thematic focus of ESG products (e.g. with a very high degree of taxonomy-conform activities).This danger (of ill-

allocated risk) potentially even aggravates if any such default option would be built into automated ("robo") advice-linked algorithms used to a growing degree by retail customers in today's markets.

Question 52: In your view, is it important to better measure the impact of financial products on sustainability factors?

No.
The AFPDB would not see a need to fundamentally improve the impact measurement of financial products. Actually, in our eyes, the standards used within the EU on assessing the impacts of specific instruments allocating investment to an impact purpose (such as Green bonds) are already very advanced and sophisticated, often setting the scene for the international ESG landscape.
The AFPDB also would like to stress the role rating agencies have in the context of above question. As much as the differences in their methodologies makes it necessary to evaluate their assessment in detail, this also creates a welcome situation as each rating agency strives for the best/most adequate approach thereby, following free market principles, improving the overall quality of ESG-assessment further through "competition for quality".
Finally, The AFPDB makes reference here again to the statement given in answering question 14, that minimum data entry standards are of high use when centralising ESG-related company information in newly created data space with the aim to allow for better qualitative judgements. "

Question 53: Do you think that all financial products / instruments (e.g. shares, bonds, ETFs, money market funds) have the same ability to allocate capital to sustainable projects and activities?

Yes.

As expressed in our answer to question 7, the AFPDB believes that there is no one-size-fits-all approach of ESG financing.

As the ESG project's funding and hedging needs are diverse, so should the product offering.

In this regard, it is important to note that the true scaling-up of ESG finance will be highly dependent on the ability to secure both a primary and a secondary market for ESG investments.

Also, in order to embark all economic players in the EU ESG policy it is crucial to adopt a holistic view of ESG strategies that duly includes those contributing to the transition of our economy and society towards a more sustainable model.

In this perspective, it is more important to consider both the direct and indirect contribution of products to the capital allocation towards sustainable activities and projects.

Structured products have a role to play in ESG finance alongside other primary and secondary market instruments. They currently already support the transition of our economies notably through the various ESG-index strategies that they promote. By doing so, structured products channel important flows of investments towards ESG objectives and contribute to sustaining the liquidity of the underlying listed companies that implement this ESG agenda.

About the AFPDB

The AFPDB (French association of the structured and listed retail investment products) represents the interests of the main issuers of structured products that distributed in France. Their product range includes both exchange traded securitised derivative products, such as warrants, turbos and certificates, and structured products (e.g. EMTN) distributed through public offering or private placements.
The main goals of the association are:

- Promoting and contributing to the development of this industry on the French and European markets;
- Representing and advocating for the industry's interests, notably with the public authorities and regulators, the regulated markets and other trading venues and the other industry associations, as the AMAFI;
- Promoting the use of common industry standards, notably as regards product typology, in cooperation with other European associations;
- Collecting, producing and keeping up-to-date statistics and studies on the French structured product market.

The AFPDB members commit to comply with the AFPDB Code of conduct and to implement the product to polity as laid out by the AFPDB (European Structured Investment Products Association) to which the AFPDB is affiliated.
The AFPDB Legal and Regulatory Committee actively contributes to the marketplace reflections on work-streams concerning the showing and distribution of structured products.
Industry workshops involving both manufacturers and distributors are periodically organized by the AFPDB. They contribute actively to industry proposals in areas such as the implementation of the main regulations, the investor education programs, the disclosure and communication of key product information to, respectively, distributors and final clients.

Information, news and publications: www.afpdb.org

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