Final response to European Commission's consultation on SFDR implementation: Executive Summary

# Executive Summary

The Institutional Investors Group on Climate Change (IIGCC) welcomes the opportunity to respond to the Commission’s targeted consultation on the implementation of the Sustainable Finance Disclosure Regulation (SFDR). IIGCC is the leading European-focused investor membership organisation for collaboration on climate change. IIGCC has over 400 members across 27 countries (including a substantial EU-based membership), representing more than €65 trillion in assets. We primarily represent institutional investors – mostly asset managers and pension funds – and our response to the consultation is framed with these stakeholders in mind. We are not responding to the consultation as a direct financial market participant, and our responses on specific sustainability-related components of the consultation focus primarily on climate and wider environmental factors.

IIGCC welcomes the overarching aims and intent of the SFDR. The regime is a fundamental component of the EU’s sustainable finance architecture, and a key tool for increasing transparency over sustainability-related risks and opportunities, tackling greenwashing, and ultimately reorienting capital in line with the transition to net zero. However, investors have faced a number of challenges and barriers in relation to their implementation of the SFDR, and we welcome this wide-ranging review that we hope will help to improve the functioning and clarity of the framework. In particular, we urge the Commission to consider and account for the following positions and recommendations:

**Clarifying the definition of ‘sustainable investments’ under SFDR and adequately accounting for investment in transitioning assets**

As the Commission has noted, the EU will require around EUR 700 billion of additional annual investment to meet the objectives of the Green Deal, REPowerEU and the Net Zero Industry Act, the majority of which will come from private finance. Reorienting capital towards sustainable investment is a key aim of the EU’s Sustainable Finance Action Plan, and SFDR is one of the main policy tools designed to achieve this aim. However, there remains a lack of clarity as to whether transitioning assets, and transition-focused investment strategies, can be treated as ‘sustainable’ under SFDR. To facilitate a whole-of-economy transition, it will be essential for the Commission to fully recognise and embed the concept of transition finance within the framework.

We acknowledge the Commission’s efforts to clarify this issue through [Q&As](https://www.esma.europa.eu/sites/default/files/2023-05/JC_2023_18_-_Consolidated_JC_SFDR_QAs.pdf), and welcome the recent publication of non-binding guidance and definitions for transition finance. However, the continued lack of prescription, particularly for investments covered by transition plans, has meant that investors continue to interpret this concept broadly and lack the certainty needed to pursue much-needed transition focused investment strategies with confidence. For example, it could be interpreted that investments with credible, science-based transition plans would not, according to the Commission, ‘be considered as sufficient’ unless they meet Do No Significant Harm (DNSH) test today (rather than in the future). In IIGCC’s view, this could limit the capacity of investors to hold assets that may be carbon-intensive today, but which have the potential to align with net zero over time. It is precisely these types of assets whose transition will deliver the greatest impact on real world emissions reductions, and it is important that SFDR acknowledges that investment in these assets is a credible way of contributing to sustainability objectives and reorienting capital towards the transition.

However, we emphasise the need to assess the credibility of transitioning assets against appropriate, robust criteria, otherwise there is a risk that such assets ‘transition’ indefinitely without making any meaningful progress on achieving emissions reductions. Progress against the criteria for transition plan disclosures as set out in the European Sustainability Reporting Standards (ESRS) would be a good example of a credible standard for assessing transition progress, as well as the indicators established under the [Climate Action 100+ Net Zero Company Benchmark](https://www.climateaction100.org/wp-content/uploads/2023/03/Climate-Action-100-Net-Zero-Company-Benchmark-Framework-2.0..pdf).

**Clear categories and criteria for products pursuing sustainable objectives or promoting environmental/social characteristics**

We strongly agree with proposals to introduce some form of product categories and criteria for assessing the sustainability performance of assets under SFDR. This would enhance the credibility of funds pursuing sustainable investment objectives or promoting sustainability characteristics. It would also help to address ongoing issues in the market wherein SFDR is being used as a de facto labelling regime, despite being designed as a disclosure regime with limited prescriptive requirements.

It should be noted that investors and wider financial market participants have spent considerable time and effort, at cost, to implement SFDR and a complete overhaul of the framework may therefore be suboptimal. With regards to the options presented by the Commission, our preference would be for a ‘hybrid’ approach that builds on existing concepts and requirements where possible while recognising the need for clear, transparent and credible product categories, underpinned by robust criteria. Of the categories proposed by the Commission, we are supportive of categories A, B and D, However, we have reservations about the credibility of category C, noting that while exclusions may form *part* of a sustainable investment strategy, in and of themselves they should not qualify as the basis for such a strategy.

We strongly encourage the Commission to introduce a ‘mixed’ or ‘blended’ category that combines elements of one or more of the proposed product categories (e.g. investment in assets meeting a credible standard of sustainability *and* investment in assets that have the potential to improve their sustainability performance over time).

Lastly, we agree that a baseline level of sustainability disclosure for all financial products, irrespective of their sustainability claims, would be helpful for increasing transparency. It may also help to address concerns that FMPs pursuing sustainable investments are left at a competitive and cost disadvantage through the additional disclosures they are required to make compared to FMPs who do not pursue sustainable investments. These baseline disclosure could include the integration of sustainability risks into the investment process and a limited number of principal adverse impact indicators (e.g. total GHG emissions).

**Addressing usability and implementation challenges with the existing framework**

FMPs have undertaken extensive work to implement SFDR since it entered into force in March 2021. However, a lack of clarity over key definition and concepts, and sequencing challenges that have reduced the availability and quality of relevant data, have led to divergent interpretations of the requirements and increased the cost and complexity of implementation. This consultation provides an opportunity to provide greater certainty and clarity over underpinning concepts, assess the relevance of certain disclosures (e.g. entity-level reporting on principal adverse impacts) and promote coherency between SFDR and the wider regulatory framework for sustainable finance.

**Promoting interoperability with wider disclosure regimes**

Interoperability and compatibility between SFDR and wider sustainability disclosure regimes is essential for investors with global horizons who seek to allocate capital on a cross-border basis. It is imperative that policymakers mitigate the risk of fragmentation and reduce reporting burdens for FMPs, and enable FMPs to assess the sustainability credentials of investees on a like-for-like basis. In particular, we encourage the Commission to take stock of the FCA’s proposals for Sustainability Disclosure Requirements and investment labels, and encourage ongoing engagement with counterparts in other jurisdictions to support alignment.