
AFME response to the European Commission targeted consultation on the implementation of the Sustainable Finance Disclosure Regulation (SFDR)

15 December 2023

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the European Commission's targeted consultation on the implementation of SFDR (the "Consultation Paper"), which is an area of key importance for AFME members. Due to the nature of the consultation, which includes various questionnaire style responses, we have not completed the individual questions but have instead set out below views from our members on the key high level policy points.

AFME members welcome the opportunity to comment on the proposals and the overall direction of travel for the potential reforms to the SFDR regime. Comments have been provided in the time allowed however we note that some of the proposals put forward in the Consultation Paper represent a potentially fundamental shift in the approach required under SFDR. We therefore wish to highlight the need for separate consultation on any proposals that the European Commission decides to take forward in order to allow stakeholders to provide detailed feedback on the details and more granular requirements of any specific changes.

AFME members also wish to emphasise the importance of taking the opportunity as part of the SFDR review to streamline the regime and ensure coherence with other legislation in order to better facilitate the overall policy aims of SFDR, which we discuss further in our responses below.

Response to section 1.2: Do you think the SFDR disclosure framework is effective in channelling capital towards investments considered sustainable, including transitional investments ('investments considered sustainable' should be understood in a broad sense, not limited to the definition of sustainable investment set out in Article 2(17) of SFDR)

SFDR does not currently adequately take account of how capital market activity affects companies' decision making in the real economy. SFDR covers exclusively: (i) the provision of lending and cash products, omitting the role of derivatives and secondary markets in allocating capital to the real economy; and (ii) certain specific types of managed financial products listed under article 2(12), omitting other investment products such as structured products which play an important role in allocating EU retail savings to the economy.

We recommend, as ISDA has proposed¹, that a common methodology for the measurement of derivatives is developed across the three SFDR ratios: PAIs, Taxonomy and Sustainable Investments. We encourage further work to achieve this through continuous collaboration between the Platform on Sustainable Finance, the European Commission, the ESAs and relevant industry stakeholders.

The fact that MiFID recognises that MiFID instruments can address clients' sustainability preferences demonstrates that SFDR products are not the only ones capable of channelling capital towards the sustainable economy, hence calling for a recognition of non-fund products (e.g. structured products, derivatives) in the sustainable regulatory framework and alignment of rules.

¹ See ISDA's [response](#) to the Joint ESAs Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures, 4 July 2023

Response to section 4: Potential establishment of a categorisation system for financial products

The experience of AFME members in practice since SFDR came into effect aligns with the observations set out by the European Commission in the Consultation Paper that, despite the policy intent for the SFDR product level regime to function as a disclosure and transparency regime, in practice Articles 6, 8 and 9 of SFDR are being used as de facto product labels. This disconnect between the original policy intent underpinning the SFDR product level regime and the effect of the regime in practice has resulted in a number of challenges, both for firms subject to the requirements of SFDR as well as for investors looking to interpret, compare and utilise the disclosures when making decisions in relation to the allocation of capital. In particular, as the product level regime wasn't designed as a labelling regime, the natural consequence of this in practice has been that the Article 6, 8 and 9 requirements do not currently provide a sufficient basis for a labelling regime to operate effectively and have not resulted in an efficient or effective system for investors' understanding of sustainability matters.

In light of these challenges, which are well recognised in the market, in particular in relation to the breadth and variation of funds and other investment products that apply the Article 8 categorisation, AFME members support the aims of the Consultation Paper to address these challenges and evolve the SFDR regime in a way that produces better outcomes for investors and which is also more efficient, consistent and effective for firms subject to SFDR to apply in practice.

Whilst AFME members support the evolution of the SFDR regime in this way, members also wish to highlight that SFDR has been highly complex to implement. This has resulted in significant time and costs that have already been committed to the implementation of the SFDR product level regime, not just in relation to making and maintaining the relevant disclosures, but also the significant on-going costs associated with maintaining the policies, procedures, governance and resources necessary to ensure on-going compliance with the SFDR product level requirements. AFME members would urge the Commission to take this into account when considering any amendments to the regime in order to avoid a disproportionate burden on firms in scope including, where possible, by leveraging the work already done by firms to implement SFDR so far. Minimising the cost to firms subject to SFDR will also reduce indirect cost to investors.

AFME members would also urge the Commission to carefully consider the approach to grandfathering as the transition between the existing regime and any updated expectations has the potential to cause significant confusion for investors, particularly if the 'existing' product level regime has to operate side by side with any amended requirements for a transitional period. In particular, the breadth and range of different approaches and methodologies already put in place by financial market participants to comply with the existing SFDR requirements is very wide and therefore further changes in this regard have the potential to cause significant confusion and uncertainty for investors in relation to the meaning and application of the product level classifications, risking further damage to confidence in these classifications and in turn undermining the overall aims of SFDR. Accordingly, this emphasises the need for an effective grandfathering and transition period for any changes made to the SFDR product level regime.

Whilst AFME members do not wish to see the time, effort and costs already spent on implementing and complying with SFDR lost, members also recognise that amending the regime represents an opportunity to address the issues identified and move to a regime which is more efficient and cost effective in the long term. Accordingly, AFME members would support a review of SFDR aimed at reconciling its design as a disclosure regime against its use as a de-facto labelling regime. In this regard, AFME members would support an approach to product level classification that mirrors existing investment strategies and how end-investors define their sustainability preferences. More broadly, MiFID II and IDD ESG preferences should be fully consistent with SFDR as well as the EU Benchmarks Regulation, the EU Green Bond Standard and the PRIIPs Regulation.

The introduction of clear and binding product classifications that investors can better understand would: (1) enable better alignment with investor expectations and objectives; (2) provide a clearer basis for expressing the sustainability features of a financial product in practice; and (3) serve to mitigate some of the potential greenwashing risks associated with current market practice (of using SFDR as a de facto labelling regime) as identified in the Commission's Consultation Paper. In respect of greenwashing in particular, ensuring investment strategies are clear and binding, in order to leverage the use of a classification (which is also a clear descriptor of what is actually occurring in the investment process), may be able to address this.

This approach would also simplify the application of the requirements by preparers, who would be able to better reflect their strategy and approach in the disclosures, as well as ensure that fund labels facilitate the assessment of clients' sustainability preferences and support the identification of suitable products for the purpose of distributing sustainable investment products to end-investors, including retail investors. AFME members believe that SFDR, as drafted, is not retail investor friendly, and therefore a review of the regime would be an opportunity to address this by making the underlying concepts that support the classifications less complex and more accessible to retail investors. This will help to ensure alignment between the obligations applicable to financial market participants under SFDR and the sustainability related obligations applicable to, for example, manufacturers and distributors of financial products under the MiFID II requirements.

It is also important that a revision to SFDR facilitates the types and variety of investment scenarios and investment needs of investors, rather than a purely hierarchical approach to classification. For example, in order to recognise and support the importance of transition assets, AFME members consider that any product categorisation system should include a specific sub-category relevant to transition. For instance, classifications could distinguish between products that pursue sustainability objectives to invest in assets that are either:

- a) already sustainable, as measured by credible metrics, or
- b) have the potential to improve their environmental or social credentials, in accordance with a credible transition pathway.

The first sub-category provides flexibility to capture the variety of different approaches to sustainable investment and the latter would capture transition investment thereby filling one of the gaps identified in the concepts set out in the current SFDR product level regime.

Global fragmentation in ESG regulation remains an on-going issue and a barrier to achieving the ultimate aims of the sustainable finance transition. In addition to the requirements of SFDR, firms also need to take into account the global requirements that they may be subject to when making product level disclosures. Fragmentation, lack of alignment and incomparability across global product level disclosure requirements also creates significant confusion and complexity for investors. Accordingly, as the European Commission reviews SFDR and considers potential changes to the product level regime, having regard to developments in other jurisdictions (such as the proposals from the US SEC in relation to sustainable investment funds and the UK FCA's Sustainability Disclosure Requirements and investment labels regime) with a view to maximising interoperability would be a significant means of achieving better outcomes in this regard and is therefore an approach that is strongly supported by AFME members.

Response to section 3.1: Entity level disclosures

Are these disclosures useful?

In relation to the disclosures required under Articles 3 and 5 of SFDR, the lack of comparability and consistency across these disclosures can make it difficult for firms to compare and draw conclusions from the information provided relevant to their investment decision making.

In relation to the disclosures required under Article 4 of SFDR, this information has proven challenging for preparers to source and collate the data in practice. While firms must follow a prescribed disclosure template, firms tend to have diverse investment strategies, including those which are sustainability focused and those which are not, depending on client preference. Disclosure at entity level regarding how the firm takes principle adverse impacts on sustainability factors into account, in relation to all its investment decisions, is only useful where these disclosures are comparable. Yet, as firms have very different and bespoke investment strategies, these disclosures are often not comparable in practice. Statements often include disclaimers and exceptions to clarify information related to the firm's structure, resulting in unclear or less user-friendly disclosures despite the resource and effort firms expend making these disclosures.

In this context, is the SFDR the right place to include entity level disclosures?

As noted in the Consultation Paper, both SFDR and the Corporate Sustainability Reporting Directive (CSRD) introduce entity level disclosure requirements with a double-materiality approach. CSRD and its European Sustainability Reporting Standards (ESRS) have been designed to capture datapoints required by other pieces of EU sustainable finance legislation, including SFDR. Accordingly, AFME members consider that the SFDR entity level disclosure requirements should be reviewed in light of the ESRS and consideration given to streamlining these where the SFDR disclosures do not add additional benefit beyond what is required under CSRD.

To what extent is there room for streamlining sustainability-related entity level requirements across different pieces of legislation?

AFME members strongly support the streamlining of sustainability-related entity level requirements across different pieces of legislation in order to promote efficiency, effective comparability and to minimise fragmentation. In particular, members consider that there is a significant opportunity to streamline the entity level disclosure requirements of SFDR and CSRD and would strongly support consideration of where this can be achieved as part of the review of the SFDR regime. To the extent that entity level requirements are retained within SFDR, members strongly emphasise the need for SFDR to be aligned with CSRD and the ESRS in terms of definitions, timings and materiality rules.

Response to section 3.2.1: Standardised product disclosures - Should the EU impose uniform disclosure requirements for all financial products offered in the EU, regardless of their sustainability-related claims or any other consideration?

AFME members consider that, as a primary focus, the SFDR product level disclosure requirements should be streamlined and rationalised as set out in our above comments. This would help to reduce the long-term costs for producers, and consequently for investors, and to facilitate a more consistent and cohesive regime. As a secondary matter, consideration could be given to extending some simplified disclosures to products that do not use a product category / label, but that nevertheless integrate ESG considerations to some extent, to facilitate the provision of material ESG information that is relevant for end-investors. This could include any

material (clear, fair and non-misleading) sustainability-related information with the option to use a voluntary template but retaining flexibility in relation to the format and content of such disclosures to take into account the wide range of products and information that such disclosures need to accommodate.

About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.²

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² AFME is registered on the EU Transparency Register, registration number 65110063986-76