

EBF response to the SFDR consultation

Key considerations

13 December

Introduction

The SFDR's broad objectives are still relevant. However, we have identified a number of key shortcomings with the interpretation and implementation of existing requirements and welcome the consultation as an opportunity to strengthen the effectiveness of the Regulation. We have set out recommendations aimed at improving the usability of the framework and transparency for end-investors, with a particular focus on retail investors.

The current set-up of the SFDR has number of key shortcomings:

- the disclosures are too complicated and not user friendly for end investors, especially retail investors
- it is not cost efficient- the costs associated are disproportionate to the benefits
- data gaps including from non-listed companies and projects in emerging markets
- it does not always support the assessment of clients' sustainability preferences in accordance with MiFID rules.
- coherence with other pieces of EU Sustainable Finance Framework should be improved

In general, we believe the SFDR **has not been working adequately**. In many instances it has been used as a proxy labelling and marketing tool. Proprietary methodologies, while being essential to leverage on the innovation capability of the market and should not be prohibited, makes comparisons quite challenging.

The **legal requirements and concepts are not sufficiently clear**. The interpretation of concepts and methodology of disclosures (e.g., for PAIs) vary between financial market participants, which makes it hard to compare.

Examples:

- The overarching concept of “sustainable investment” is open to interpretation and each national competent authority has a view on how it should be used in practice. There are diverging approaches to determining and calculating sustainable investments currently present in the market.
- Supervisors also interpret certain other concepts differently, such as the PAI consideration at fund level. (currently, it is unclear what it means “to consider”).
- Derivatives’ contribution in funds’ reporting is inconsistently recognized across the 3 SFDR metrics (PAI, Taxo alignment and SI) and reporting methodology is unclear.
- Other concepts are not sufficiently clear, such as “ESG” or “Promote ESGS characteristics”. In addition, as no minimum criteria has been identified to assess exact meaning, we face a large diversity in Article 8 products with no means to validate this qualification.

We therefore see the most value of this review in improving clarity, embedding a principle-based approach across the regime for removing overlaps with other entity-level disclosure requirements and defining more proportionate and decision useful product-level disclosure requirements accordingly. If a categorization system is introduced, it is important that the current transparency requirements in the regulation (when it comes to external transparency reporting) are reduced. The addition of a categorization system on top of the current transparency requirements is consequently not suitable.

Overall, the SFDR review should be **based on a pragmatic approach with emphasis on the need of retail investors**. Keeping in mind that extensive resources have already been used to implement the SFDR, we advocate for **building as much as possible on elements that have become familiar to the market** as well as aligning with global financial market initiatives where possible. It would be important to ensure that the categorization accommodates the majority of products **with sustainability characteristics on the market** while not preventing further innovation and **includes a transition finance aspect in the categorization system with clear criteria that prevent greenwashing**.

The information should be **simplified and made user friendly** to support in particular retail investors in finding financial products that match their sustainability ambitions. The current disclosures are overwhelming and too complex for most investors to enable them making informed decisions. The existing disclosure complexity also poses several concerns for market participants such as legal uncertainty and reputational risks.

Distributors also have challenges in providing a balanced palette of products with varying sustainability profiles of the products they distribute due to the **difficulty of comparing products on their disclosure information**.

To **enhance the understanding of investors, in particular retail investors, the interaction of the SFDR with other pieces of the EU Sustainable Finance Framework need to be considered holistically.** Consistency between SFDR, MiFID and PRIIPS KID is important. The criteria set for the ESG benchmarks, and the criteria defined for sustainability product categories should also be closely aligned. The products passively tracking a PAB or a CTB should automatically be deemed to satisfy the criteria of a future sustainability product category, but this does require the PAB and CTB requirements to be brought in line with the requirements on biodiversity and human rights expected under SFDR.

Costs

Regarding the one-off and recurring annual costs associated with complying with the SFDR disclosure requirements it may be challenging to provide accurate figures given the complexity to attribute costs for personnel. This is because usually only part of the total working time of employees is dedicated to SFDR requirements. The external costs for data providers are also challenging to allocate as some of the data was used also prior the SFDR implementation.

A significant proportion of these costs was associated with the difficulty of interpreting and implementing some of the key principles and definitions underpinning the regime, and the legal costs associated with obtaining counsel or reclassifying products in accordance with each new iteration of interpretative guidance issued by the Commission or the ESAs.

Despite the challenges to allocate costs, SFDR has led to a structural increase in costs for sustainable financial products. It must be **avoided that the revision of the SFDR further increases costs for clients that want to invest sustainably.** This is all the more relevant for portfolio management services where the costs are not borne by numerous investors.

Data gaps

The FMPs are still facing difficulties in obtaining good-quality data, especially regarding:

- the proportion of taxonomy-aligned investments at product level.
- the contribution to an environmental or social objective,
- element of the definition of ‘sustainable investment’ at product level
- entity level and product level PAIs, including when assessed in the context of DNSH test.

Concerning the use of estimates, the SFDR is rather flexible in allowing their use, although the level of clarity on what kind of estimates is rather limited. FMPs are usually using entity level PAIs / taxonomy aligned investments (product level)/ sustainable investments (product level estimates from data providers based on data coming from the investee companies (same for taxonomy aligned investments) or from other source and external ESG score models. The

engagement with investee companies to encourage reporting of the missing data varies widely.

The main limitation concerns disclosure by issuers, in particular in certain geographies with the lack of binding regulation on sustainability reporting. This is particularly challenging for impact funds in emerging markets and novel or small investees. To meet this challenge, banks have to **rely on data providers** that also provide estimated data as there is **no public information available from issuers but this is not possible for most non-listed investments where investors must rely on gathering data and making estimates** which is further increasing costs. This is especially important for taxonomy data and PAI. The challenges are **further aggravated by the mismatch between different legislative pieces** of the EU sustainability frameworks and the timeline for corporate reporting under CSRD which are subject to a materiality assessment and will only be available at a later stage.

Entity level disclosures

There is room for **streamlining sustainability-related entity level requirements across different pieces of legislation** mostly regarding to contents, timing, and materiality assessment. In addition, the scope of these regulations differs. For instance, the SFDR disclosures are required at entity level, while CSRD disclosures may be required at consolidated level. As a result, for complex firms, statements published in accordance with articles 3 and 4 of SFDR capture simultaneously different lines of business, all with different approaches to considering adverse sustainability impacts of investment decisions on sustainability factors. Statements must then be filled with disclaimers and exceptions to clarify information related to the firm's structure which will not be relevant to end-investors - becoming unclear, dissonant, and not user-friendly as a result.

We see therefore room for streamlining sustainability-related entity level requirements across different pieces of legislation by relying on entity-level CSRD disclosures and product-level SFDR disclosures. There is a high degree of overlap between SFDR and CSRD and we recommend that SFDR is revised accordingly. The ESRS have been designed to capture all datapoints required by other pieces of EU sustainable finance legislation.

Both entity and product level sustainability disclosures can support investor decision-making. However, disclosures about investments should be at product level as investors ultimately need information to choose which financial product to invest in. Entity level indicators that are considered the least useful are those which still have very low coverage such as activities negatively affecting biodiversity-sensitive area, radioactive waste ratio, exposures to water, hazardous waste, gender pay gap. The coverage for some PAI's is too low to be meaningful at the moment.

If entity level indicators were to remain in the SFDR, it is important that SFDR indicators should be simplified and aligned with CSRD/ESRS in terms of PAI definitions, calendar, and materiality

assessment rules. This will improve the data quality, coverage, and comparability of the SFDR reporting significantly.

Given the materiality approach in the CSRD, we urge the European Commission to clarify that the indicator reported as non-material under ESRS by an investee company does not contribute to the corresponding indicator of principal adverse impacts in the context of the SFDR disclosures. **We encourage the Commission to fully align the materiality rules in SFDR with the final materiality rules in the ESRS.** SFDR disclosure preparers should be allowed to use 'zero' when the investee discloses 'zero' after their materiality assessment. This clarification should be translated in the L1 text of the SFDR.

Product level disclosures

We believe that sustainability related disclosure requirements at product level should be independent from any entity level disclosure requirements. While we agree in principle that product disclosures under the SFDR are to be publicly available, we believe that confidentiality aspects need to be taken into account when specifying the information that should be made available to the public under the SFDR. Confidentiality rules in SFDR should be aligned with ESRS S1 where the undertaking is not required to disclose classified information or sensitive information, even if such information is considered material.

Having product related information spread across precontractual disclosures, in periodic documentation and on website is extensive and repetitive and it could be simplified. The current breakdown of information between precontractual, periodic documentation and website disclosures are not appropriate and user friendly. The requirements to report on PAIs are too extensive, not easy to understand for clients and seems to diverge from the principles of SFDR. On one hand, the SFDR requests asset managers to be transparent and "autonomous" (within certain boundaries) in the definition of methodologies to identify ESG or sustainable financial products, on the other hand it lists granular requirements through a wide array of PAIs. **Therefore, the number of PAIs to be applied at product level should be reduced and simplified to the climate and social related ones.**

There are also **methodological challenges** connected to PAIs reporting. It is not well defined how PAI should be considered at product level nor whether it is necessary to take into account all the indicators. This depends on the supervisor itself and different approaches across geographies can already be witnessed.

Furthermore, the optional PAIs make disclosures less comparable. **Mandatory disclosures on a fixed and limited set of PAIs would make SFDR more decision-relevant for investors.**

Extension of the SFDR to other financial products

We assume that the question of extension relates to the definition under the SFDR and thus only refers to the products currently within the scope of application (Article 2 no. 12 SFDR,

namely "financial products"), such as UCITS funds, financial portfolio management services, etc.

Even though we understand the rationale to enhance the level playing field between “sustainable” and “non-sustainable” financial products and increase transparency on harmful activities on the level of a financial product, we believe that, before any considerations of the extension to all products under SFDR (including Article 6, which is expected to substantially increase administrative costs of other financial product than the ones making sustainability-related claims), **the following steps should be undertaken to further reduce administrative costs for disclosures under SFDR. and allow sufficient time for gradual adaptation by financial market participants:**

1. **Reduce the costs and burdens** related to the sustainable disclosure of financial products currently covered by SFDR. Current PAI framework is too granular and provides for too many indicators. Take into account the specific, private, tailor-made nature of portfolio management services.
2. **Fix the incoherence related to Art. 8 products which are not required to take into consideration PAIs;** this element is in contrast with what is currently provided in MiFID (where, for sustainable preferences' purposes PAIs must be considered)
3. **Undertake a thorough cost-benefit analysis** of an extension of SFDR disclosures to additional financial products.

In any case **no extension of prospectus requirements should be considered retroactively** for financial products no longer available for placement as this would disproportionately increase costs. Similarly, and with the same rationale, **financial products subject to additional payments should be excluded by this extension** of application of SFDR, eventually considering only new products in placement.

Developing a categorization system

The current flaws of the SFDR are broadly acknowledged, including lack of comparability and usefulness for the investors’ understanding of sustainability matters. It has to be however also acknowledged that it is already widely used, including as a labeling system by some financial market participants.

Substantially changing the SFDR concepts will therefore further hamper the credibility of the sustainable finance regulatory framework and will represent the loss of millions of euros of investments by FMPs if the internal systems and processes have to be revamped again. Putting the current system completely aside and creating a completely new categorization framework could expose financial market participants to reputational risks due to the transition that would be needed to move sustainable financial products from the actual concepts of Art. 8 and 9 to new categories. .

Therefore, **if a categorization scheme is to be developed for financial products currently in the scope of the SFDR, it would make sense to build on the SFDR elements, reconciling its design as disclosure regime against its use as a de facto labelling regime.**

The Art. 8 and Art. 9 approach could therefore be a starting point in order to develop a clear and comprehensible categorization system aligned with the **disclosure requirements that however need to be simplified compared to today**, in addition to minimum quantitative requirements. This will eliminate the need for additional disclosure requirements when a product falls within a specific sustainability product category and will decrease the risk of greenwashing claims.

However, we **also see challenges in building the categorization system based on the current SFDR** given the plethora of approaches and methodologies currently in place. This could be an obstacle for finding a common approach for a categorisation without seriously affecting the product range of financial market participants. It may also be challenging to formulate clear categorization which will be too rigid to prevent innovation.

Concerning taxonomy alignment criteria, in principle, we believe that a minimum proportion of investments in taxonomy aligned activities shall be required as a criterion to fall under some of the product categories (noting there is no social taxonomy). **However, in practice it currently makes little sense, due to the lack of data and very low values in the alignment.** Given the importance of transition finance, the current revision should **take the opportunity to consider introducing a transition investment aspect within the categorization system**, which could consider different transition finance practices, both at entity level and level of the asset. based on science. The EBF is advocating for increased reflection of transition finance withing the EU Sustainable Finance Framework and this could be an opportunity to also further build on the EC Communication on Transition Finance from June 2023 which we support. Businesses transition efforts should be documented in transition plans. These plans should be designed with high levels of commonality and standardization.

Supporting measures

Should new categorization system be introduced, it should **be supported by specific measures**. The implementation of SFDR required great efforts for the whole industry to define product frameworks to comply with requirements defined for Art.8 and 9 products, to invest in quality data and to develop tools for the integration of all the information in management systems, to establish monitoring and control procedures, etc. In addition, clients are still not fully familiarized with SFDR concepts, more time is needed for commercial teams and clients to really understand in depth the current framework.

So, if a categorization regime is proposed, sufficient time as well as measures to support this transition are essential. We therefore suggest to the Commission a **grandfathering clause for existing product disclosures**. Also, since the ESAs have published their final report

regarding the possible amendments to the RTS recently, we believe the Commission **should not amend the RTS in order to avoid further implementation costs until it is clear whether and how the legal text of the SFDR will change** (which would entail further amendments to the RTS).

To increase the usability, we believe it would be useful that a potential regulatory attempt to digitalize sustainability disclosures by financial market participants **builds on the European ESG Template (EET)** which has been developed by the financial industry to facilitate the exchange of data between financial market participants and stakeholders regarding sustainability disclosures. It would also be useful to make all **product information disclosed under the SFDR available in the upcoming European Single Access Point as soon as possible**.

Finally, we believe it is important to promote interoperability with rules established in other jurisdictions (e.g., FCA, SEC) and facilitate implementation with a **mapping of how labelling criteria compare across these frameworks**.
