Executive summary

Eurosif's response to the European Commission targeted consultation on the implementation of the SFDR

Key messages

- Overall, the Sustainable Finance Disclosure Regulation (SFDR) has improved transparency on the integration of sustainability risks and consideration of adverse sustainability impacts in investment decisions and financial advice. It effectively embedded the double materiality principle in EU law by putting sustainability risks and impacts at the centre of investment decisions.
- However, the current SFDR is insufficiently clear in the definition of some key terms. Additionally, despite being a disclosure-based regulation, the framework has been used by market participants as a product classification system. This leaves room for interpretation by market participants and supervisors, leads to market fragmentation and raises investor protection concerns.
- The SFDR framework needs to be reviewed to build on its achievements and ensure it is fit for purpose to further deliver on its objectives: to enhance transparency on sustainability-related considerations in investments and help channel capital to investments contributing towards the transition to a sustainable economy.
- These improvements should include clarifying definitions, establishing mandatory disclosure requirements for all financial products, and creating formal product categories based on the products' demonstration of sustainability objectives, underpinned by minimum criteria and with specific disclosure requirements.
- Eurosif proposes to establish three categories of products, reflecting their main objective: "sustainable investments", "transition investments", and "binding environmental and/or social factors".
- Products that do not comply with the criteria of any of these categories should clearly state so in precontractual documentations. Such products should be prohibited from making sustainability, transition, or other ESG-related claims.
- To ensure comparability of information and a level playing field, minimum disclosures should apply to all financial products. These should include how ESG factors, including sustainability risks, are integrated in the investment process, and the consideration of a set of Principal Adverse Impacts (PAI) indicators.
- Consistency with other EU sustainable finance rules including the Taxonomy Regulation, the Corporate Sustainability Reporting Directive (CSRD)/European Sustainability Reporting Standards (ESRS) and the Benchmarks Regulation, should be assessed. Moreover, eventual changes to the SFDR framework should be reflected in a consistent manner in other regulations, including in the MiFID2/IDD sustainability preferences advisory process and PRIIPs Key Information Document.

Summary of Eurosif's response to the consultation

Categorisation of products

As an overarching goal, we believe the SFDR framework should be reviewed to enable it to deliver on its objectives, i.e. incentivising capital flows towards investments contributing to the transition to a sustainable economy, increasing transparency on integration of sustainability risks and consideration of sustainability impacts in investment decisions and financial advice.

The current use of SFDR as a product classification system by financial market participants reflects a need for such a framework. Eurosif believes a formal product classification should be established within SFDR, which should be adjusted accordingly.

To achieve this, a clearer delineation between product categories is required to ensure that Financial Market Participants (FMPs) can classify their investment products appropriately and in a manner that clearly conveys the sustainability objectives and characteristics of the product.

Product categories should be defined based upon their ability to demonstrate sustainability objectives of the products, which could be reached using a variety of investment strategies. The product categories should be underpinned by a set of clear criteria.

Products falling within SFDR categories would have to comply with horizontal disclosures, including the percentage of their portfolio aligning with the Taxonomy. They will also have specific disclosures depending on their investment strategy and in relation with their sustainability objectives. **Products would also have to measure and disclose their sustainability performance against these objectives**.

The names of these categories should be established following a consumer survey to ensure they are meaningful for retail investors.

Eurosif proposes to adopt a hybrid approach building on the foundations of the current SFDR framework to establish three product categories:

1. **Products with a "sustainable investments" objective** should demonstrate an alignment with positive impacts on the environment/society and/or financing already sustainable activities.

   The rationale for this category is to incentivise investments in sustainable companies with a positive impact on sustainability matters. It should build on the "sustainable investments" concept under SFDR, while clarifying and complementing its key underlying notions:

   - "Environmental and/or social objective" would mean e.g. complying with a minimum threshold of alignment with the Taxonomy or targeting measurable sustainability projects/outcomes based on reliable and broadly recognised frameworks, methodologies, or standards.
   - "Do No Significant Harm" would be translated as mandatory exclusions (based on exclusions already implemented by Paris-Aligned Benchmarks), demonstrating

binding positive screening for assets with positive impact and that all mandatory PAI indicators are taken into account in the investment process.

- Invest in companies with "good governance" practices should be linked to minimum safeguards such as investee company compliance with OECD guidelines / UN Guiding Principles. Referring to minimum social and governance safeguards would be practical and help with regulatory consistency.

2. **Products with a "transition investments" objective** should demonstrate a measurable contribution to positive real-world impacts. Minimum exclusions of non-transformable activities would be required.

   The rationale of this category is to define minimum safeguards to ensure transition claims are substantiated and measured:

   - Establishment, implementation and reporting of a formalised sustainability-oriented engagement/voting strategy with measurable, time bound specific sustainability objectives and targets and a sustainability-focused action plan to achieve those including escalation measures and eventual divestment strategy.
   - Investments in companies implementing a credible transition plan, with a link to transition plans under the Corporate Sustainability Reporting Directive (CSRD) and as reflected in the Corporate Sustainability Due Diligence Directive (CSDDD). Subject to appropriate safeguards, proxies such as Article 8 Taxonomy CapEx disclosures or other relevant international transition plan frameworks for companies from outside the EU could be considered.
   - Specific indicators should be established to assess over time the performance against the transition objective.

3. **Products with a "binding Environmental and/or Social factors" objective** should demonstrate the integration of binding environmental and/or social factors at the heart of the investment process.

   The rationale of this category is to reflect sustainability approaches going significantly beyond regulatory requirements, such as the integration of sustainability risks in the investment process. Criteria to consider are:

   - Systematic analysis of ESG factors and their incorporation based on the combination of mandatory exclusions (based on Paris-Aligned Benchmarks exclusions) and binding positive screening.
   - Consideration of specific KPIs, such as PAI indicators and relevant benchmarks, to assess performance over time against the objective.
   - A threshold of investment universe left after the application of the exclusion & positive screening should be established as a criterion for this category.

Products that do not comply with any of the minimum criteria defined in the categories of the reviewed SFDR framework should clearly state this fact in their precontractual documentation.

Such products should not be allowed to make sustainability, transition or other ESG-related claims. This should be consistent across product-level documentation, websites, and marketing communications.

The categorisation framework should also cater for specific types of investment funds, such as fund-of-funds or multi-assets/blended approaches that could qualify for several categories and propose clear rules for their classification.

Entity-level and product-level disclosures

Overall, Eurosif supports maintaining robust disclosure requirements within the SFDR framework. However, product-level and entity-level disclosure requirements may need to be recalibrated to make sure they are fit for purpose and consistent with eventual changes to the framework.

Entity-level disclosures should be revised and improved: Eurosif believes entity-level disclosure regarding PAI should focus on the specific sustainability due diligence policies that are established by FMPs with regards to environmental and social adverse impacts across the range of all their financial products, in accordance with sectoral legislation.

Eurosif acknowledges that the current SFDR Article 4 disclosures are not meaningful to compare entity-level PAI indicators between financial market participants. However, at the level of the individual FMP, there is still merit in calculating an aggregated entity-level metric to assess the evolution of adverse impacts over time. Requirements for undertakings to disclose their integration of sustainability risks (Article 3 SFDR) and their remuneration policies with regards to this integration (Article 5 SFDR) should also be maintained.

Product-level PAI disclosures should be strengthened: principal adverse impact disclosures are especially meaningful at product-level, where relevant PAI indicators can be selected depending on the product's objective and investment strategy/type of assets. In addition, Financial Market Participants are already required to know their product-level footprint when calculating their entity-level PAIs.

Eurosif supports introducing minimum disclosure requirements for all financial products: all financial products should be required to disclose how they integrate ESG factors, including sustainability risks in the investment process, and their consideration of a given set of PAI indicators. Given the improvements expected in the coming years regarding availability of the sustainability data due to the application of the ESRS, all mandatory PAI indicators included in Table 1 of Annex I of the SFDR Delegated Regulation could eventually be considered by all financial products. However, a phase-in approach may need to be considered, first starting with climate, diversity and human rights indicators.

Additional disclosures should be required on a comply or explain basis: whether and how the product integrates exclusions or positive screening policies, aligns a percentage of its portfolio with the Taxonomy, or benefits from a specific sustainability-related engagement strategy. As mentioned above, products falling within SFDR categories would have to comply with these disclosures.

Precontractual documentation templates should be reviewed to ensure this information is presented as a simple and clear overview of the product's sustainability objective and features. More granular information such as these disclosures should be made easily accessible to end investors if they wish so.

Eurosif does not oppose in principle the presentation of the sustainability characteristics of products on a scale to facilitate comparisons, especially for retail investors. However, such comparison should be limited to products with similar and comparable investment strategies.

Consistency of the EU sustainable finance framework

Coherence with other EU sustainable finance rules, including the Taxonomy, CSRD/European Sustainability Reporting Standards (ESRS), and Benchmarks Regulation (BMR), should be assessed.

Moreover, potential forthcoming modifications to the SFDR framework must be consistently reflected across other EU sustainable finance regulations. For example:

- Eurosif reiterates its support for the European Commission to leverage on the proposals of the Platform on Sustainable Finance to further extend the Taxonomy framework to cover social objectives and harmful and intermediate activities.
- It will be particularly relevant to prevent duplication, inconsistencies or overlaps between SFDR entity-level disclosures and the future sectoral ESRS that may be developed for the financial institutions within the scope of the CSRD. It may be useful to consider SFDR as a de facto sectoral standard for asset management under CSRD while considering whether some disclosures would need to be adjusted or added during the SFDR review.
- The categorisation of products in the reviewed SFDR framework should be reflected in the MiFID2/IDD sustainability preferences advisory process, with questions that could be based on the product categories/objectives and their underlying criteria.
- The PRIIPs KID should present the sustainability characteristics of products in a more specific, user-friendly way and consistently with its eventual category/objective.

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EU Transparency Register n°: 480715239269-75

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