Position paper APG AM - SFDR Targeted Consultation

APG Asset Management N.V. welcomes the in-depth review of the Sustainable Finance Disclosure Regulation (SFDR) and is pleased to have the opportunity to respond to the targeted consultation on the implementation of the SFDR, published on 14 September 2023. On behalf of its pension funds clients, APG Asset Management manages the pension savings of 4.8 million participants, representing a value of approximately 508 billion euros. The SFDR is of great importance to APG Asset Management and its pension fund clients who are also subject to the SFDR.

APG Asset Management fully supports the SFDR and its objectives and sees it as an important first step to provide transparency to investors on sustainability aspects of their investments. We see merit in the double materiality of the disclosures, requiring transparency from an 'outside-in' perspective (impact from investments on people and planet) as well as an 'inside-out' perspective (sustainability risks affecting the investments). In addition, we strongly support the idea behind the SFDR that sustainability related claims must be substantiated.

We see the consultation as an important second step to further improve the quality and effectiveness of the SFDR disclosures. By improving the quality and effectiveness, investors receive meaningful information which may contribute to the EU's sustainable finance policy objective to attract private investment for the transition to a more sustainable and climate-neutral economy.

At the same time, we see room for improvement by simplifying product disclosures, removing some concepts as they do not contribute to achieving the objectives of the SFDR and focussing on transition.

In summary, our key proposals are:

1. Move away from the concept of sustainable investments or define the concept appropriately and put more emphasis on transition
2. Remove the classification requirement in terms of article 6, 8 and 9 products
3. Remove the PAI entity statement
4. Require a minimum set of disclosures for all financial products
5. Simplify sustainability preferences to better fit the product disclosures

1. The concept of sustainable investments and lack of emphasis on transition

The concept of sustainable investment is a key element in the SFDR framework being a determinative factor for product classifications, product disclosures and sustainability preferences under MiFID II. However, unlike the EU Taxonomy, the SFDR does not include a clear definition, leaving discretion to financial market participants (FMPs).

In our view this leads to the following undesirable consequences:

i. pressure on FMPs to claim high percentages of sustainable investments in their products leading to a tendency to apply less stringent methodologies, which may result in greenwashing;
ii. hampering comparability of financial products by investors;
iii. FMPs facing various definitions of sustainable investments (own definition and the client or other external managers definition) leading to complex and confusing investment processes; and
iv. less focus on transition.

Although we are confident that data coverage will improve over time, we have concerns that data coverage will to a certain extent remain challenging, because of investments not falling into the scope of the CSRD (for instance companies located outside of the EU).

For these reasons, we suggest to: either remove the concept of sustainable investments from the SFDR definitions and instead focus on disclosures, or include a clear and comprehensive definition of the concept to be used across the market.

We favour the first option. We think the second option is hard to achieve as what is considered a sustainable investment will evolve in time. In our view the focus should be on fair, clear and not misleading product disclosures.

A minimum set of disclosures should therefore apply to all products and should not only focus on adverse impacts, but also on the positive contribution of the financial product and investments in transition and enabling activities. In paragraph 4 we will further elaborate our proposal to simplify the product disclosures.

In our opinion, in absence of a comprehensive definition of sustainable investments, FMPs should be allowed to use this term in their communications, as long as the communication is consistent with product disclosures. We see no merit in an embargo on the use of terms like 'sustainable'. Sustainability is a new area and what is considered as sustainable will evolve in time and differ per industry.

2. No classification of financial products in article 6, 8 and 9 products

We support the SFDR in its purpose as a disclosure regulation and see merit in one standard set of minimum disclosures for all financial products, regardless of sustainability characteristics. This will also tackle the current misuse of article 8 and 9 as proxy labels.

We are hesitant about the introduction of new labels as we see a risk that the same issues as currently observed with the concept of sustainable investments and the misuse of articles 8 and 9 would occur. In this regard we refer to the recently published IOSCO Final Report on Supervisory Practices to Address Greenwashing, that identifies the lack of consistency in terminology, labelling and classification of sustainability-related products as one of the challenges when addressing the risk of greenwashing.

In case labelling is to be introduced, we are of the opinion that this should be voluntary and be based on clear measurable requirements, applied consistently across the market and be easy to digest for investors. When introducing labelling, we believe this should not entail the introduction of new concepts but should be based on existing disclosure requirements, such as applying a certain percentage of taxonomy alignment, being a well-defined science based concept, which is regularly updated. Further, any labelling should, in our view, only apply to the retail market. As professional investors already apply their own concepts of sustainability, which for example relates to certain exclusions or focuses on (certain) UN Sustainable Development Goals (SDG's), we see no merit in applying labelling for professional investors.

3. Move away from the PAI entity statement

We are positive about the current entity disclosures introduced in articles 3 and 5 of the SFDR that relate to the integration of sustainability risks into investment decision making and remuneration, adding transparency for investors on entity level from an 'outside-in' perspective.

In contrast, we believe the PAI entity statement pursuant to article 4 SFDR has little or no value for end investors when making meaningful comparisons, because the statement is complex and there is no information on individual products. The relevance of PAI entity statements is also questionable as asset managers are obliged to include outcomes of individually managed portfolio's, merely reflecting their client's investment beliefs and not so much the beliefs of the asset manager itself. We feel this type of reporting has no added value and leads to an unnecessary administrative burden.

4. Require same set of minimum disclosures for all financial products and simplify product disclosures

The current product disclosures are not sufficiently useful for investors because they are extensive, complex and contain various inconsistencies. We are happy to see that the new product disclosures proposed by the

ESAs in their final report on the draft RTS published on 4 December 2023 already tackle some inconsistencies and are less complex.

In order to reach a level playing field and to further simplify the disclosures, we suggest further optimizing the templates by requiring a standard set of simplified minimum disclosures applicable for all financial products, regardless of sustainability characteristics.[1]

Therefore, we suggest introducing the concept of impact disclosures based on double materiality. Such disclosure could cover four elements:

i. Positive contribution, which could for instance be linked to contributing to (certain) SDGs, being an established method, already widely used in the European market;
ii. Adverse impact disclosures, based on the existing PAI indicators (preferably a limited set of PAI indicators, and no "voluntary" PAIs);
iii. Taxonomy-alignment and transitional and enabling activities; and
iv. Sustainability risk integration.

The first three elements would cover the “inside-out approach” whereas the latter would cover the “outside-in approach” therefore remaining the double materiality perspective. For adverse impact, a standard set of PAI indicators could be used, corresponding with the CSRD, based on the mandatory PAI indicators in table 1.[2]

In addition, with the above changes and disclosure requirements for all products we believe the additional website requirements of article 10 SFDR should be removed, as these requirements are unnecessarily burdensome and we very much doubt whether these would add any further transparency for investors.[3]

5. Simplify sustainability preferences

We question whether the current concept of sustainability preferences contributes to positive changes in investment decisions, because of (i) the link to the undefined concept of sustainable investments and lack of focus on transition, and (ii) the broad reference to the PAI indicators.

Therefore, we suggest simplifying sustainability preferences, in line with product disclosures, by:

i. removing sustainable investments;
ii. introducing preferences around contribution to SDGs;
iii. clarifying preferences around PAI indicators, by referring to a standard set of PAI indicators, based on table 1, from which the client can indicate which indicator(s) the FMP should – somewhat – take into account (meaning: actively identifying, and mitigating negative impact during investment processes); and
iv. extending preferences on taxonomy alignment by adding transitional and enabling activities.

In line with our suggestions around product disclosures, FMPs should report on all these four elements, both precontractual and periodical.

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[1] This means instead of two different templates for article 8 and article 9 products, we suggest to only have one template, applicable to all products.
[2] Provided that some PAI indicators may need to be revised and clarified as part of level 2 review. The revised PAI indicators should preferably also take into account international standards so as to contribute to data coverage.
[3] The publication requirement should not apply to individually managed portfolio’s.