Vanguard

22 December 2023

Vanguard response to the targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR)

To the Commissioners,

Vanguard welcomes the opportunity to respond to the European Commission's targeted consultation on the implementation of the EU Sustainable Finance Disclosures Regulation (SFDR). Vanguard supports the Commission's intention to promote trust and transparency in financial markets – including as it relates to sustainable investment products. We appreciate the opportunity to offer our perspective on behalf of individual investors who are saving for long-term goals. While we appreciate that the SFDR is a crucial element of the EU's sustainable finance framework, the regulation poses several challenges for firms in implementing the current regulation and does not currently achieve optimal outcomes for retail investors in the EU.
We believe that it is important not to lose sight of the principal objectives of the SFDR framework – to provide clear and transparent information to support investment choices for investors so that they are able to select the sustainable products that are right for them and meet their investment goals. We therefore welcome the consultation and upcoming SFDR review, providing an opportunity to refine the existing framework and hopefully simplify and clarify information for retail investors.

About Vanguard

Vanguard's core purpose is to take a stand for all investors, to treat them fairly, and to give them the best chance for investment success. The interests of our more than 50 million individual investors around the world, who are saving for long-term goals such as retirement or a new home, are at the centre of everything we do. We are proud to serve European investors and we continue to invest in our commitment to the market. Since entering the European market in 1998, we have worked to lower the cost of investing for European consumers, and to encourage them to adopt straightforward investment principles, including setting appropriate goals, having a balanced portfolio, and maintaining a long-term perspective.

As an investment manager, Vanguard provides a range of product options, inclusive of index and active funds, to serve our clients' investment needs. We believe, and our investors' returns show, that investors are best served by diversified portfolios that include appropriate allocations to the broad global stock and bond markets. Vanguard also offers a suite of ESG funds that allow investors to benefit from high-quality, low-cost investing products and reflect their ESG preferences, where they so desire. Vanguard's ESG product line-up across the Europe region, comprising both index and active strategies, currently holds $8.1 billion in AUM and signals robust demand.

Vanguard investors have a diverse set of investment goals, time horizons, risk tolerance levels, and personal preferences. Vanguard aims to provide investors with the information and products they need to make sound investment choices to help enable them to meet their financial goals and reflect their personal preferences. This aspect of Vanguard's mission carries through to the perspectives on sustainable finance disclosure which we outline in this letter.

The importance of meeting retail investor needs with a categorization system

Vanguard welcomes and appreciates the EU Commission's efforts to provide more clarity and consistency for investors when considering a potential EU-level product categorization system. As the Commission acknowledges in the consultation, although intended as a disclosure framework, the SFDR has increasingly been used as a labelling regime by market participants, which is not yet fit for purpose.

Given the framework was drafted with a different purpose and is not designed to generate product labels, the overall credibility and consistency of sustainability claims in Europe has been negatively impacted.

It is of utmost importance to us – and we believe to the Commission as well - that a future review of the framework does not lose sight of the ultimate objective: **making it easier for investors to choose products that are suitable for them and can help them meet their investment goals**. We believe clarity and consistency in product categorization or labelling enables investors to consider a product's risks and rewards more accurately, so they can make sound choices about how to allocate their savings and achieve their investment goals. This is particularly important in the ESG space, where rapid growth and product evolution have contributed to confusion and misunderstanding.

Overall, if the market or the Commission is to adopt a categorisation system, we believe such a system should be voluntary, well-articulated, and inclusive of high-quality product types that are in-demand by investors. If well crafted, this could provide investors with targeted information that demonstrates a specific investment approach, allowing them to make sound investment choices- and perhaps make better sense of a complex, heterogenous ESG product landscape. With that in mind, we would like to offer suggestions to consider for a future proposal:

- **Categories that reflect investment strategies:** To focus on investor preferences and understanding in sustainability products, Vanguard is in favour of the Commission's suggested Approach 1 (Question 4.1.2), which would build a categorisation system around investment strategies, and not on Articles 8 and 9, which focus on more general characteristics of the funds' investments and underlying companies. This stance emphasises flexibility within the system, acknowledging that different investors may have diverse considerations when integrating ESG factors into their portfolios. By opting for this kind of categorisation system, the objective is to provide a comprehensive framework that can ideally accommodate a spectrum of ESG products, offering investors the latitude to tailor their portfolios to align with specific sustainability goals or ethical considerations.
- **Inclusion of products that exclude activities and/or investees based on ESG-related factors ("exclusionary ESG products")**: We strongly encourage the Commission to ensure the categorisation system includes products that primarily use exclusionary strategies as a means of addressing ESG risks and preferences (as is suggested by the Commission in Question 4.1.4 as "product category C"). We believe investors stand to gain from a comprehensive ESG offering, rather than leaving this important set of products out of the framework – and unintentionally favouring a set of products that may be more active, and often higher in cost and lower in diversification. While the latter set of products and factors may have a place in an investor's portfolio, their higher costs may deliver lower returns to investors or may simply not meet an investor's goals and risk tolerances. Costs and asset allocation are the two biggest drivers on whether investors are able to meet their investment goals. Exclusionary ESG funds, offer substantial advantages to investors seeking to both (1) mitigate their ESG risk or express their preferences, and (2) benefit from the long-term returns generated by high-quality, low-cost investing in passively managed, broadly diversified, index funds. Exclusionary-based ESG index funds present investors with straightforward and easily comprehensible options, aligning with the goal of providing accessible choices within the sustainable investment landscape. This is a key point that is the focus of our consultation questionnaire response.
- **Ensure minimum criteria for product categories are proportionate and relevant to the category in question:** We support the Commission's intention to consider minimum criteria needed for a financial product to fall under different product categories, and the implication

(in Question 4.1.10) that this might differ depending on the product category type. We encourage the Commission to align these criteria to the investment strategies associated with the product category. Regarding specific criteria, we would agree that an exclusionary fund should be expected to have some form of exclusions in order to qualify for the category. Related, we would not expect an exclusionary product to be required to have an engagement strategy or an objective related to an outcome beyond reflecting the returns of the stated index, as the primary investment strategy is to track a stated exclusionary index and its returns. While some investors may choose products that have additional strategies, including typically more expensive products that place focus on sustainability goals and strategies, we also believe that some investors, when comparing investment products and their trade-offs, may choose exclusionary products because of their simplicity, diversification, low cost, and track record of long-term returns.

- **A single and coherent regulatory umbrella for product-related disclosure and marketing rules:** Additionally, we believe that product-related classification, disclosure and marketing rules should be consolidated under a single and coherent regulatory umbrella, all tied to the established categorisation system. This proposed regulatory coherence aims to streamline the oversight of ESG products, ensuring that disclosure and marketing practices are uniform and directly aligned with the predefined categories. By unifying these regulations, the intent is to eliminate potential discrepancies and foster a more cohesive and standardised approach to sustainable investment, ultimately enhancing clarity and trust in the market. To further ensure accurate and transparent marketing, we suggest the Commission be clear that the use of "ESG" (and related words listed under Question 4.4.2) can be used in fund names and marketing materials as long as they are fair and not misleading. We believe allowing clear use of "ESG" and related words, where appropriate, supports the objective of enabling investors to have transparency into key elements behind a fund's approach. It would be a mistake to introduce rules that prohibit non-labelled exclusionary ESG funds from marketing and naming themselves accurately, especially as the categories are proposed as a voluntary regime. For example, if an ESG index fund follows the "XYZ ESG Index", it would be reasonable to name the fund "XYZ ESG Index fund" or something similar, assuming, of course, the name of the index appropriately reflects and discloses how its exclusionary benchmark is related to its stated name. If, under these requirements, the fund could not use this name, investors would likely be (understandably) confused, especially if the fund was required to change its name to one that now differs meaningfully from its underlying index or intended exclusionary strategy.
- **Consolidation of entity-level disclosures under CSRD, as opposed to as a component of a potential product categorisation system:** We believe a product categorization system should be product-focused and prioritize information that holds substantial utility for investors, making them easily comprehensible and accessible, and without unnecessary duplication of other disclosures. Therefore, while we support the concept of entity-level material ESG risk disclosure for investee companies, we recommend retaining all entity-level disclosures under the existing CSRD (Question 3.1.3), and thus no entity disclosures would be retained under SFDR. By consolidating entity-level disclosures under CSRD, the regulatory landscape remains well-organized, with each directive having a distinct focus and purpose.

Interaction with other sustainable finance regulations

As a global asset manager, we are supportive of efforts to drive greater international and European consistency in sustainable finance disclosure initiatives, and we believe coordination of these efforts will improve the effective functioning of the capital markets. Asset managers are already complying

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with ESG regulations from other jurisdictions, including within the EU, and we are a strong proponent of the harmonisation of sustainable finance rules where it might benefit investors in terms of clarity and downstream costs to their products. A categorization system does not exist in isolation and should be well-aligned with other elements of the sustainable finance framework. We want to emphasize the practical consequences of firms' operating across multiple jurisdictions which apply different interpretations of ESG regulations. Fragmented approaches across different jurisdictions run the risk of a lack of clarity and potential confusion for investors and across the capital markets. In this regard, we emphasise the need for a global level playing field and legal certainty for market participants.

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Thank you for your consideration of our views, as we look to partner with you on promoting transparency in the financial markets and the availability of a diverse set of clear, high-quality investment options to meet investor needs. While we focus here on areas we believe are of greatest important to individual investors – a clear and inclusive categorisation system and cohesion with related regulations – we provide additional feedback on the SFDR in our questionnaire response. We welcome continued discussion and also attach further feedback in your consultation questionnaire.

Sincerely,

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