Postbus 93514
2509 AM Den Haag
Nederland
Tel 003170 356 9335

Position AII response to targeted consultation on implementation of SFDR

Ensure investors can easily invest in financial products with ambitious sustainability values and impacts

ASN Impact Investors
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Cover letter

ASN Impact Investors welcomes the opportunity to provide our views on the SFDR and the possible options to improve the framework. The SFDR has resulted in improvements on transparency in the overall market. However, it falls short of providing retail and institutional investors with effective information for finding financial products that match their sustainability preferences: the disclosures are overwhelming and too complex for most investors. The SFDR should ensure investors can easily invest capital in financial products with ambitious sustainability values and impacts.

SFDR should provide sustainability information that is relevant for investors when deciding in which financial products to invest

Transparency is at the core of SFDR with the purpose of supporting investors in finding financial products that match their sustainability ambitions. To achieve this, the disclosures should be relevant for decision-making by investors; information must be comparable, understandable, accurate, easy to find and appropriate for investors. For the latter, it is important to keep in mind that different retail investors and institutional investors may rely on different types of information when investing. As most Dutch retail investing is through execution-only, SFDR disclosures should not only align with the MiFID sustainability preferences but also be relevant as stand-alone disclosures and be integrated in, for example, Key Information Documents (KIDs).

Although SFDR aims to provide more transparency, it falls short of providing investors with decision-relevant and comparable information. We believe the following changes would make SFDR more relevant to end investors:

- Mandatory product level disclosures for all financial products
- Information and datapoints that resonate with end investors
- Effective and simple product categories that distinguish sustainability ambitions
- Standard disclosures for financial products in the same category.

In the end the devil is in the details, so the technical standards as specified in the Commission Delegated Regulation should be adjusted to effectively shift to decision-relevant information for investors.

Require all financial products to disclose sustainability information for comparability

Currently investors cannot compare the positive and negative sustainability impacts of both sustainability-focused and non-sustainable products. SFDR focuses on extensive disclosures for sustainable products creates cost disadvantages through the extensive disclosures and data requirements that are not applicable to non-sustainable products. Also, for asset managers who were already were focused on sustainability, the SFDR did not result in significant changes to investment policies. The overall impact is that end investors still cannot easily compare products based on SFDR disclosures, and that the increased costs did not necessarily lead to better sustainable financial products.

Furthermore, the disclosures will only be decision-relevant to retail investors if disclosures focus on information and metrics that resonate with people’s everyday lives, such calculating the carbon footprint as CO_2-eq per 1000 euros instead of per million euros or disclosing exposure to specific harmful economic activities. For comparability it remains important that all financial products follow the same unambiguous calculation method and clear guidance on data.

Mandatory disclosures on a limited set of sustainability information for all financial products would make SFDR more decision-relevant for investors. We specifically suggest that financial products disclose:

- A limited set of mandatory PAI indicators, for example key metrics on climate change, biodiversity and human rights.
- Exposure to pre-defined sectors that are harmful or are at higher risk of adverse impacts on climate change, biodiversity and human rights.

The key is to keep these disclosures simple and focused on topics and metrics relevant to end investors.

Remove PAI statements at entity level as they are not decision-relevant for investors
We believe that 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. The Principal Adverse Impact (PAI) statements at entity do not provide insight in any specific financial product that an investor may be interested in; and the choices in optional PAIs and different possible interpretations of data points and calculations severely limit comparability.

We support removing the PAI statement at entity-level, removing non-mandatory PAI indicators, and limiting the number of mandatory PAI indicators. Instead we suggest all financial products disclose a limited set of mandatory PAI indicators, as stated above. Entity level policies, such as the policies on sustainability risks and how they are integrated in the remuneration policy, can remain when providing meaningful information that is more generally applicable to an asset manager's products or services.

Product categories should serve investors in finding financial products that match their sustainability preferences
We support the development of product categories as long as the categories and accompanying disclosures are simple to interpret accurately by retail investors. In other words, investors should be able to easily understand how sustainability has been incorporated in a financial product and distinguish the sustainability ambitions of products with similar investment strategies.

The European Commission suggests two approaches in the consultation, and the AFM has suggested an alternative labelling approach in their position on the SFDR review. We do not have a strong preference for any particular approach as the effectiveness will highly depend on the specific implementation.

Approach 1: ensure difference in sustainability ambition levels between products is not lost
In approach 1, the European Commission suggests categorizing sustainability products into four categories:

A Products investing in assets striving for targeted, measurable solutions to sustainability related problems.
B Products aiming to meet credible sustainability standards or adhering to a specific sustainability-related theme.
C Products excluding activities and/or investees with negative effects on sustainability.
D Products aiming to bring measurable improvements to transition the sustainability profiles of assets that are invested in.

The main advantage to developing new categories based on investment strategies of financial products, is the potential for retail investors to quickly gain insight in the sustainability performance in relation to the investment strategy of different products. However, the main challenge of the suggested categories is the risk that investors cannot differentiate between the sustainability ambition levels of comparable products. For example, the category on excluding investees involved in negative activities could range from relatively light exclusion such as coal and tobacco which would remove a limited number of companies from the investment universe, and products like our funds with strict criteria leading to a universe of only a few hundred investees.

A possible solution would be to include more product categories to differentiate sustainability ambition levels supported by suitable criteria, next to an explicit category for non-sustainable products. Care should be taken that the number of product categories does not become too large which could inadvertently make it too complex for retail investors to compare products. Another challenge is that financial products could fit in multiple categories which could provide investors with a more holistic view of the investment strategies, but again makes comparisons between products more complex. The alternative is to make the categories mutually-exclusive, but this could limit innovation in new sustainability strategies if products are made to fit the categories.

Should approach 1 be followed, the set of categories should sufficiently cover broad investment strategies while ensuring that investors can easily identify and compare the sustainability ambitions of individual financial products.

Approach 2: ensure the criteria differentiate between more (art. 9), less (art. 8) and unsustainable products in a meaningful way for investors.

In approach 2, art. 8 and 9 classifications in SFDR would turn into real product categories with specific minimum criteria. One advantage of this approach is that it builds further on processes and systems implemented the past years. For an investor perspective, the most important merit is the potential simplicity in distinguishing between products with (1) higher sustainability ambitions, (2) lower sustainability ambitions, and (3) products that don't consider sustainability.

There are two main challenges to this approach. First, investors potentially still lack an easy way to identify and understand investment strategies. Lacking this information makes it harder to compare similar financial products on their sustainability. Second, concrete criteria and further clarification of concepts are required to ensure comparability and clear differentiation. The criteria should also take into account data availability and the ability of funds to disclosure the required information. For example, relying on metrics specific to CSRD that are not widely disclosed globally could inadvertently limit investments that fund sustainable projects and companies in emerging markets.

Should approach 2 be followed, the chosen criteria for art. 8 and art. 9 products should differentiate products in a way that is understandable for investors, with requirements that are suitable for all types investments, and disclosures that help investors identify and compare investment strategies.

AFM labels: ensure the criteria are based on well-defined concepts and take into account data-availability outside companies reporting under CSRD.

The AFM has suggested an alternative system with four categories by dividing financial products along investor impact and the sustainability performance of assets. This is done by creating three labels with the remainder without label:

- Sustainable impact products.
- Sustainable products.
- Transition products.

The AFM approach has two key characteristics. First, it creates a categorization based on relatively simple theoretical concepts. However, the distinction should also be made sufficiently concrete for retail investors by emphasizing the underlying investments. It is easier to understand that a product without investments in high impact sectors is sustainable, than it is to understand the criteria determining which companies are effectively transitioning. Thus, the label 'sustainable impact products' could suggest it being more sustainable than 'sustainable products', whereas the actual criteria may not support this. Second, the suggested criteria for the labels provide a relatively high threshold. At the same time, products that do not meet the label-criteria can still implement sustainability characteristics or objectives. If the criteria remain sufficiently high, this would ensure differentiating between sustainability ambitions. However, comparing products with similar investment strategies may become more difficult as the there could be less harmonization between products without a label. Another important consideration is that the categories would only be meaningful if there are sufficient financial products that fall within each category; if most fall within a single category, retail investors would have insufficient guidance to choose products within that category.

A further point of improvement would be that SFDR concepts on which the criteria are based should be better defined and take into account data-availability outside of the EU. For example, many sustainable products invest in companies that do not report under CSRD, both inside and outside the EU. Requiring investments in activities covered by the EU taxonomy to be taxonomy-aligned could unintentionally limit the label to portfolios concentrated in EU-companies.

Should the AFM labels be used, the criteria should be suitable for all types of investments and result in product labels that are consistent with investor expectations as well as supported by disclosures for easy identification of comparable investment strategies.