THE
INVESTMENT
ASSOCIATION

Response to the European Commission SFDR consultation

Summary of key views submitted via the online questionnaire

20 December 2023

About the Investment Association

The Investment Association (IA) welcomes the opportunity to respond to the European Commission's consultation on SFDR. We champion investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Today, IA members manage €2.7trillion for European clients and have invested €820 billion into EU businesses and projects needing capital. Our members have more than 2100 funds domiciled in the EU, and they serve millions of individuals in every Member State from 642 office across Europe. Our vision is one where Europe's citizens, UK and EU, are empowered to make investment decisions right for their own circumstances. It is one where true potential of sustainable investment is unlocked.

Summary of key views submitted via the online questionnaire

Globally-consistent and comparable standards are of paramount importance for client outcomes and fragmented approaches to sustainable finance legislation across different jurisdictions risk unnecessary complication, confusion and diseconomies of scale. Despite SFDR not being onshored in the UK, firms conducting business on a cross-border basis, which includes a large portion of IA members, had to consider their SFDR obligations in those jurisdictions where they carry out business. SFDR has been a significant piece of legislation for firms to implement, regardless of a firm's sustainability strategy/profile in terms of their product offering. SFDR introduced completely new provisions and concepts for firms across the board including how firms categorise their products, despite SFDR not being intended to be a categorisation regime. Firms have dedicated significant resources to implementing SFDR which has included many parts of the business including marketing, product development, legal, risk and compliance.

The IA supports a voluntary retail marketing labelling system and a clear disclosure regime that ensures standards are raised and consumer confidence in the market is improved. However legislation must serve consumers effectively and should aid the wider process of stewardship and capital allocation, in a

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proportionate manner, as part of the transition to a more sustainable future, considerate of net zero and positive social contributions.

What follows is a summary of key views included in the answers to the online targeted questionnaire.

Scope

We appreciate that SFDR is not a retail only framework. However, portfolio management services provided on the basis of segregated mandates are currently in scope SFDR and we encourage the European Commission to consider having them out of scope. Their inclusion leads to duplication of disclosures, in particularly where a client that is subject to SFDR delegates portfolio management to an investment firm that is also subject to the same requirements. Segregated mandate disclosure needs need to be considered separately and on their own merits.

Entity level reports

While we fully support transparency to investors and are supportive of the concept of Principle Adverse Impacts (PAI) at product level, we do not support the disclosure of PAI at entity level and recommend that entity level reporting is removed from SFDR. Disclosure of mandatory and opt-in PAI indicators at entity offers little insight to investors on the impact of their underlying investments and indeed could potentially mislead investors in to thinking they are an indication as to how sustainable the firm is that is selling the financial product when in fact PAI at entity level in SFDR is a reflection of the firm's asset mix and geographic exposure. Furthermore, investors do not invest in a corporate EU entity. Drawing any meaning from entity report and attributing adverse impact to a single investment is very difficult considering the high level at which the report is drafted from. The year-on-year metrics are also affected by factors such as asset mix and assets-under-management changes which distort the disclosures and risk confusion or misleading clients. Investors are better served with a focus on product level reporting. Even for product level reporting, the scope for any sustainability-related disclosure requirements should be focused on criteria/factors/indicators actually aligned with the sustainability claim of the strategy and used in the investment process for a particular strategy.

The entity level requirements should be reflected in the EU's Corporate Sustainability Reporting Directive (CSRD), which is the most appropriate legislative instrument for entity-level requirements..

Product level disclosure

Any financial product using the suggested voluntary categorisation system should automatically trigger sustainability-related reporting obligations. However, products should not be forced in to committing to a certain number of PAIs. The PAI disclosures at product level should depend on what is material in terms of the underlying investment strategy and it is important to draw a distinction between pre-contractual disclosures and ex post reporting.

Careful consideration also needs to be given regarding how different levels of disclosure align, interact and could interchange, and how the information could be provided to all audiences, preferably in a digital format. However, templates, by their nature, may not provide the requisite flexibility to disclose on the broad range of sustainable investment approaches that investors want and this needs to be taken into account when designing the capabilities of digital communication.

We do not support having product-level disclosures expressed on a scale - it would be extremely challenging to determine which objective information should be expressed on a scale given the wide array of ESG issues and the subjective nature of these issues.

The current approach in SFDR to have product related information spread across three places, i.e. in precontractual disclosures, in periodic documentation and on websites, needs reviewing and streamlining. We support information being provided in precontractual and periodic documentation. However, we question the need to have more detailed disclosures available on websites as per Article 10 of SFDR given the overlap in the content requirements of precontractual and website disclosures. It is less useful information and investors do not generally look at it compared to the information in precontractual and periodic documentation. Website disclosures should only be required for products offered to retail investors. We question the benefit of website disclosures for products only offered to professional investors with bespoke investment mandates.

Product categorization

The IA is supportive of a principles-based voluntary product categorization regime aligned with what the product is seeking to achieve, similar to that in Approach 1 outlined in the European Commission's consultation where categories are split according to the type of investment strategy of the product. In the UK Financial Conduct Authority (FCA) research published in July 2021, there is the suggestion that consumers place weight in a medal, possibly because they view it as a kitemark or quality assurance. If there is a product categorization system in the EU that ensured a certain standard is in place, consumers are likely to pay this most attention. Similar to the sustainable investment labels in the UK under the recently finalised Sustainability Disclosure Requirements (SDR) regime, there will have to be objective qualitative minimum standards/criteria for the labels, based on verifiable data. Rather than prescribe minimum thresholds or criteria, we would suggest a principles-based approach that seeks to hold the fund manager to account for the sustainability claims made by a fund. As with any strategy, funds that pursue sustainability-related goals should be able to provide transparent disclosures describing how sustainability considerations are integrated in the strategy and demonstrate through reporting that they have achieved what they set out to achieve.

We broadly support the four suggested categories as they are based on the intentionality of the fund and they will also promote interoperability between the EU and other international regimes, notably the UK and US. A key consideration in the development of a product categorisation is to ensure that the underlying base line criteria is not developed in such a way as to make it difficult for specific asset classes to obtain a label or be included in a category. Some products will have a mix of assets that cut across all categories in order to achieve diversification desired by investors and ultimately, investors need to know whether the investment aligns with their sustainable investment objective and is it clear to them from the disclosures, what they are investing in.

Mutual exclusivity of categories - IA consumer testing shows retail consumers do not want to see multiple labels on fund documentation. While we support the categories should be designed in a mutually exclusive manner, the ESG strategies/tools that a product may employ to achieve its intention should not be mutually exclusive and that products invested in more than one category are still able to receive a label, otherwise, there is a risk of compromising on the liquidity profile of the assets to meet the product classification requirements. A key consideration in the development of a product categorisation is to ensure that the underlying base line criteria is not developed in such a way as to make it difficult for specific asset classes to obtain a label. Some products will have a mix of underlying assets that cut across all categories in order to achieve diversification desired by investors.

MiFID 2

The way sustainability preference have been defined in MiFID II Delegated Acts clearly does not align directly to the current SFDR Article 8 and 9 funds and has proved quite difficult for firms to interpret. We do not want an approach that prevents clients from investing in, for example, ESG risk-managed strategies, if they are in fact the right strategies for their preferred investment outcomes (i.e. strategies without a dual objective). Ideally, "sustainability preferences" should allow for strategies covering the full breadth of possible investment outcomes that investors may be targeting in line with their particular sustainability needs and suitability preferences process should allow investors to be matched with the right strategies for them.

Naming and marketing rules

In line with the views we expressed to the FCA during the SDR consultation, any prohibition on product names and marketing materials by restricting the use of ESG-related terms to products adhering to the categorisation regime should be disproportionate to the harms EU regulators are trying to mitigate/avoid. For example, we have concerns regarding the prohibition of terms like 'responsible' which is used extensively and by funds that are pursuing strategies that go beyond ESG integration but would not reach the bar to receive a fund label/category in, for example categories A, B and D. While ESG integration may be understood by some in the industry to be synonymous with responsible investment, IA research with retail investors showed that a relatively high percentage of investors see 'responsible investing' as an umbrella term for a broad range of sustainable and responsible investing approaches (ranging from exclusions to investing in line with ethics but also encompassing considering risks related to the environment, society and governance before investing in a company). Restricting the use of the term 'responsible' in marketing to funds that receive a sustainable label would imply that responsible investment has a narrower scope, which does not align with retail investor understanding.

Alignment with UK FCA SDR and investment labels regime

On 28 November, the UK FCA published its final rules and guidance on a Sustainability Disclosure Regime accompanied by investment labels. The UK labels align with the Commission's suggested categories A, B and D. In addition, the FCA has included a fourth label 'Sustainability Mixed Goal' which can be used by funds/products that invest in a mix of assets across categories A, B and D. Any new EU sustainability product categorisation systems needs to accommodate products, especially multi-asset funds, that invest in a combination of assets that are already sustainable (category B) and assets that have the potential to improve over time (Category D). As the UK industry absorbs and operationalises the new SDR regime, the IA would welcome an opportunity to discuss our practical experience with the European Commission on all aspects of SDR, including the four new voluntary investment labels.