Response to the European Commission's targeted consultation on the SFDR

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include private and public sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has over 600 members located in 66 jurisdictions. See www.icmagroup.org.

The feedback to the European Commission's targeted consultation on the implementation of the Sustainable Finance Disclosure Regulation (SFDR) is given behalf of ICMA and its constituents, especially by the Asset Management & Investors Council (AMIC) and the Executive Committee of the Principles. Our detailed comments are presented in the response form to the Commission's questionnaire. This letter summarises our key responses to and positions on the various questions raised by the European Commission. In a nutshell:

- **Current requirements of the SFDR**: While the SFDR's adoption has been positive, it currently fails to fulfil its primary objective of investor protection and helping sufficiently channel capital towards sustainability for various reasons including use of disclosures as labelling, complexity and overload of disclosure requirements, data unavailability, lack of clarity and minimum standards in key regulatory concepts, etc. All these can lead to legal uncertainty, potential greenwashing, and reputational risks.
- **Interaction with other sustainable finance legislation**: While the Commission and the ESAs have recently provided various guidance on addressing inconsistencies between different pieces of legislation, there is still a need for further improvement and clarity.
- **Potential changes to disclosures**: Going forward, the disclosure requirements and templates should be shortened, streamlined, clarified, made proportionate and focused on most material issues. Within these parameters, there is support for uniform disclosures across all products, regardless of the presence of sustainability claims. Where possible, disclosures should leverage expected data from the application of international standards (e.g., ISSB) and recognise other existing taxonomies.
- **Potential establishment of a categorisation system**: Our members clearly and strongly support an EU official categorisation system, however there are divergent views on how to achieve this. In any case, introduction of labels based on investment objectives and intentions should, to the extent possible, leverage the existing requirements and processes that have been resource intensive to implement. We note strong support for a transition-focused Category D. There is also support for Category A and B, but international fragmentation should be avoided in labels' design. We do not however support the exclusion-focused Category C. Also, while we do not propose any specific criteria for labels at this stage, we present some high-level recommendations and principles to guide the process.

Nicholas Pfaff
Deputy Chief Executive and
Head of Sustainable Finance

Nicolette Moser
Senior Director
ICMA AMIC

Özgür Altun
Associate Director
Sustainable Finance

I. Current requirements of the SFDR

The SFDR's broad objective to support the EU's shift to a sustainable future through transparency and investor protection and help capital flows towards sustainability is even more relevant as sustainability challenges are intensifying in the EU and across the world. The SFDR's adoption has been a positive development as it provides a common framework for disclosure and requires substantiation of sustainability claims where they exist.

Nevertheless, the framework has so far not fulfilled its objectives for a variety of reasons: (i) misuse of disclosures as labels; (ii) overload and complexity of disclosure requirements coupled with their divergent interpretation and application; (iii) current and potential future widespread data unavailability; (iv) lack of definitions and regulatory clarity on key concepts and requirements; and (v) inconsistency between different sustainable finance regulations, etc. The framework also does not sufficiently accommodate transition-themed investments.

Some specific challenges have been raised regarding the current Art.8/9 based regime. In some cases, the principle-based approach on "Sustainable Investments" with no minimum criteria creates an unlevelled playing field for FMPs who apply stricter definitions and conservative methodologies. The PAI disclosures are mainly designed for large cap DM issuers and structurally disadvantages EMs, High Yield etc. For fixed income products, the investable universe is generally considerably reduced for Art.9 classification including due to the 100% Sustainable Investment requirement. The latter does not allow any margin for efficient portfolio management techniques to be applied while creating uncertainty in case of disqualification of a sustainable bond as per FMPs' own standards. Conversely, Art.8 is very broad and currently lacks minimum quality conditions to serve as a reliable classification.

All these issues lead to legal uncertainty, as well as greenwashing r and reputational risks while hindering capital allocation towards sustainability. There is therefore a consensus regarding the need to address these. However, due consideration should be given to past efforts and costs already invested to implement the current regime. A repeat of these costs and efforts needs to be avoided or minimised while the detailed and technical improvements should be addressed at Level 2 legislation.

II. Interaction with other sustainable finance legislation

We welcome the Commission's and the ESAs' efforts to ensure consistency between different EU sustainable finance legislations and rules.

Nevertheless, in a number of areas there is room to further ensure consistency and enhance interactions between different sustainable finance regulations. For example, the consideration of taxonomy aligned investments as Sustainable Investment provides a practical relief mostly for green use-of-proceeds instruments as these are relatively easier to be in full alignment with the EU taxonomy aligned compared with vanilla instruments of investees. The expanded materiality analysis under the CSRD/ESRS as well as the fact that not all investees will be in scope mean that some data gaps are likely to persist over time. Most FMPs noted also that the consideration of EU climate benchmarks aligned funds as Sustainable Investments has not led to a re-qualification wave towards Art.9 due to the remaining uncertainties and inconsistencies between the two legislations.

III. Potential changes to the disclosure requirements

As a general comment, for the SFDR to fulfil its objectives, we believe **the priority should be to rationalise, streamline, and clarify the disclosure requirements** to avoid complexity, data overload, and divergent interpretations and applications. Disclosures should also generally focus on the most material issues. There is also a need to simplify disclosure templates accordingly while some FMPs also proposed the introduction of a simple ESG template for all products (e.g., 3 pages max).

Entity-level PAI disclosures currently provide little or no value given that asset owners invest in products but not in asset managers. Asset managers also have diverse business focus and product offerings, and as such, entity-level PAIs fail to achieve the intended comparability. At a minimum, they should be streamlined, shortened, focus on material issues, by also considering specifics of different asset classes, investment focus, and strategies.

We also reiterate our earlier view (see our SFDR Level 2 response) that the **EU should consider making at least some disclosures subject to FMPs' materiality assessment** given the expanded materiality assessment scope on the investee side CSRD/ESRS. Moreover, regarding FMPs' entity-level disclosures, the relationship between the application of the CSRD/ESRS and the SFDR should be clarified, and duplicative obligations should be avoided.

Future disclosure requirements should consider international data availability since many portfolios are global. This can be achieved by leveraging expected data availability and metrics from international standards such as the ISSB IFRS S1 and S2 and recognising other taxonomies around the world as equivalent disclosures where appropriate.

We are supportive of uniform disclosures provided these are of limited number (e.g., 1 to 3), meaningful, practical, proportionate in light of the fact that there may not be any sustainability claim at all. Conversely, such uniform disclosures should be made highly visible.

The specific content of uniform disclosures should be determined at Level 2 legislation. They should be based on indicators that are likely to be most material across different types of investments, leveraging also some existing PAIs and processes implemented by FMPs. A positive tilt disclosure, such as funds' exposures to companies with transition plans aligned with ESRS, ISSB, and/or ICMA CTFH could create incentives for companies to voluntarily adopt transition plans and help advance the decarbonisation momentum across the economy including throughout the value chains.

There are diverging views on whether different uniform disclosures should apply depending on the nature of investments (e.g., EMs, SMEs, etc.). In any case, where disclosures are quantitative in nature, qualitative assessments and contextual information should be allowed to accommodate different situations and circumstances and avoid creating investment biases penalising some type of investees (dark green vs. transitional) or geographies over others (e.g., DM vs. EM investments). It may also be possible to distinguish how a same specific disclosure embeds and caters to different situations without fragmenting the uniform disclosure requirements depending on the nature of investments. For example, a uniform disclosure on the exposure level to companies with transition plans could also be inclusive of SMEs and EM with science-based transition targets (instead of plans) to accommodate proportionality in line with the Commission's transition finance definition of June 2023.

IV. Potential establishment of a categorisation system

There is a strong support for a clear categorisation system regulated at EU level as this would facilitate investor understanding of sustainability strategies and objectives, help address greenwashing, avoid fragmentation in the EU, and help with efficient distribution systems.

However, stakeholders' views diverge significantly on which Approach to take to achieve this. Building on the current de-facto classification system (i.e., based on Art.6/Art.8/Art.9) and supporting it with minimum criteria under Approach 2 would help minimise new substantial implementation efforts and costs and avoid further confusion in the market as existing regime would be further cemented by the time a Level 1 change is implemented. Conversely, creating a new categorisation system could bring additional clarity for the benefit of investors since labels would be based on investment objectives and intentions. The latter could also ensure a better international alignment with other jurisdictions, such as the recently finalised UK fund labelling rules.

We therefore support a blended approach that introduces clear labels based on investment objectives and intentions while building on the existing processes have been difficult and costly to implement as much as possible (e.g., by using a shortened list of existing PAIs focused on most material issues).

Regardless of which Approach to take, these are our high-level principles and recommendations for the way forward:

- When introducing common and objective minimum criteria for each category, avoid very stringent labelling criteria that could restrict sustainable investing into a niche market and hinder innovation while potentially creating asset concentration and financial stability risks.
- Avoid or at least minimise international fragmentation and divergence in labels' design, names, underlying criteria by considering other jurisdictions' initiatives, to the extent possible.
- Bearing in mind portfolios are global, avoid Eurocentric design, data requirements and criteria by also leveraging the implementation of international standards (e.g., ISSB, other taxonomies) to the full extent possible.
- Consider targeted measures in labels and labelling criteria in order not to disadvantage other jurisdictions (e.g., EMs) or smaller entities (e.g., SMEs).
- Adopt an asset-neutral stance as much as possible as an overarching approach while leaving the underlying criteria flexible for FMPs to accommodate different asset classes through their methodologies and asset selection criteria.

Regarding the product category examples provided by the Commission, we note the following points:

- We strongly support a transition-focused label (Category D) in all cases, which is partly explained by the fact that the current SFDR regime is not perceived as incorporating transition sufficiently. However, such label should be supported with clear minimum criteria and standards to maintain credibility and avoid controversy.
- We also support Category A (products aiming at targeted, measurable sustainability solutions) and Category B (products meeting credible sustainability standards or adhering to a specific theme). However, we reiterate our earlier point regarding the need to avoid international fragmentation in labels' design, names, and underlying criteria.
- We do not support an "exclusion" focused label (Category C) given that exclusion is rather an investment strategy that could apply across the board and serve as a minimum criterion for other product categories.

The use of product categories should also be mutually exclusive, i.e., a fund should only be able to qualify only for one label. We recommend considering creating a general product category that can include assets and investments qualifying for other labels in a similar fashion to the Dutch Regulator AFM's proposal and the label "Mixed Goals" recently introduced by the FCA. Among other things, such approach would help avoid an overly restricted sustainable investing framework, asset concentration, and liquidity and financial stability risks while being inclusive of different asset classes and investment strategies that may not easily fit in a single label at a time.

There should also be no "de jure" or "de facto" hierarchy, bias, prioritisation between different labels. However, transparency on the level of sustainability ambition, either resulting from the current performance or committed future improvements vias plans or targets, could still benefit end-investors and help them make informed choices.

We support additional disclosures for products that make sustainability claims or fit within the product labels provided by the EU. What such disclosures would ultimately be depends on the nature of sustainability claims or labels and their underlying criteria. We reiterate our view on the general need for disclosures to be rationalised, streamlined, clarified, and made materially focused, practical, and proportionate.

We also agree that product categories should be accompanied by specific rules on marketing communications and naming restrictions in line with existing rules on misleading marketing communications. There is however a need for enhanced coordination between different EU policymakers as ESMA recently consulted on some sustainability-related terminology restrictions. Also, if uniform sustainability disclosures are adopted across all products as discussed above, the scope of naming restrictions may need to be narrower (e.g., limited to "sustainable" and "impact").

Most FMPs are however against a mandatory external verification requirement at this stage as funds are already subject to authorisation and review by competent authorities.