18-12-2023

SFDR 2.0

WeeFin Position on SFDR level 1 review

WeeFin General Position (1/2)

- **SFDR has begun to show positive impacts, with its effects gradually becoming more evident :** It has made sustainability a central topic of discussions in the financial industry, encouraging the incorporation of sustainability into investor strategies. SFDR has initiated the quest for transparency, funds comparison in the financial industry, but to date, its impact has been limited despite significant efforts from industry players to ensure compliance with the regulation.
- **However, challenges remain :** financial actors efforts focused mostly on compliance rather than the development of more ambitious methodologies. Challenges related also to providing **clear and understandable information to end investors** must be addressed, and transparency and education are essential elements of this process.
- **Inconsistencies in timing, scope, and content between SFDR, CSRD/ESRS, and EU Taxonomy pose challenges.** It is notably related to the fact that many EU initiatives utilise different definitions of sustainability (Taxonomy, SFDR, MiFID II). These misalignments need resolution to ensure clarity for end investors.
- **WeeFin advocates for transparency, clear disclosure rules, and improved methodological guidance (DNSH, SI, PAI, good governance..)** rather than risking a complete overhaul through the creation of new funds categories. The path toward transparency should be led by regulators, working collaboratively with financial institutions, to leverage this clarity for the purpose of informing, guiding, and educating end investors.
- **WeeFin recommends mandatory product-level disclosure for all funds.** We strongly endorse the Commission's proposal to broaden the scope of sustainability disclosures for all products regardless their classification to ensure better comparability and transparency and alignment with MIFID II & IDD ESG. This reporting would consist of questions with yes/no responses or checkboxes, allowing for both quantitative and qualitative information. The questions would cover various aspects, including commitments, processes, and resources used by funds. All funds would be required to make disclosures, and additional disclosure requirements would be activated when a 'yes' response is given. Funds responding with 'no' would need to provide an explanation along with an improvement plan. The questions would address several key themes, including exclusion criteria, scoring methodologies, threshold values, Principal Adverse Impact (PAI) assessment, climate transition plans, and alignment with the EU Taxonomy, among others. This reporting framework would also be closely linked with the EET and designed to be machine-readable for efficient data processing.

WeeFin General Position (2/2)

- **Creating new funds categories** (approach 1) may appear to be an initial solution to help final investors better understand and navigate ESG fund strategies, but in reality, **it may not enhance transparency significantly**. Many funds have multiple strategies, and can fall into several categories. This diversity can lead to confusion among end investors.
- **Funds categorization may discourage funds from aligning with predefined standards.** Some attempts at standardization, such as the European taxonomy, have not proven effective even after 5 years, as reflected investors alignment engagement rate close to 0%.
- Nevertheless, adopting this approach would **require the development of an entirely new framework, potentially adding more complexity and delaying achievement SFDR's primary goals** as increasing transparency, reducing greenwashing, and promoting the integration of sustainability into investment decisions.
- **WeeFin advocated for preserving diversity in sustainable fund strategies:** as many funds employ multiple strategies each with its nuances and perspectives.
- **Approach 2 aligns more closely with WeeFin's recommendations.** We believe it's crucial to leverage existing frameworks and enhance them by introducing minimum requirements, but without converting classifications into formal categories. WeeFin propose delating Articles 6, 8, and 9 concepts, as they can lead to confusion and misinterpretation in order to set a unique reporting template for all fund. We recommend using national labels for marketing purposes to categorize strategies instead of implementing product categorization with SFDR.

Section 1 : Current requirements of the SFDR

WeeFin general position

The Sustainable Finance Disclosure Regulation (SFDR) framework has been in application for a few years, and its **positive impact is becoming increasingly evident**. It has accelerated the integration of sustainability into investor strategies, offered a tool for comparing European ESG funds, and enhanced transparency in funds compared to the situation prior to SFDR's implementation.

However, SFDR implementation is **currently time-consuming,** with all efforts have focused on regulatory compliance. There is a need to simplify and clarify the regulatory framework to facilitate better ESG practices. We consider the SFDR review as a valuable opportunity to address existing inconsistencies within the sustainable finance framework.

While SFDR represents a positive step, **there are opportunities for improvement**. Challenges related to providing clear and understandable information to investors must be addressed, and transparency and education are essential elements of this process.

It is acknowledged that there is a **gap between SFDR purposes and outcome**, with lingering gaps, including the use of classifications as marketing labels, an excessive focus on reporting rather than the development of ambitious methodologies, non-uniform reporting, and limited coverage in certain data (PAI indicators).

Final investors are **overwhelmed by an abundance of information** that is not always consistent. With funds pre-contractual and periodic documents of 10 pages in average and a total of 3 entity-level reportings (not to mention policies and reporting required by other sustainability initiatives (Article 29 ECL, TCFD, exclusion policy, Transparency code ...), too much information can obscure essential message.

Some terms and KPIs **must be clarified and simplified** : even though we have percentages for SI, they may not be sufficiently useful for investors, much like the case with Principal Adverse Impacts. Only the taxonomy provides clear foundations for comparisons. However, it is currently not very useful due to underutilization (with a taxonomy alignment rate close to 0%).

It is crucial to mandate a **minimum base of information and data to be disclosed** (indicating whether yes/no they calculate, they consider) by all funds, regardless of their classification

WeeFin **advocates for transparency and the need to specify and clarify disclosure rules**. We encourage regulators to provide more methodological guidelines and pedagogy to avoid ambiguities and misinterpretations and enhance transparency.

Section 2: Interaction with other sustainable finance legislation

WeeFin general position

Although the Commission and the ESAs have recently proposed guidelines to combat the disparities between the various pieces of legislation, there is **still a need to refine them and increase pedagogy and methodological clarity.**

Sustainable finance regulations are **intentionally designed to be interrelated,** yet various inconsistencies present challenges to their robust implementation and, in some instances, undermine their core objectives. Among the most significant misalignments that result in data gaps, we find **disparities in timing, scope, and content between SFDR and CSRD/ESRS, as well as between EU Taxonomy and SFDR.**

SFDR and Taxonomy Regulation (ex: coexistence of two different "**Do Not Significant Harm**" principles and two "sustainable" terms at different levels)

Some divergence between **SFDR's DNSH and PAB/CTB DNSH** : the focus is primarily on climate criteria, with minimal or no due diligence on social and governance themesand.

These inconsistencies, both in terms of timing and content, lead to challenges **in implementing the sustainable finance regulatory framework, which, in turn, may not be clear to the end investor.**

Rather than developing new reporting standards, which could lead to confusion and potentially conflicting regulation, we believe minimum **disclosure requirements could be linked to existing tools and regulations.**

However, gap in term in data is expected to diminish over time with corporate reporting set to start in 2025.

Section 3 : Potential changes to disclosure requirements for financial market participants

WeeFin general position

In the future, it is advisable to simplify, **streamline, clarify, and make disclosure requirements and templates more concise, proportional, and centered on the most material issues.**

WeeFin suggests **prioritizing the quality and consistency of principal adverse impact (PAI) indicators over quantity,** advocating for a smaller, well-defined set of indicators to ensure meaningful, accurate, and comparable reporting across the financial industry.

Regarding streamlining entity-level disclosure requirements across various legislations, WeeFin believes there is **some room for harmonization,** but SFDR should **primarily focus on products.**

- WeeFin believes that SFDR may not be the ideal framework for **entity-level disclosures,** as they often appear poorly structured and overly generalized, making their implementation challenging, **especially for large companies.** Other national regulations or initiatives like CSRD, TCFD, Article 29 ECL etc., could be utilized for entity-level disclosures to maintain clarity and avoid unnecessary duplication.
- WeeFin considers **SFDR suitable for product-level disclosures**, as it promotes transparency and comparability. **WeeFin supports the imposition of uniform disclosure requirements for all financial products offered in the EU, regardless of their sustainability-related claims or other considerations. This approach would enhance transparency and facilitate quicker classification of funds, helping investors make informed decisions.**

We propose that a fundamental **set of disclosures should be mandatory for all financial products**, regardless of their nature. Additionally, there could be a trigger mechanism for ESG-focused funds (when the fund respond "yes" to several questions regarding ESG consideration), requiring them to provide more comprehensive and detailed disclosures to meet the specific needs of sustainability-conscious investors. WeeFin believes that **additional disclosure requirements are necessary when financial products** make sustainability claims. When a fund claims to consider, take into account or implement metrics or processes related to sustainability, it should be required to provide additional information to explain the nature of these commitments, how they are implemented, and the expected sustainability outcomes.

WeeFin strongly advocates for machine-readable and digitally-ready product information to enable easy comparisons. WeeFin views the European ESG Template (EET) as a suitable model for digitalizing sustainability disclosures. However, we emphasize the importance of making this model accessible to all market participants, not just distributors.

Section 4 : Potential establishment of a categorisation system for financial products

WeeFin general position

Standardizing fund categorization can offer initial clarity to investors. **However, it may not necessarily lead to a significant shift towards sustainability**. Funds categorization might discourage funds from conforming to predefined standards or reduce their level of ambition, especially considering variations in EU countries' rules.

- ***Too Strict: The Case of the Taxonomy***

Our study revealed that only 10% (8 funds) of those examined demonstrated any alignment with the Taxonomy. Surprisingly, even the actor with the highest alignment commitment (5%) failed to fully comply. In theory, establishing quantitative and precise criteria could provide a common framework for defining "Sustainable" activities and guiding financial flows toward sustainability. However, the practical complexity of implementing the European Taxonomy has had the opposite effect, discouraging many actors from embarking on this path due to its intricacies and calculations.

- ***Too Vague: The Case of SFDR***

A significant issue arises in distinguishing ambition level between Article 8 and Article 9 funds. Contrary to expectations set by SFDR, our study found no notable differences in ambition and transparency between these two categories. Even though Article 9 funds are supposed to be significantly more ambitious (aiming for 100% SI), in practice, being categorized as Article 9 carries limited meaning. The risk of greenwashing remains consistent. SFDR's foundation of sustainable investment relies on the concept of double materiality, incorporating indicators to measure positive contributions and the consideration of Principal Adverse Impacts. Regrettably, this concept is inadequately integrated among market players, with 60% lacking quantifiable indicators and 66% failing to provide transparency about their methods for addressing Principal Adverse Impacts.

It's important to **preserve the diversity of sustainable fund strategies**, many funds have multiple strategies (products may involve a combination of exclusions, transition, and sustainable investments), which can lead to confusion among end investors.

Approach 2 aligns more closely with WeeFin's recommendations. We believe it's crucial to leverage existing frameworks and enhance them by introducing minimum requirements, **but without converting classifications into formal categories.**
WeeFin's vision involves **simplifying the current system in favor of a unified reporting framework** for all financial market participants, eliminating the need for specific classifications: Articles 6, 8, or 9. This unified reporting would ask relevant questions to each fund, regardless of it ESG strategy and it commitment level. "No" responses would trigger requests for explanations and action plan for improvement, while "yes" responses would trigger for more detailed disclosures and could activate minimum requirements (such as coal exclusion thresholds for climate funds, engagement ..).

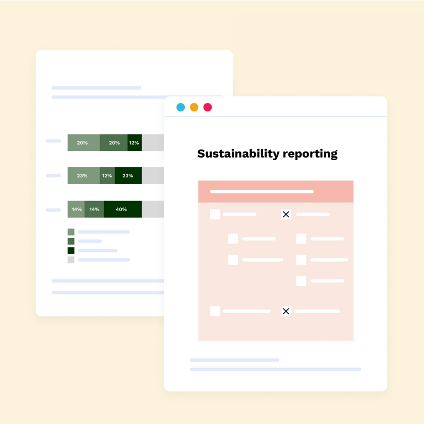
WeeFin feedback on product categorisation

Approach 2: Converting Articles 8 and 9 into formal product categories, and clarifying and adding criteria to underpin the existing concepts of environmental/social characteristics, sustainable investment, do no significant harm, etc.

WeeFin advocates against converting Articles 8 and 9 into formal product categories. We propose eliminating Articles 6, 8, and 9, as they can lead to confusion and misinterpretation. We recommend using national labels for marketing purposes to categorize strategies instead of implementing product categorization.

Clarification of existing concepts (environmental/social characteristics, sustainable investment, do no significant harm, etc)

Introduction of minimum requirements : sustainability risks, engagement process, PAI reporting, normative and sectoral exclusion with specific criteria depending of the fund strategy



- Standardised and unified reporting for all funds
- Questions with yes/no answers or tick boxes with quantitative or qualitative information
- Questions relating to commitments, processes and resources used.
- All funds must disclose. Additional disclosure applies if yes by explaining textually how and/or other questions are activated. Comply or explain if no by explaining improvement plan. Some questions integrate minimum requirements depending on fund disclosure.
- Several thematic asked : exclusion, scoring, threshold, PAI, climate transition, taxonomy, etc....
- Link with EET and machine readable.

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