Mazars Group
61 rue Henri Regnault
92075 Paris La Défense Cédex
France

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European Commission
Directorate-General for Economic and Financial Affairs
Rue de la Loi 170 / Wetstraat 170
1049 Bruxelles / Brussel
Belgium

Re: Response to the targeted consultation and public consultation on the implementation of the Sustainable Finance Disclosure Regulation (Consultation period: 14 September 2023 – 15 December 2023)

Dear Commissioners,

Mazars welcomes the European Commission’s invitation to participate in the targeted consultation regarding the implementation of the Sustainable Finance Disclosures Regulation (SFDR). We are grateful for this opportunity to provide our insights and feedback.

Our firm is actively involved in the public discourse around sustainability reporting, particularly in France through the *Commission Nationale des Commissaires aux Comptes*. Additionally, we contribute to the ongoing effort to standardise sustainability reporting at the European Union (EU) level. Our Honorary Chairman, Patrick de Cambourg, chairs the Sustainability Reporting Board of the European Financial Reporting Advisory Group, closely associated with various European regulations and initiatives, including the SFDR.

Our experience in implementing the SFDR for financial market participants across the EU and for Third Country firms operating within EU markets positions us to offer valuable observations and comments for this consultation. Moreover, Mazars’ subject matter experts participate in trade association working groups such as those of the European Fund and Asset Management Association, the Association of the Luxembourg Fund Industry, the Association for Financial Markets in Europe, the Irish Funds Industry Association and The Investment Association, further informing our contribution to this consultation.

Mazars recognises the SFDR as a critical tool in promoting transparency within the financial sector and in achieving the EU Action Plan’s primary goal: directing greater investment capital towards sustainable economic activities. This regulation is key to mitigating the effects of human-caused climate change, in line with the Paris Agreement. Since the SFDR's implementation, we have identified a need for a comprehensive review of stakeholder experiences. This review aims to clarify misconceptions and highlight crucial aspects of transparency.

Best regards,

Phuong Gomard

Partner – Global Head of Sustainable Finance

Introduction

In light of the evolving sustainability regulations within the EU finance and banking sector, a thorough understanding of the complex interplay between various directives and legislations becomes imperative. This is especially pertinent in the context of the Corporate Sustainability Reporting Directive (CSRD) and the European Banking Authority Environmental, Social and Governance (ESG) Pillar III, both of which are deeply intertwined with fundamental ESG legislation, including the EU Taxonomy. This need is further emphasised on the global stage with initiatives like the Task Force on Nature-related Financial Disclosures and the Network for Greening the Financial System. A key consideration is the development of a labelling framework, which, though not initially envisaged, must now be comprehensively addressed.

With these considerations in mind, Mazars is committed to providing insights on four key areas of the consultation, leveraging our extensive experience in various countries where asset management is prominent. Our contribution includes technical challenges we have faced, observations from our clients in the financial market and feedback from discerning investors.

Classification of Financial Products

Our review of the SFDR and feedback from clients highlight significant challenges and ambiguities in its application. The primary concern is the lack of specificity within Articles 6, 8 and 9, leading to varied interpretations.

The European Securities and Markets Authority has attempted to clarify these issues through Q&As, but substantial ambiguity remains. These efforts have inadvertently led to a multitude of interpretations, especially regarding the distinction between activities that promote environmental or social characteristics and those that constitute sustainable investments.

To improve clarity and reduce ambiguity, a more definitive and detailed articulation of these articles is essential. While refining these definitions, it is crucial to maintain the flexibility asset managers need in portfolio construction. Currently, the interpretation of Articles 6, 8 and 9 is largely left to asset managers, which contributes to ongoing ambiguity.

Transparency needs to be a universal aspect of SFDR, with clear distinctions between Articles 8 and 9. These distinctions should be based on specific reference indicators. In this context, the establishment of labelling criteria should include elements like impact strategies, exclusions and a clear link to the EU Taxonomy. This approach suggests a dual labelling system: an SFDR label outlining fundamental criteria from Articles 8 and 9, and national labels like ISR and GreenFin in France, each with their own minimum standards. The SFDR would then serve as a baseline for portfolios to qualify as sustainable, providing a clear benchmark rather than adding to the existing confusion.

Principal Adverse Impact

The reporting of Principal Adverse Impacts (PAIs) is a crucial element in the implementation of ESG disclosures. It is intended to provide investors with valuable information about the impact of their investments. However, the practical application of these requirements has presented significant challenges, including difficulties in understanding PAIs, inconsistent applicability and issues in data disclosure and retrieval.

A key issue is the challenge of correlating investment decisions made in the reference year with the data disclosed. The market often experiences missing data, leading to an incomplete portrayal of indicator performance. The coverage of data for these indicators ranges from low to moderate, undermining the disclosure's intended purpose. To address this, we propose a simplified reporting template with fewer data points. This would allow financial market participants and advisors to focus on gathering significant data points, with the option to disclose others on a voluntary basis.

Moreover, financial market participants and advisors encounter challenges in validating data received from third-party sources. Currently, there is an overreliance on controls like expert estimations and peer comparisons, with insufficient due diligence systems for data verification. We suggest the regulatory licencing of rating agencies as a step towards ensuring data reliability and security.

Mazars' observation that the definitions and formulas related to the PAI Statement are overly complex or absent further complicates matters, Clear ESG-terminology and a standardised set of formulars would greatly facilitate the implementation of these requirements.

In conclusion, to effectively mitigate the risk of 'greenwashing' and uphold the integrity of sustainable practices, introducing more precise and prescriptive definitions, along with potential thresholds, is critical.

Exploring Interactions with Other European Regulations

Mazars has closely examined the intricate interplay between the SFDR and other European sustainable finance regulations. A key challenge in this domain is identifying synergies and commonalities among these regulations, given their complexity and the interwoven nature of their legal texts. These regulations, particularly in their definitions of sustainability, often contain overlapping and interconnected provisions, complicating the task of achieving harmonious and uniform reporting standards.

EU Taxonomy

Regarding the EU Taxonomy, we have pinpointed critical areas for alignment with the SFDR, particularly concerning the Taxonomy's six environmental objectives. However, discrepancies remain, notably in the application of the "Do No Significant Harm" principle, leading to divergences between the regulatory framework and the classification system. A more unified approach would facilitate a consistent understanding of adverse impacts.

The definition of sustainability varies across initiatives, creating different interpretations of the EU's ecological transition efforts and potentially undermining transparency goals. Each piece of sustainable finance legislation serves a unique role, but the broader objective of ecological transition necessitates a cohesive understanding of these varied policies and their implications. A unified definition of sustainability would be instrumental in achieving this.

Under Article 6, SFDR should mandate comprehensive disclosure of the ESG impact of financial products. Financial market participants and advisors must detail how sustainability risks are integrated into investment decisions and the potential impact of these risks on financial product returns. When sustainability risks are deemed non-material, a clear justification should be provided.

Mazars acknowledges the move towards a more sustainable financial landscape, marked by the integration of ESG standards. This transition will likely impact various financial key performance indicators (KPIs), such as return on equity and management fees. Detailed explanations of these metrics are crucial for investors, illuminating the indirect benefits of investments when assessed from a sustainability perspective.

Increased transparency is necessary, particularly in explaining investment strategies and portfolio exclusions. For instance, asset managers should elucidate their decisions regarding non-investment in fossil fuels, thus providing clear reasons for such exclusions. This approach aligns with the objectives of the EU Taxonomy and clarifies the types of exposures excluded due to their inconsistency with these goals. The integration of pre-contractual documents should be mandated in the service of achieving this alignment and the associative transparency gains.

CSRD

The need for convergence also extends to the Corporate Sustainability Reporting Directive (CSRD). The upcoming CSRD mandates detailed quantitative and qualitative disclosures about a company's activities and transition plans, introducing precise ESG-related KPIs.

By 2027, a significant number of financial market participants and advisors will be required to submit sustainability reports, providing the SFDR with a wealth of KPIs to enhance its effectiveness. These indicators will shape the strategies and portfolios of market participants, increasing their specificity and relevance. Regulatory emphasis on integrating a broader range of ESG KPIs into strategic frameworks is essential. Additionally, enabling market participants to utilise the diverse requirements of various legislations is crucial to developing more sophisticated, focused and transition-oriented strategies.

Summary Recommendations

Novel Product Categorisation System

There is a strong consensus on the need for a revamped product categorisation system under the SFDR. It is widely recognised that the SFDR has not fully met its intended objectives, highlighting the necessity for an updated and more effective categorisation framework.

Simplification of PAI Statement

We advocate for a more streamlined PAI Statement template, featuring fewer data points. This simplification would facilitate the collection of significant market data by financial market participants and advisors, allowing for voluntary disclosure of additional data. Additionally, the establishment of clear ESG terminology and a standardised set of formulars would significantly ease the implementation of these requirements.

Uniformity in Sustainability Definitions

The review of interconnected regulations reveals notable inconsistencies in the definitions of sustainability. These varying interpretations, arising from different initiatives, lead to mixed views on the EU's ecological transition commitment. Therefore, harmonising sustainability definitions across initiatives is critical to maintain a coherent approach to ecological transition.

Alignment with EU Taxonomy

Aligning the SFDR and the EU Taxonomy is a crucial aspect of our analysis. This effort aims to synchronise key indicators between the SFDR and the EU Taxonomy, especially regarding its six environmental objectives. However, it is important to address the existing differences, particularly in the application of the "Do No Significant Harm" principle.

Leveraging CSRD KPIs

The impending CSRD will soon require a large segment of financial market participants to submit comprehensive sustainability reports. These reports are expected to offer a wealth of KPIs that could significantly bolster the efficacy of the SFDR.