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European Commission
Directorate-General for Financial Stability, Financial Services and Capital Markets Union
1049 Brussels
Belgium

Targeted Consultation – Implementation of the Sustainable Finance Disclosures Regulation (SFDR)

Dear Sir or Madam,

On behalf of Deloitte[1], we are pleased to respond to the Targeted Consultation on the implementation of the Sustainable Finance Disclosures Regulation from September 14, 2023. Based on our assurance and advisory experience with the Sustainable Finance Disclosure Regulation (SFDR), we hereby highlight what we deem to be the most important topics to consider for this consultation and going forward for the further development of the SFDR.

Deloitte welcomes the upcoming review reassessing the efficiency and effectiveness of the SFDR in meeting its objectives. We share the view that the SFDR plays a more significant role, beyond being an ESG reporting framework, for enhancing the transparency of sustainability information for end-investors. It acts as a key pillar of the EU's sustainable finance policy for attracting private investment and supporting the transition to a sustainable and climate neutral economy. Based on our experience as investment funds auditors, we have observed that financial market participants (FMPs) have used the framework provided by SFDR as a product labelling regime. However, the flexibility afforded by this framework, which often lacks clear guidelines, means that it is not currently appropriate for this purpose.

Our comments and suggestions are intended to balance the need to strengthen consistency, through applying requirements as specified in Articles 8 and 9, while maintaining flexibility for entities to disclose relevant information (and not be required to disclose information that is not material).

Furthermore, we emphasise some areas where we think that the reporting burden for FMPs and investee companies could be reduced, without significantly impairing the quality of the information provided. We focus on identifying minimum criteria that more clearly define the products falling in the scope of Articles 8 and 9, to also mitigating greenwashing. Therefore, we suggest the European Commission consider the following:

a) Clarifying the definition and the application of key SFDR concepts, such as 'sustainable investment' (SI), and introducing the concept of 'assets in transition';

b) Making more reporting requirements subject to materiality assessments and ensuring the alignment of the required methodology with other sustainable finance regulations; and

c) Introducing minimum criteria for SFDR Articles 8 and 9, as a categorisation system for sustainable financial products.

[1] For more information, see the link to Deloitte.

In the annex, you will also find our answers to the detailed questionnaire.

This response complements Deloitte's response[2] on July 4, 2023, to the ESAs Joint Consultation Paper 2023-09 of April 12, 2023, on the Review of the SFDR Delegated Regulation regarding PAI and financial product disclosures.

1. Clarifying the definition and the application of key SFDR concepts, such as 'sustainable investment' (SI), and introducing the concept of 'assets in transition'

Deloitte observes that some legal requirements and concepts in the SFDR, such as 'sustainable investment', 'principal adverse impact' and 'all investments' are not sufficiently clear. This can prevent capital from being allocated to sustainable investments as effectively as they could be, as well as creating legal uncertainty and reputational risks for financial market participants (FMPs) and financial advisers. The risk of greenwashing should also be considered.

a) Adopting clear and applicable requirements for the 'sustainable investment' definition, and introduce the concept of 'assets in transition'

In practice, we have noticed that a large majority of stakeholders have found it challenging to understand and implement the concept of 'sustainable investment', and the disclosures it requires in the periodic report. We find that the definition set out in Article 2(17) of the SFDR is not sufficiently clear. In particular, based on our experience, FMPs find difficulties in:

a) Clearly justifying the positive contribution to an environmental or social objective, because these sustainable objectives are also not defined;

b) Assessing that such investments do not significantly harm any of the environmental and social objectives, despite the clarification given in Article 51(d) and Article 59(e) of the Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022, by taking into account the indicators for adverse impacts in Table 1 of Annex I, and any relevant indicators in Tables 2 and 3 of that Annex of that regulation.; and

c) Ensuring that the investee companies follow good governance practices as required by SFDR, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance, as no standard criteria have been defined.

d) Moreover, we suggest exempting all the Funds that invest in real estate assets from the need to undertake a good governance practices assessment because it is not possible to check the governance for direct investments in buildings for which there is no companies in the loop. Furthermore, we do not consider that it is relevant to verify the good governance of the asset manager or the property manager.

We also note that, today, the SFDR allows for individual approaches for the definition of sustainable investment. This does not promote comparability among financial products issued by different FMPs, and it could lead to significant risks of greenwashing. This may incentivize FMPs to adopt a rather broad definition of what a sustainable investment means, as the KPI is part of the sustainability preferences of MiFID II and IDD. We consider that clearer rules could create clarity, allow for comparability and reduce greenwashing risks.

2 Deloitte's response on the April 2023 ESAs Joint Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures

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Furthermore, we recommend integrating and defining a concept of 'assets in transition' under the SFDR framework. This concept is already used by FMPs in the design of financial products, although they use different approaches. Considering investments in assets, which may not yet be sustainable for the environment and/or society but that are in transition to becoming more sustainable over time, could, in our view, be useful to support an overall economy transitioning to a more sustainable future.

If our recommendation is followed, the SFDR regulation could set minimum requirements to be disclosed in the pre-contractual document of funds that commit to invest in 'assets in transition', for a more coherent approach, such as:

a) Defining short and medium-term targets for the achievement by the fund of positive contribution to a sustainable objective;

b) Describing the robust evidence expected to be collected by the fund about assets' potential to improve environmental and/or social characteristics or sustainable investment objectives, as a basis for selecting assets;

c) Asking the fund to explain how it monitors the application of good governance practices (as required for sustainable investment) and satisfactory progress on potential DNSH breaches;

d) Defining KPIs for measuring the 'assets in transition' progress and demonstrating their potential, over time, to meet the targets.

Moreover, and to facilitate financing these assets, we also suggest requiring Article 8 and 9 products investing in these assets using minimum thresholds. For example, to be categorized as an Article 8 financial product, a minimum of x% (tbd) of investments should be in 'transition assets' and/or 'sustainable assets'.

b) Reducing the number of Principal Adverse Impact indicators

The SFDR disclosure requirements consist of a wide variety of KPIs covering different topics. Some are mandatory while others are additional. The objective of the PAI reporting is to inform stakeholders of a wide range of relevant sustainability-related topics on impacts of investments on external sustainability matters In our view, the added value of reporting several PAIs relating to the same topic (for example additional PAIs 9, 10 and 11 in table 3) is questionable.

Having similar KPIs relating to the same topic negatively affects the significance of each single KPI, except notably for CO2 related indicators which are each specific and meaningful.

As a result, the objective to inform financial advisors and retail investors might be missed, due to the extensive and complex PAI disclosures. Investors should not be confronted with an overwhelming amount of information. Instead, they should be able to rely on effective, clear, and significant KPIs to make their investment decisions.

We strongly recommend reviewing the whole list of KPIs and taking steps towards a clear, understandable, and useful selection of mandatory PAIs, focussing on the usability and understandability of the information disclosed. Focusing on material and therefore decision-useful KPIs per topic, beyond being less costly, would be more helpful, relevant and would increase comparability between FMPs.

c) Establishing a definition of "all investments"

The asset allocation in the periodic report provides a graphical representation of the investment strategy followed by the financial product. It therefore includes relevant information (e.g., which part of the portfolio ends up in the bucket "other"). In the current form, we observe different implementation approaches across

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markets. Clear guidance on how to calculate the asset allocation is necessary for a consistent implementation across FMPs.

2. Making more reporting requirements subject to materiality assessment and ensuring methodology alignment with other sustainable finance regulations

a) *Explicitly confirming in the SFDR the possibility to consider the materiality assessment included in the ESRS*

We support the approach of the delegated regulation on ESRS adopted by the European Commission on 31 July 2023, which specifies that the sustainability reporting under the Corporate Sustainability Reporting Directive (CSRD) should provide information identified as material after conducting a double materiality assessment. Based on this principle, information that is not considered material would not be reported by investee companies, even if it relates to an SFDR-relevant indicator. The company will only have to explicitly state that the datapoint in question is “not material”. Therefore, FMPs and financial advisers may assume that any indicator reported as not material by an investee company does not contribute to the corresponding indicator of principal adverse impacts in the context of the SFDR disclosures.

This is why we fully support the European Commission position in favour of this presumption (cf. the FAQs on the Adoption of European Sustainability Reporting Standards issued on 31 July 2023) and the proposed amendment to the SFDR by the ESAs, in their Final Report on the draft Regulatory Technical Standards on the Review of PAI and financial product disclosures in the SFDR Delegated Regulation published in December 2023 – (proposed review of art. 7 §3: “*Financial market participants may consider datapoints assessed as non-material by investee companies reporting in accordance with Annex I to [Commission Delegated Regulation XXX], ESRS 1 General Requirements, Section 3.4 Impact materiality and Section 3.5 Financial materiality as not contributing to adverse impact measured by the corresponding indicator in Annex I of this Regulation*.”).

In the context of the revision of SFDR, we would expect that it is confirmed that the ESRS materiality assessment should clearly support and limit the SFDR reporting requirements, as the ESRS define the sustainability information that is considered relevant for annual reports for a wide range of stakeholders.

b) *Ensuring methodology alignment*

The methodologies for calculating, processing, and consolidating KPIs must be coherent to ensure consistency, readability, and comparability between information produced according to the SFDR, the CSRD and the EU Environmental Taxonomy Regulation.

In this context, we encourage greater interoperability between EU regulations, to ensure that entities are not required to prepare multiple sets of reports, or a plethora of different metrics under different standards. Preparing multiple sustainability reports and calculating similar KPIs on different methodologies is time consuming and costly for EU companies. It may also reduce the comparability of KPIs on the same topic. That is why we suggest that the European Commission addresses these issues, to allow for the provision of useful and relevant information at a reasonable cost for FMPs and investee companies. We encourage the revision of the SFDR and its alignment with the latest developments of the CSRD/ESRS, EBA Pillar 3 and the EU Taxonomy. In particular, economic activities which are classified as sustainable under the assessment of the Taxonomy criteria shall also be considered sustainable under the SFDR, as mentioned by the EC in its 12 June 2023 Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the SFDR (2023/C 211/01, FAQ 4).

c) *Avoiding duplication of disclosure at entity level for the FMPs, if other sustainable finance legislations request the same or similar reporting*

Deloitte welcomes the question as to whether the SFDR is the right place for entity-level disclosures. The current SFDR approach seems inconsistent with the European Commission's efforts to reduce the reporting burden of companies.

With the CSRD, the extension of the scope of the NFRD is expected to impact large asset managers and funds structured as companies (except UCITS and AIF funds)[3], with additional ESG reporting requirements. Notably, they will be required to report information on PAIs. It is important to consider whether they are already subject to reporting the PAIs statement under the SFDR. Therefore, entities in scope of both the CSRD and SFDR should only report once at the entity level, under one of these, rather than both.

Such an overlap would not only be very burdensome but also detrimental to the clear and consistent understanding of investors, who could receive the same or similar information presented in different templates and formats (for instance, in the periodic report template under the SFDR as an appendix to the annual report, versus disclosure in the management report of the annual report under the CSRD).

3. Introducing minimum criteria for SFDR Articles 8 and 9 as a categorization system for sustainable financial products

Deloitte has observed that the SFDR is not only being used as a disclosure framework, but rather as a labelling and marketing tool in the case of Articles 8 and 9 instruments. This has also changed the way that FMPs design their products.

Articles 8 and 9 financial products are widely recognised in Europe, and have shaped the single market. Financial products under both Articles reached the EUR 5 trillion milestone at the end of September 2023, representing a share of 56.4% of the EU funds available for sale in the EU[4], according to the latest Morningstar Review of SFDR Article 8 and Article 9 funds.

However, the SFDR classification does not clearly help investors to appreciate the extent to which financial products and their investments are sustainable, as FMPs have implemented their categorisations with divergent interpretations and a large diversity of frameworks. In this context, we encourage a categorisation system for financial products at EU level.

The European Commission proposed two broad strategies for a categorisation system for financial products. Deloitte does not agree with the approach proposed by the European Commission of not considering the SFDR anymore and focusing on the type of investment strategy and introducing new concepts. We do not question the need for a more precise classification system for financial products. But we consider that removing the existing SFDR classification could prove to be counterproductive. The significant SFDR implementation efforts by FMPs since March 2021, and the confidence of institutional investors in Articles 8 and 9, should not be overlooked.

We therefore support the choice of establishing a standard categorisation system for financial products built on the distinction between Articles 8 and 9 and the existing concepts embedded in them, by adding

[3] which meet two of the three criteria (more than €20 million balance sheet total, more than €40 million net turnover, more than 250 employees)

[4] From Morningstar Direct Database, excluding money market funds, funds of funds, and feeder funds

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minimum criteria to define products in the scope. This would entail setting specific, measurable, achievable, relevant, and time-bound (SMART) requirements, which will directly support the transition to a sustainable, climate-neutral economy, and facilitate comparisons between financial products based on their sustainability considerations.

We therefore make the following recommendations as examples of what could be minimum requirements:

a) Considering that the criteria dedicated to the Article 9 be more demanding than those for Article 8;

b) Defining minimum binding ESG approaches for qualification as Article 8 or Article 9 funds;

c) Requiring a minimum threshold of underlying assets aligned with environmental and/or social characteristics for Article 8 products;

d) Requiring a minimum threshold of underlying assets invested in activities aligned with the EU Environmental Taxonomy for Article 9 products;

e) Specifying the type of Article 8 and 9 financial products that would be required to report on principal adverse impacts (PAI);

f) Introducing more precise requirements for funds' names and the use of terminology related to ESG, such as 'sustainable', 'ESG', 'green', 'responsible', 'impact' or 'net-zero'… These should be linked and reserved to specific product categories.

We would appreciate your consideration of the comments above in the revision of the SFDR.

If you have any questions concerning our comments, please contact Laurence Rivat in Paris at +33 1 55 61 67 60 and Pablo Zalba in Madrid at +34 9 14 38 19 08.

Yours sincerely

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