

AFM position paper on improving the SFDR

Towards more meaningful and consumer-friendly sustainability disclosures

The market for sustainable finance has grown rapidly since the European Commission announced its **Sustainable Finance Action Plan in 2018**. One of the plan's main goals is to reorient capital flows towards sustainable investments, in order to achieve sustainable and inclusive growth. Adequate and clear information on sustainability is essential for the functioning of the sustainable finance market. For this reason, mandatory disclosures on sustainability risks, adverse impact, characteristics, and objectives have been introduced through the Sustainable Finance Disclosure Regulation (SFDR).¹

In the light of the current consultation on a review of the SFDR², the AFM proposes improvements to the framework to make it more meaningful to investors and the objective to reorient capital flows to where impact is made. In this position paper the AFM proposes changes that should ensure that the legislative framework is better suited to supporting investors (particularly retail investors) in their sustainable investment decision-making. The proposed changes concern not only the disclosures but also a proposal for minimum quality requirements for certain categories of sustainable products, in line with consumer expectations. This can, in turn, help investment professionals to provide meaningful sustainability-related investment advice to their clients.

This paper aims to stimulate further discussion on the direction of the SFDR level 1 review. The AFM welcomes discussion on the content of this paper.

Our key proposals:

- Ensure a level playing field: require minimum adverse impact disclosures for all financial products, regardless of their sustainable characteristics.
- Introduce sustainable product labels that investors can understand, such as “transition”, “sustainable” and “sustainable impact”, to ensure alignment with investor expectations and objectives as well as the actual sustainability profiles of investment products.
- Attach specific minimum quality and disclosure requirements tailored to each of these labels, to address greenwashing risks and make classification under one of these labels meaningful in market practice.
- Remove the current “Article 8” and “Article 9”, to tackle their current misuse as proxy labels.
- Allow other products that do not meet the quality requirements for any of the sustainability labels to disclose their ESG credentials with reduced disclosure requirements. Such products, however, should not be allowed to claim adherence to a sustainability “label”.
- Amend rules for client advice (MiFID and IDD) in line with legislative changes to the SFDR so that intermediaries and investors can make effective use of SFDR disclosures to select a financial product that meets their clients’ sustainability preferences.

¹ Amongst other legislative initiatives, such as the EU Taxonomy, CSRD, climate benchmarks and product governance and suitability amendments to MiFID and IDD.

² The Commission launched a [targeted consultation](#) on the implementation of the SFDR on 14 September, with the aim of performing a comprehensive assessment of the framework.

1. Moving towards more consumer-oriented sustainability disclosures

SFDR information aims to give investors meaningful and reliable insight into the degree of sustainability of financial products. Such transparency is crucial to facilitate the flow of capital towards the sustainable investments that are necessary for the transition to a sustainable economy. SFDR disclosures support investors in making these investment decisions.

The upcoming comprehensive review of the SFDR offers the opportunity to reassess the functioning of the framework and to further improve and adjust it where necessary. The SFDR has been a pioneering force of legislation regarding transparency on sustainability matters in the financial markets. It has been applicable since March 2021 and has provided investors with more standardised and reliable information on the sustainability aspects of financial products.

In this paper, the AFM offers several recommendations to improve the framework and provide investors with more consumer-friendly and reliable sustainability information. We describe 1) the issues we have seen with the SFDR since its application in 2021, 2) consumer perspectives on sustainable investments, and 3) concrete proposals to improve the SFDR legislative framework.³ The paper concludes with challenges that must be taken into account.

2. What have we seen so far?

A step forward

The implementation of the SFDR has been a good step forward in providing investors with structured sustainability information on financial products. Due to the SFDR, financial market participants are required to substantiate their sustainability claims, not only in the precontractual phase but also periodically. This means that it is no longer possible to claim that a financial product is sustainable without further explanation and periodic reporting on actual performance. This helps to address the risk of greenwashing, and supports investors in assessing the actual degree of sustainability of a financial product. This is a great improvement compared to the situation prior to the SFDR.

Disclosures are too complex

However, the information that is disclosed based on the SFDR is not always easy to understand⁴ and compare, especially for retail investors. Consumer research shows that retail investors find it hard to assess the actual degree of sustainability of a financial product based on the SFDR disclosures in the mandatory product information template. In addition, the distinction between products reporting under Articles 8 and 9 is not clear for investors. These results are unfortunate and warrant careful reconsideration of the current framework, in particular because research shows that retail consumers are, in fact, very interested in making sustainable investments and more prone to being misled by unsubstantiated sustainability claims⁵.

Use of Articles 8 and 9 as sustainability labels

The categorisation of financial products along the lines of SFDR Articles 8 and 9 has led to their misuse as sustainability labels in the market. The SFDR makes a distinction between financial products that promote environmental and/or social characteristics (Article 8) and products that have sustainable investments as their objective (Article 9). Based on the applicable article, financial market participants have to provide specific product disclosures. With the implementation of the SFDR in market practices, we have seen that the market has been using the distinction between these categories as *de facto* labels for a certain degree of sustainability. However, these categories are not meant to be used as product labels and are not suitable for this purpose.

³ The proposals mainly deal with “inside-out” (i.e. impact) aspects of SFDR disclosures, as this is what many sustainable investors seek and where the biggest improvements can be made.

⁴ Based on consumer research by the AFM as part of the SFDR level 2 review, expected publication November 2023.

⁵ AFM publication [In close-up: Sustainable Investors](#), 2022.

The misuse of Articles 8 and 9 can be a source of greenwashing. The distinction between financial products that promote sustainable characteristics and products with sustainable investments as an objective is not clear and therefore prone to different interpretations. Both categories include products with a varying degree of sustainability, as well as very different sustainability strategies. In particular, there is no meaningful sustainability quality threshold for products that report under SFDR Article 8, which makes its misuse as a sustainability label especially problematic. This also leads to an uneven playing field for providers of products with greater sustainable characteristics or objectives vis-à-vis providers with less ambition.

Current market practices with regard to SFDR Articles 8 and 9, however, demonstrate a clear desire for consumer-friendly sustainability product classifications. Although the SFDR is not meant as a labelling regime, the fact that it is so widely used in that way shows that there is a strong desire amongst financial market participants, distributors and investors alike to use relatively simple classifications for sustainable products, in order to navigate the complex matter of sustainability in investments. Any review of the SFDR should take this into account. In this paper, we make some concrete proposals to this end in paragraph 4.

Struggle with the definition of sustainable investments

The definition of sustainable investments under 2(17) SFDR is an open norm that leaves room for a wide interpretation that is not always in line with investor expectations. Within the SFDR, the concept of sustainable investments is an important building block. The categorisation of a product's disclosure requirement (Article 8 or 9) within the SFDR is dependent on the interpretation of this concept. However, the meaning of a sustainable investment is complex and therefore only loosely defined. This leads to a wide variation of investments and investment strategies being considered "sustainable", while these considerations are not always in line with investor expectations. The percentage of sustainable investments of financial products is given a prominent place in SFDR disclosures, in order to assess the degree of sustainability of financial products. However, without strict(er) requirements on what can be considered a sustainable investment, a comparison between products based on this percentage has only limited value.

3. Retail investors' perspective

An AFM study⁶ in 2022 shows that most sustainable investors seek to make sustainable impact through their investments. Other research shows similar results.⁷ The AFM study shows that consumer expectations with regard to sustainability vary. In line with earlier studies, the AFM found that the most important objectives for sustainable investments are, in this order:

- (1) Impact; these investors want to make impact by bringing about positive sustainable change with their investment (this can happen through either exclusion/inclusion or engagement practices);
- (2) Ethical; investors want to invest in companies that are in line with their personal norms and values, also referred to as "value alignment"; and
- (3) Return; investors regard sustainability as a way of achieving a better risk-return ratio.

Based on current SFDR information it is not always possible for retail investors to see which sustainability expectations a financial product meets.

The study also showed that consumers find it difficult to distinguish between products that make impact versus products that are value-aligned. Previous research by the AFM in 2022⁸ already showed that sustainable funds vary widely in the way they define sustainability. This also makes it harder for investors to select a financial product that meets their sustainability preferences.

⁶ AFM publication [In close-up: Sustainable Investors](#) 2022.

⁷ See also [What do your clients actually want? Understanding and estimating household demand for sustainable financial products](#), 2° Investing Initiative, 2022.

⁸ AFM [exploratory study - Sustainable investment funds](#) (only in Dutch) 2022.

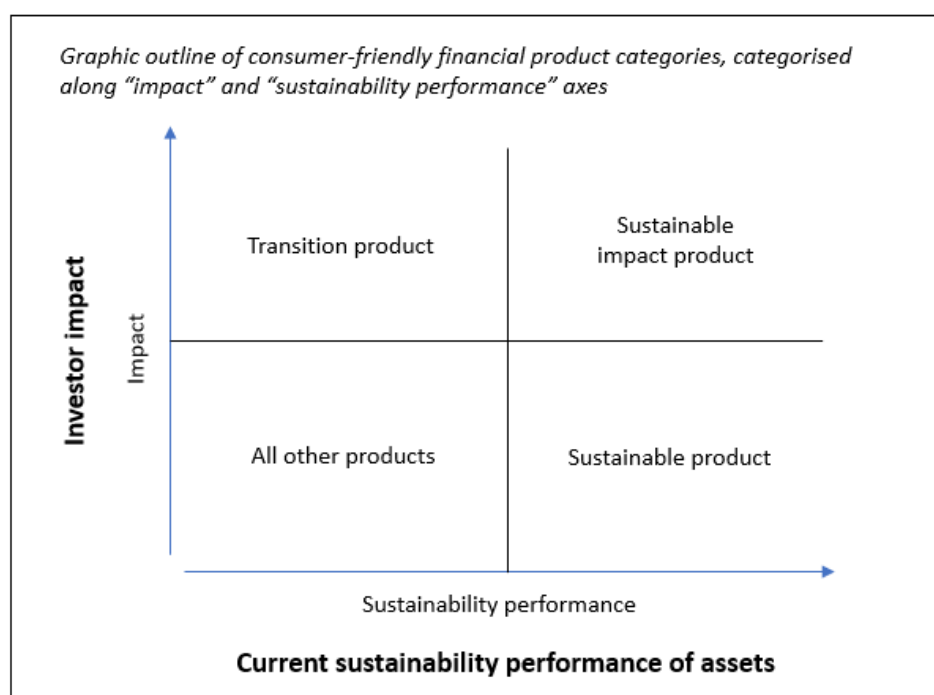
4. Proposal for a sustainable financial product framework that combines quality requirements with disclosure requirements.

Many of the issues mentioned above could be solved by making the SFDR framework more investor-oriented, through better and more consumer-friendly product categorisations. Based on the experiences with the SFDR so far and consumer research, we propose to move away from the current SFDR distinction between products with “sustainable characteristics” and “sustainable investment objectives”. This current distinction creates confusion in the market with regard to interpretation of terms such as “promotion of characteristics” and “sustainable investment objectives” and does not correspond to the objectives and expectations that investors (particularly retail investors) have. In order to better align disclosures and categorisation with investor objectives, we propose to introduce a framework that distinguishes products along the lines of their different types of sustainability profiles and strategies. Disclosures should be tailored to these sustainability profiles, to ensure they are most useful for investors when making their investment selection.

Minimum disclosure requirements for all products, plus minimum quality requirements for products that wish to qualify as a specific type of sustainable product.

In order to ensure a minimum level playing field, all financial products should provide a minimum set of disclosures on sustainability impact. The AFM is in favour of a disclosure regime that supports a level playing field for all financial products with or without sustainable features. This would mean that all financial products should make disclosures on a limited number of sustainability indicators in order for investors to assess the most important negative impact. These disclosures will be supplemented with differentiated disclosure requirements depending on products’ sustainability claims. This system would not only help investors to select sustainable products but also to quickly assess what products do not incorporate sustainability and to compare the negative impact of different financial products.

We distinguish three main sustainable investment categories, which differ on the one hand in terms of the current level of sustainability of the underlying assets and on the other hand in terms of the impact (additionality) of the investment itself. This is also often referred to as “company” impact vs “investor” impact. Investors often expect minimum sustainability standards for investee companies when it comes to sustainable products. They also often express a preference to make impact. These preferences are depicted in the graphic below.



Sustainable product labels, with minimum quality requirements as well as additional disclosure requirements, can guide financial market participants, distributors and investors through the complexity of making sustainable investment decisions. The four categories depicted above should be the basis on which investors can be informed about sustainability. In order to protect retail investors, products that aim to be classified under one of the three “sustainable” product labels (in the top row and right column) and to market themselves as such should meet minimum quality requirements. In addition, each category should have its own set of additional disclosure requirements tailored to the sustainable specificities of the respective product categories.

See **Table 1** below for a proposal for specific quality and disclosure requirements for each category. By introducing the three labels, we do not intend to create a ranking of financial products with regard to sustainability. The suitability of a particular product category is ultimately dependent on the sustainability preferences of the investor.

We propose to create specific labels for:

- 1) **Transition products:** products that invest in companies that are not yet sustainable (but plan to become so) and aim to create impact through active management of the investments. These products are well-suited to investors who seek to make sustainable impact, but are open to investing in assets that have yet to make the transition.
- 2) **Sustainable products:** products that do not necessarily make measurable, active impact through the investment but are intended to cater to investors that demand investments in sustainable assets only. These products are suitable mostly for investors who seek to invest in assets that are aligned with their values.
- 3) **Sustainable impact products:** products that seek to make direct and measurable impact through investments, by financing underserved markets or companies that have a tangible positive impact on sustainability factors. In these products, underlying assets would have to qualify as already sustainable; the focus is on growth of these markets or companies. This category would be well suited to investors who favour positive sustainability impact over return, due to the scarcity of suitable investments and high risks associated with this profile. In current market practice, only a limited number of products would qualify for this category.

Products that do not meet the quality requirements for any of the specific sustainability labels, but that do have sustainability characteristics or objectives, should still disclose these. Such products would fall into the “other products” category. Standardised disclosure requirements to be met by all products will allow these products to distinguish themselves from products that do not have any sustainability characteristics. However, in the interest of consumer protection, they should not be allowed to market themselves as if they were carrying a sustainability qualification, as they do not meet any of the minimum quality requirements for the “sustainable product” categories.

The SFDR requirements apply to a wide array of financial products; not all of them will be able to meet the above criteria to qualify for one of the “sustainable” classifications. Some financial products will explicitly focus on more than one category. For example, in the case of a pension fund that has a well-diversified portfolio, the product might only be partially able to meet the thresholds for one of these categories. To acknowledge this, we propose to allow such financial products to report on percentages of the total portfolio of investments that do fall within the quality requirements of “transition”, “sustainable” or “sustainable impact”.

Table 1:

In the table below we propose the three different investor-oriented sustainability labels with both minimum quality requirements and mandatory disclosures. The first set of disclosure requirements is applicable to all financial products with or without sustainable characteristics, including products with a sustainability label.

Minimum quality requirements	Minimum mandatory disclosure requirements (both precontractual and annually)
All products (both products with sustainability labels and those without)	
No specific requirements	<p>1. Report (y-o-y) on negative impact indicators⁹, such as:</p> <ul style="list-style-type: none"> - GHG emissions - Biodiversity - Human Rights - Labour Rights <p>2. Report on presence of sustainability characteristics and/or objectives (y/n).</p> <p>If yes:</p> <ul style="list-style-type: none"> - specify the <u>characteristics</u> and/or <u>objectives</u> - specify the <u>strategy</u> (e.g.. exclusion, inclusion, best-in-class, etc.) through which these are (or are to be) attained. <p>3. Report on the presence of a greenhouse gas emission (GHG) reduction target (y/n)</p> <p>if yes:</p> <ul style="list-style-type: none"> - Specify the reduction target, include separate reporting on actual reductions and reductions by the use of carbon credits.¹⁰
Products with “transition” label	
<ul style="list-style-type: none"> - Product has objective to generate positive, measurable social or environmental impact alongside a financial return. - The investment strategy provides additionality through active management (i.e. engagement), and the products accordingly have an engagement strategy. - Apply exclusion criteria referred to in Article 12(1)(a)-(c) of Commission Delegated Regulation (EU) 2020/1818 [ESMA fund name GLs proposal]. 	<ul style="list-style-type: none"> - Report on investor impact strategy (i.e. theory of change), including: <ul style="list-style-type: none"> o Impact targets (KPIs); o Engagement strategy (incl. how shareholder engagement is integrated into the investment strategy of the product, how the investee companies are monitored and how voting rights are exercised as well as how dialogue is conducted with investee companies); o Exit thresholds; o Metrics regarding measurement of investor contribution.

⁹ These indicators can be based on the PAI indicators of the SFDR delegated regulation (or a subset thereof).

¹⁰ In line with the proposed disclosures on GHG reduction targets as part of the current SFDR level 2 review.

<ul style="list-style-type: none"> - Investee companies have a credible transition plan (with short, medium, and long term targets). Where possible based on the CSDR standards.¹¹ Investee companies that do not yet have a plan in place should have one within two years of being part of the portfolio. - Product has transition targets in line with Paris (decarbonisation) and/or Kunming/Montreal agreements (biodiversity). - Product invests a minimum of 80% of AuM according to its sustainability strategy. 	<ul style="list-style-type: none"> - Report on overall product transition plan incl. short-term, medium-term and long-term targets, in line with CSRD requirements. - Report annually on progress with regard to transition plan targets.
Products with “sustainable” label	
<ul style="list-style-type: none"> - Product has objective to invest in sustainable assets.¹² - In the case of an environmental objective: where investments are in activities covered by the EU Taxonomy, investments should be taxonomy-aligned in order to qualify as sustainable. - Where investments are in activities that are not covered by the taxonomy or that have a social objective, the FMP should have its own set of criteria in order to qualify investments as sustainable. - No investments in companies that do significant harm to ecological or social objectives. - All sustainable assets are aligned with Paris goals (excluding instruments for specific purposes)¹³. - Product invests a minimum 80% of AuM according to its sustainability strategy, provided that all AuM adhere to “do no significant harm” criteria. 	<ul style="list-style-type: none"> - Report on taxonomy alignment of investments. - Report on the criteria and % of other sustainable assets (i.e. where not covered by the EU Taxonomy). - Report on the content of other assets (where relevant).

¹¹ Where possible the transition plan should be based on standards and guidance available under Directive (EU) 2022/2464 and its reporting standards. See also the [Commission recommendation on facilitating finance for the transition to a sustainable economy](#), in particular recommendation 7 on the use of a credible transition plan.

¹² E.g. sustainable investments in companies, real estate or corporate bonds.

¹³ Investments for certain specific purposes such as hedging or liquidity (see EC SFDR Q&A July 2021).

Products with “sustainable impact” label	
<ul style="list-style-type: none"> - Product has objective to generate positive, measurable social or environmental impact alongside a financial return. - Investor provides financial additionality, by financing underserved sustainable sectors or markets. - No investments in companies that do significant harm to ecological or social objectives. - All assets are aligned with Paris goals (excluding instruments for specific purposes)¹⁴. - Product invests a minimum of 80% of AuM according to its sustainability strategy, provided that all AuM adhere to “do no significant harm” criteria. 	<ul style="list-style-type: none"> - Report on taxonomy alignment of investments. - Report on the criteria and % of other sustainable assets (i.e. where not covered by the EU Taxonomy). - Report on the content of other assets (where relevant). - Report on investor impact strategy (i.e. theory of change), including: <ul style="list-style-type: none"> o Impact targets (KPIs), metrics; o Metrics regarding underserved markets and measurement of investor contribution (causal link of impact may be difficult to demonstrate, but plausible link should be provided); o Engagement strategy (if applicable) (incl. how shareholder engagement is integrated into the investment strategy of the product, how the investee companies are monitored and how voting rights are exercised as well as how dialogue is conducted with investee companies). - Report annually on progress with regard to targets.

5. Challenges

Naming of funds should be aligned with the above classifications. When products as a whole do not meet the criteria, they should also not be allowed to carry these specific (or closely related) terms in the product name. And of course, all claims about sustainability labels should be accompanied by the required disclosure.

There are also challenges with investments whose sustainability performances (or indicators) are harder to establish, such as government bonds. Depending on the further development of indicators that can measure the performance of non-company investments, these can also be included in the proposed categories at a later stage.

Data availability

Data availability remains an issue for financial market participants in complying with the SFDR. The availability and quality of data will only become more important once the assessment of quality requirements is based on it. This should be kept in mind during the discussion on sustainability reporting requirements for companies. Where possible, a link should be made between SFDR-required information and the information to be disclosed by investee companies. At the same time, financial market participants should take care not to make sustainability claims that they cannot substantiate. The proposals in this paper are aimed at legislative changes

¹⁴ Investments for certain specific purposes such as hedging or liquidity (see EC SFDR Q&A July 2021).

that are expected to come into effect in the medium term (i.e. the latter part of the 2020s), when some of the data challenges should have been resolved.

Administrative burden

If all products are required to make minimum sustainability disclosures, some financial market participants who do not offer sustainable products will be faced with additional disclosure requirements compared to the current situation. On the other hand, by creating disclosure requirements linked to specific product categories, the overall reporting requirements will become more focused on the type of product and thereby less burdensome for a number of sustainable products, in particular when they do not fall under one of the labels.

SFDR information as a basis for further sustainability-related investment services

Alignment of improved SFDR disclosure requirements with product governance and suitability requirements is necessary. Although the proposed adjustments to the SFDR framework would entail another overhaul of information that is provided for investors (particularly retail investors), and the creation of three “sustainable” categories may appear to add complexity, we believe these would provide easier-to-understand and more meaningful differentiation between sustainable product types. However, it is of paramount importance that the distribution of these products is equally adapted to ensure better alignment with retail investor preferences and expectations. As such, any amendments resulting from the review of the SFDR should be accompanied by similar changes to the requirements for product providers and distributors (in MIFD and IDD) further down the sustainable investment value chain.

Information disclosed under the SFDR should not only help investors who select financial products themselves, but also the investment professionals who guide investors in this process. To provide optimal support to retail investors, SFDR information must be as useful as possible for actors along this investment value chain and be linked to the actual preferences and interests of retail investors. Retail investor preferences should be assessed on the basis of concepts that are understandable and useful for them. Creating sustainable financial product categories with minimum criteria, such as those suggested in this position paper, would be an important and appropriate step forward to support this process.



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