FNG
Forum Nachhaltige Geldanlagen

FNG Position paper regarding the

European Commission Consultation "Implementation of the sustainable finance disclosure regulation (SFDR)"

Main Points

1. We very much welcome this consultation: We agree with the diagnosed issues (Part I) and call on the Commission to use the review to ensure that the SFDR is on track to support the transition to sustainability in the best way possible.

2. Interaction with other sustainable finance legislation: We welcome that the Commission is bearing in mind the interlinkages between SFDR and other SF-legislation. We see a general need to reform the integration of sustainability preferences as laid down in MiFID II, and in particular if product categories are introduced when amending the SFDR.

3. Potential changes to the disclosure requirements for financial market participant: Disclosures are needed both at entity and product level, with a strong focus on the latter. The PAIs are an important instrument and should be developed further. It is difficult to rank the PAIs according to their usefulness across all sectors. The whole market should disclose information regarding sustainability aspects.

4. Potential establishment of a categorization system for financial products: Whether a product category – either in the sense of a disclosure category or a proper standard – is successful in promoting the objectives of the SFDR depends on the design and implementation. We therefore do not back one of the policy options proposed in the consultation paper (develop Art. 8/9 into product categories or introduce four new categories), but rather recommend a list of issues to consider regardless of the route pursued. Important points include:

- *Any categories need to be well-defined with clear boundaries built on an overarching framework.*
- *If Articles 8 and 9 are used as a basis, it is key that proper limits are defined for those categories. This would include a clearer definition of key concepts such as sustainable investments.*
- *Built on what is there: Where possible, the EU Commission should built on industry standards to ensure that standards are practical.*
- *The topic of impact investing should be more developed in the Sustainable Finance regulatory framework and in the SFDR.*
- *If categories regarding transition products and impact products are established, we stress that such categories are not to be ranked in a hierarchical manner, but rather considered as both crucial contributions to sustainable finance goals.*

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1. Introduction

The objective of the Sustainable Finance Disclosure Regulation (SFDR) is to limit possible greenwashing and to contribute to fostering the financial system's transition towards sustainability, as well as providing support to businesses that are already sustainable.

Considering the importance of these goals, we very much welcome the Commission's consultation on the implementation of the SFDR. The SFDR is a key piece of legislation in the EU sustainable finance framework – not least because it was the first to complete the legislative process.

However, we very much agree with the problems diagnosed in the consultation paper: while the SFDR was conceived as a transparency tool, it is now being used as a product categorization. Certain concepts lack clarity and/or are very broad, such as "sustainable investment" in Art. 2 (17). In our Market Study over 60% of respondents saw misunderstandings about EU regulation as a reason for greenwashing allegations; around half of respondents saw a lack of standardization and a clear definition of sustainable finance as reasons.[1]

We urge the Commission to address these criticisms, while bearing in mind that it is paramount to keep the ultimate goal – financing the transition towards sustainability – in mind when reviewing and amending the Regulation.

Finally, we would also like to point out that since the different pieces of legislation are closely connected (as the Commission acknowledges in Part II of this consultation), it can be difficult to take a stand on a specific policy option, because a lot depends on the amendments made to the SFDR.

We very much welcome this consultation. We agree with the diagnosed issues (Part I) and call on the Commission to use the review to ensure that the SFDR is on track to support the transition to sustainability in the best way possible.

2. Interaction with other sustainable finance legislation

Coherence of regulation across different legislative documents is crucial. We therefore welcome that this consultation does not only focus on the SFDR as a standalone regulation, but bears in mind that the SFDR is one piece in the puzzle of EU sustainable finance regulation. Including questions on the interaction between different acts, as well as finding and following a common thread across the relevant pieces of legislation is important in order to create synergies.

Key concepts should be aligned across different acts (e.g. Do no significant harm principle). How and what exactly needs to be aligned will depend to a large extent on the future design of the SFDR.

We would like in particular to draw attention to the integration of the sustainability preferences according to MiFID II. If product categories are introduced in the SFDR, MiFID II would have to be amended accordingly. We have outlined our critique of MiFID II in our response to the ESMA Call for Evidence on the matter, and call on the Commission to reduce complexity to allow advisors to provide sustainable investment advice without having to explain complex concepts to retail investors.

We welcome that the Commission is bearing in mind the interlinkages between SFDR and other SF-legislation. We see a general need to reform the integration of sustainability preferences as laid down in MiFID II, and in particular if product categories are introduced when amending the SFDR.

3. Potential changes to the disclosure requirements for financial market participants

a. Disclosures at entity and product-level

Overall, we consider both disclosures at entity-level and at product-level useful, and only together provide the information needed to take an informed investment decision. However, the focus should be on product-level disclosures.

Following this year's disclosures at entity level, we would like to point out that they are only partially useful. There is no need to compare certain information at entity level e.g. between a boutique provider offering a few ethical funds and a mainstream bank offering many funds with a different focus. Any disclosure with that objective can therefore be cut. However, it is important to disclose an overarching strategy, as well as information on links between sustainability and remuneration. Disclosures at entity-level should therefore be reviewed, however, those disclosures for which no added value can be shown should be scrapped.

Principal adverse impacts (PAI) disclosures are more meaningful at product-level, where relevant PAI indicators can be selected depending on the product's objective and investment strategy to track its potential adverse impacts. In addition,

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[1] FNG Marktbericht Nachhaltige Geldanlagen 2023

disclosure of certain PAIs (in particular GHG emissions and human rights violations) should become mandatory for all products.

As is widely known, there are still challenges around the data which is needed to assess and disclose the PAIs. While for some PAIs, data availability and quality has improved significantly, in some areas currently no data is available at all. Often, financial market participants have to rely on estimates. Differences in the assessment of companies by rating providers add another layer to a confusing picture. While in particular the data availability is set to improve over the coming years due to reporting requirements coming into force, data challenges should be considered when developing the PAIs further.

Disclosures are needed both at entity and product level, with a strong focus on the latter.

b. Principal Adverse Impact Indicators (PAIs)

We very much welcome the introduction of the PAIs, as they are a first step to provide clarity around concepts, indicators and measures used in the market. They are a key concept of the SFRD. Nevertheless, their reporting is one of the SFDR's major challenges. The disclosure according to the Commission Delegated Regulation (EU) 2022/1288 has just started, and financial market participants are in the process of learning how to use the PAIs.

As such it is essential to maintain the list of current PAI indicators and the consideration of a number of these indicators as always material, while improving their usability in the reviewed SFDR framework and their comparability across financial markets participants.

As a general point, we would like to note that the PAIs are "Principal adverse impact indicators". However, rather than actually measuring the impact, some PAIs are assessing the active steps taken to address impact (e.g. lack of human rights policy lack of monitoring of compliance with OECD guidelines). This is particularly the case for the social PAIs. The question is whether we are measuring what is actually important (rather than measuring for what we have data), and the review should look into which variables could potentially be replaced by better outcome variables.

It is difficult to generally state which PAIs are useful and which aren't, because this depends on the context of the activity. For some economic activities, certain PAIs are just not relevant (e.g. hazardous waste for a service provider), while for other sectors they might be crucial. Another PAI might be relevant, but there is no data – which reduces how useful the PAI is.

The PAIs are an important instrument and should be developed further. It is difficult to rank the PAIs according to their usefulness across all sectors.

c. Who should disclose – and according to which rules?

In order to increase transparency across the market, it is from our perspective paramount to introduce disclosure requirements for the entire market – not only for sustainable products. The Commission should look into whether the EET developed by FinDatEx – or some form thereof – could be used in this context.

We are strongly in favour of keeping the disclosure requirements the same for all groups of investors. The requirements are complex enough both to comply with and to understand (for those buying the products), we should not add more complexity by developing specific disclosure requirements e.g. for retail products.

In terms of comparability, we are against reducing sustainability to a single figure which is then used to put the product in a certain group or category. This approach signals transparency, but reducing a complex concept such as sustainability to a single number has to cut out a lot of information or aggregate it.

The whole market should disclose information regarding sustainability aspects.

d. European Single Access Point (ESAP)

The ESAP will be a core element of the disclosure framework. The first step is to get it up and running as a data hub for financial market participants to access the information they need for their disclosure.

We do not think that the information which is disclosed by financial market participants should be included as fast as possible in the ESAP. The priority and necessary first step is that financial market participants have the information they need in order to disclose.

Once the ESAP is up and running, extensions could be considered. When including the information financial market participants disclose, it should be borne in mind that this would include a new user group (end investors) in the ESAP.

Work on the ESAP should focus on providing the data input financial market participants need.

4. Potential establishment of a categorization system for financial products

The SFDR has several objectives: limit possible greenwashing; set out rules on disclosures and with that effectively require financial market participants and financial advisers to make strategic business and investment decisions; accountability and comparability and, finally, complementing other initiatives fostering the financial system's transition towards sustainability and continues to support businesses that are already sustainable.2 While of course the co-legislators must balance these objectives, the last objective seems crucial in order to foster the desperately needed transition.

An issue which has attracted a lot of interest and discussion in the consultation is the question whether the SFDR should introduce proper product standards, and, if so, what they should look like. Introducing clear product categories has several advantages. First of all, it would solve the structural problem of the SFDR, namely that it was designed as a disclosure tool but is used as a labelling scheme. Secondly, it would make it easier for retail investors and advisors to gain an understanding of different products, as it would simplify the landscape. As a consequence, we would expect to see less (discussions around) greenwashing.

However, whether product categories would contribute to shifting money into green or transition sectors is less clear. This would to a large extent depend on the design of the categories. We therefore do not back one of the policy options proposed in the consultation paper (develop Art. 8/9 into product categories or introduce four new categories), but rather recommend a list of issues to consider regardless of the route pursued. The success of any amendment of the SFDR depends on certain factors which could be applied to standards / labels, or also to categories for disclosure. They could built on the existing Art. 8/9, be used to define the four proposed product categories A-D, or for a different set of categories altogether.

As stated above, the SFDR as it currently stands has a number of objectives. Among these, from our perspective, the emphasis should be on "fostering the financial system's transition towards sustainability". In order to do so, we call on the Commission to bear the following points in mind when amending the Regulation:

Broader points

- **Setting minimum standards:** if it is clear that investments in certain activities are not acceptable, this should not be addressed by a transparency requirement, but rather by minimum standards either for financial market participants or directly for the real economy.
- **Giving consumers the chance to compare all kinds of products:** The whole market should be subject to disclosures, not only sustainable investment products.

Regarding potential categories (either as standards or as disclosure categories):

- **Any categories need to be well-defined with clear boundaries built on an overarching framework**.
- If Articles 8 and 9 are used as a basis, it is key that proper limits are defined for those categories. This would include a clearer definition of key concepts such as sustainable investments.

  Regarding the four categories proposed as an alternative, we would like to state that the category based on exclusions does not fit into the system: the other three categories are actual product categories, but exclusion is an investment strategy. We do not see the benefit of building a whole category on this strategy.
- **Built on what is there:** Where possible, the EU Commission should built on industry standards to ensure that standards are practical.

  Regarding the provision of detailed information, the Commission should assess whether it is possible to build on the EET developed by FinDatEx.
- The topic of **impact investing** should be more developed in the Sustainable Finance regulatory framework and in the SFDR. Especially if any notion of Art. 9 is kept, shared characteristics and differences between impact investments and this potential category should be made clear.
- **Related to that, the categories should consider the output.** Currently, regulation is focused on what is taken into account when making an investment, there is little emphasis on output or impact. This should be changed.
- If categories regarding transition products and impact products are established, we stress that such categories are **not to be ranked in a hierarchical manner**, but rather considered as both crucial contributions to sustainable finance goals. This would ensure that not only already green investments are traded between sustainably-minded investors, but that additional investments are made to push the transition forward.

[2] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=LEGISSUM%3A4434253

- **Different ambition levels:** If there is a desire to have different ambition levels, this could e.g. be solved by combining some form of Art. 8/9 with the four categories. This way, green and transition investments would not be compared to each other, but different ambition levels would be allowed within each category.
- **Within the current SFDR, the PAIs are an important concept. They should be developed further,** i.a. by assessing what is useful at entity-level, potentially changing some indicators and how the PAIs at product level can be strengthened.
- **Selectivity:** In terms of minimum standards for each category, we are in favour of an approach using selectivity, i.e. for a certain type of category, compared to a benchmark x% of investments have to be excluded.
- **Different asset classes:** any framework should be designed to accommodate different asset classes rather than focusing on equity. In particular it should be considered how sovereign bonds are considered.
- **A scale as is, for example used for food (nutri-score) is too simplistic for sustainable finance.** Reducing complex concepts to a single score signals transparency, however, a lot of information is lost in the process, thereby potentially reducing transparency. Another question is whether a scale would be understood de facto as another form of categorization, label or standard.

Any categories should bear in mind the following limitations:

- For both policymakers and stakeholders a lot of work has gone into developing and implementing the current disclosure system. While this is of course sunk cost, we urge the Commission to analyse which parts and concepts of the current regime have proven to be useful and keep those elements if possible. If a completely new system was established, the Commission should bear in mind that, this time, it should be thought through sufficiently to avoid further frustration by financial market participants.
- Be aware that not everything can be measured. Whilst performance measurements are key, some contributions are hard or impossible to measure. This is a challenge in particular for social objectives. The categories should not fall into the trap of valuing contributions just because we can measure them, but try to find ways of including outcomes which are truly valuable.

  This is also true for certain strategies used by financial market participants: engagement or good governance for example are difficult to measure and/or to reduce to a number or score.
- There is a trade-off between very specific definitions and leaving leeway for financial market participants and the real economy to figure out how to contribute to the socio-economic transition. The categories should indicate where we need to go in terms of targets, how we get there should be left to investors and the real economy.

This list with issues to bear in mind when reviewing the SFDR is not exhaustive. We expect discussion and work around amending the SFDR to continue during the coming year. With the upcoming election to the European Parliament, this is the right time to take stock, analyse of coherence, review and amend the SFDR. This way, the new Commission can built on this work once it is in place.

Whether a product category – either in the sense of a disclosure category or a proper standard – is successful in promoting the objectives of the SFDR depends on the design and implementation. We therefore do not back one of the policy options proposed in the consultation paper (develop Art. 8/9 into product categories or introduce four new categories), but rather recommend a list of issues to consider regardless of the route pursued.

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About: Forum Nachhaltige Geldanlagen - FNG
The FNG is the association for sustainable investments in German-speaking countries (D, AT, CH) with over 200 members. Our members include banks, investment companies, rating agencies, financial advisors, research institutions, insurance companies, NGOs and individuals.
The FNG promotes information exchange and dialogue between its members – and more broadly between the market, politics, regulation and research. We have been advocating for a legal and political framework fostering sustainable investments since 2001.
We are a founding member of the European association Eurosif.