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Summary response to the European Commission targeted consultation on the implementation of SFDR

To:	European Commission
From:	The Dutch Fund and Asset Management Association (DUFAS)
Date	15 December 2023
Subject	**EC targeted consultation on implementation of SFDR level 1**
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The Dutch Fund and Asset Management Association (DUFAS) welcomes the opportunity to respond to the targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR), as published on 14 September 2023.

Introduction

DUFAS welcomes and supports the SFDR which is aimed at strengthening transparency through sustainability-related disclosures in the financial services sector in order to support the EU's shift to a sustainable, climate neutral economy. We do see merit in more standardization of disclosures via the SFDR in order to improve comparability throughout the market and, needless to say, to avoid greenwashing which is the main purpose of the EU legislation.

However, DUFAS believes that the current SFDR framework is not achieving its primary goals and we therefore believe a number of elements should be adjusted in order to better able to achieve the goals set by the SFDR. Whilst we have a number of recommendations to this effect, the most important one is that DUFAS firmly believes that the SFDR standardized product disclosures, particularly related to adverse impact disclosures, should apply to all financial products offered in the EU, regardless of their sustainability-related claims or sustainability characteristics. We do feel that such adjustment is absolutely key in order to enhance comparability for alle financial products and to create a level playing field for all financial products.

Although, DUFAS believes on the one hand a review is needed, on the other hand building a new disclosure system from scratch is not preferable. Although we believe that the SFDR framework is not optimal (yet), given the time and effort put into implementation by the financial sector, this review should not result in all efforts being for nothing.

Current requirements of the SFDR

- *Awareness:* We believe that the SFDR indeed creates awareness in the financial services sector of the potential negative impacts that investment decisions can have on the environment and/or people.

- *Suboptimal framework:* However, the SFDR is currently suboptimal because of;

- (i) a lack of data and challenges related to data quality;
- (ii) the circumstance that certain concepts used within the SFDR, such as the notion of sustainable investment, creates a lot of uncertainty. The comparison between disclosures is not possible as there is still too much room for own interpretation, and;
- (iii) because the SFDR classification system provides unclarity, is used a label and may therefore increase to risk of greenwashing.

- *SFDR classification system*: The current SFDR classification system is far from perfect. The article 8 disclosure regime has limited value for the following reasons;

  - On one hand, there is no requirement for actual sustainable outcomes and the broadness of "sustainability characteristics" renders it meaningless which facilitates greenwashing;
  - On the other hand, because of the article 8 requirements, financial market parties are more or less forced to classify their products as article 8 or 'light green', as the SFDR defines promotion of ESG characteristics in a very broad manner contrary to promotion in a more commercial marketing context.

- *No transitioning:* Moreover, the SFDR disclosures do not sufficiently facilitate the information needed to guide private capital to the transition to a sustainable economy, which seems also to be one of the main goals of the SFDR.

- *Costs versus benefits:* Furthermore, we believe that there is disconnect between the retail investors' understanding of sustainability - namely actual sustainable impact – versus the SFDR definition of sustainability. This disconnect should be resolved, particularly, as the costs of implementation do not seem to outweigh the benefits to the retail investor. Research has shown, e.g., conducted by the Netherlands Authority for the Financial Markets (AFM), that (retail) investors have difficulties to understand the SFDR templates as prescribed. Moreover, based on figures from some of our members the total costs of SFDR disclosure requirements amounted to (approximately) between EUR 1,000,000- and EUR 2,500,000. Given such costs figures, the question arises whether these costs outweigh the benefits, which at this may stage may be limited to retail investors.

Interaction with other sustainable finance legislation

- In general, we believe that the SFDR does not sufficiently interact with other parts of the EU sustainable finance package.

- *Taxonomy:* For example, the approach to DNSH and good governance in the SFDR is only to a very limited extent consistent with the environmental, social and governance exclusions under the PAB/CTB. Furthermore, the concept of good governance minimum safeguards under the SFDR are not fully aligned with those already covered in the EU Taxonomy.

- *CSRD/ESRS*: More in particular, we believe that the SFDR disclosures are only to a very limited extent consistent with the CSRD requirements, in particular with ESRS. PAI indicators under the SFDR should be aligned and streamlined with PAI indicators published by companies under the CSRD/ESRS.

- *MIFID2 and IDD*: Furthermore, the SFDR is at this stage not sufficiently useful and comparable to allow distributors to determine whether a product can fit investors' sustainability preferences under MiFID2 and the IDD, possibly also due to a lack of data and hence sufficient and readily available products that may fulfill the prescribed criteria.

Potential changes to the disclosure requirements for financial market participants

- *Mandates/individual portfolio management:* The SFDR defines the portfolio management, also called 'mandates', as a financial product which brings the mandates under the SFDR disclosures requirements. Whether mandates should be in scope of the SFDR is something which according to a number of our members may need to be reconsidered, as mandates are strictly speaking investment services and not financial products under the sectoral financial legislation, i.e., MiFID2. On the other hand, some of our other members find merit in disclosing mandates under the SFDR as disclosing on mandates is not required in accordance with the CSRD.

- *PAI statement on entity level:* In general, DUFAS believes that the PAI statement on *entity level* is not that useful. Investors are mainly interested in and focused on the sustainability related disclosures for financial products offered by financial market participants. There is no need to investor insight on the sum of the PAI indicators on entity level nor do we think that it is useful to consider all indicators to be material from an entity level perspective, also because of lack of data. **Where the EC considers the deletion of the requirement to publish a PAI statement on entity level, DUFAS would support this**.

- *PAI indicators on product level*: We believe that disclosure of principal impact indicators on financial product level are in general quite useful. This applies to the majority of the mandatory PAI indicators. However, **we believe that such PAI indicators should be aligned and streamlined with PAI indicators published by companies under the CSRD/ESRS.** One suggestion of a PAI indicator which could be added relates to the indicator about the statistics around the exercise of voting rights.

- *SFDR disclosures on all financial products:* **DUFAS firmly believes that the SFDR standardized product disclosures, particularly related to adverse impact disclosures, should apply to all financial products offered in the EU, regardless of their sustainability-related claims or sustainability characteristics**. In other words, the SFDR reporting requirements should also apply to non-sustainable funds, which benefits (i) comparability and (ii) creates a level playing field, also in terms of costs of such disclosures.

  PAI disclosures should also be applicable to non-sustainable funds to see the negative impact from those funds, for good comparison. Minimum requirements should be set for all products, however, to a certain extent variations of disclosures may be applicable. For example, financial products with sustainability-related claims may have to add additional wording to substantiate such claims, although this should not in any event lead to a heavy burden substantiating such claims, putting sustainable products in a more disadvantaged position in comparison to non-sustainable products.

Potential establishment of a categorization system for financial products

- *Labelling or product categories need:* In general, DUFAS sees merit in having a labeling regime or product categories in place. **The circumstance that the SFDR is by the market used as a label, shows there is a need for a labeling regime.** This could be achieved by converting the current SFDR classification into product categories, but this is not necessarily the only viable option. From that perspective, we do not have any specific preference in any of the approaches as proposed by the European Commission. In addition, where there is a need for a labelling regime, it is good to emphasize that one should differentiate between retail and professional investors. Labelling is far more important for retail investors and less relevant to professional investors.

- *Overlapping sustainability categories:* We do appreciate the efforts of defining sustainability categories as proposed by the European Commission. However, **the proposed categories may not be mutually exclusive as they may be overlapping. This may lead to difficulties in choosing the right category and possibly may not always be helpful for (retail) investors**.

- *Inclusion of transitioning category, but distinguish from impact*: In any event, we do believe that if one is heading for building product categories, **we do emphasize there is a need for transition financial products, a category which is not very well embedded in the current SFDR framework.** Nonetheless, certain sustainability categories as proposed should be reconsidered. For example, category D seems to include both impact and transition. Including impact investing and transitioning investing within one category may be confusing and also give rise to greenwashing risks.

DUFAS: Dutch Fund and Asset Management Association
Since 2003, DUFAS has been committed to a healthy asset management sector in the Netherlands. DUFAS has more than 50 members: from large asset managers who invest Dutch pension and insurance assets to smaller, specialist asset managers. DUFAS increases awareness of the social relevance of investing, helps to develop sector standards and represents the sector in the implementation of new laws and regulations. In addition, DUFAS is committed to a single European market with equal regulations.

More information

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Would you like to respond, or should you have any questions? I would be pleased to hear from you. Please feel welcome to e-mail Randy Pattiselanno, DUFAS manager strategy & regulatory affairs, at rp@dufas.nl.