

# SFDR Now and Then Consultation from the EC



Is the Market ready for an in-depth  
review of the regulation?

November 2023



# Summary

1. 2 years after, is the European Commission ready to modify the regulation ?
2. Blurred definitions and poor ESG Data Quality led to greenwashing risks with in parallel SFDR categories becoming de facto labels
3. Overlocking with other Sustainable Finance regulations is messy, when reporting remains overly complex and sometimes redundant
4. Zoom on Product disclosure : reminder of as-is requirements and new categories proposed
5. Other key points not covered by the SFDR consultation
6. Our convictions

# 2 years after, is the European Commission ready to modify the regulation ?

## Context

On September 14<sup>th</sup>, the European Commission published a consultation on SFDR to assess the shortcomings of the regulation, its interactions with other components of the Sustainable Finance framework and therefore to explore options for evolutions. Main attention points are the following :

- Greenwashing risks as SFDR is not prescriptive on the definition of Sustainable Investment
- SFDR is now used as a de facto labelling scheme instead of a disclosure regime, as shown by the appearance of an Article 8 “plus” category
- ESG data are not fully reliable as of now, jeopardizing the accuracy of ESG assessment on financial products
- The reporting framework triggers major costs : data sourcing, ESG scores/KPIs, reporting generation

## Timeframe



*The next European Commission will determine both the content and the timing for a potential evolution of SFDR : legislative proposal on SFDR revision is unlikely before mid-2025 at the earliest, and the regulatory technical standards (RTS) of the new proposal would be published even later.*



## Key chapters

- I. Current requirements of the SFDR
- II. Interaction with other sustainable finance legislation
- III. Potential changes to the disclosure requirements for FMPs
- IV. Potential establishment of a categorization system for financial products



## Product Scope

- UCITS
- AIFs (Alternative Investment Funds)
- Insurance-based investment products
- Separately-managed portfolios and sub-advisory mandates



## Consulted actors

- Financial Market Participants (FMPs)
- Non-governmental organizations
- National competent authorities
- Professional and retail investors

# Blurred definitions and poor ESG Data Quality led to greenwashing risks with in parallel SFDR categories becoming de facto labels



## Limits



## Impacts





## Potential Outputs

## Impact Assessment

Business Cost (1)

**Sustainable investment definition**

Risk of greenwashing as no standard definition exists






- Downgrading of Art. 9 products due to changing guidelines from regulators 
- Recent guidelines from ESMA or NCAs limit the ability to build Art.9 products funding Transition assets 

No prescriptive definition of Sustainable investment



**Data accuracy and availability**

Limited data availability on all ESG dimensions: Taxonomy, PAI...

- Need to clarify the use of Proxy data 
- Lack of comparability between products 
- Difficulties to perform an ESG assessment at the point of sale 
- Risk of mis-selling with "light green" products distributed to engaged clients 
- Limited integration of stewardship strategy in the assessment of investment strategy 

No specific proposal to fix the lack of reliable data → Waiting for CSRD implementation

No specific approach recommended on Discretionary Portfolio Management and Funds of Funds, to assess sustainability of underlying FMPs : look-through approach vs. data feed from manufacturers




**SFDR categories and labeling**

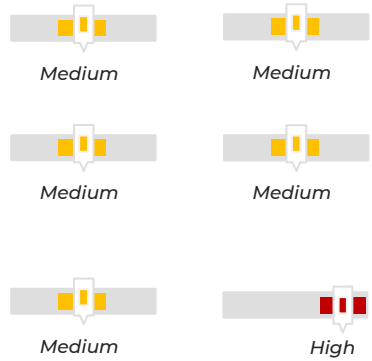
SFDR categories become labels to assess products

- Art. 8 is a mixed bag of products with various sustainability profiles 
- Art. 9 became a small category narrowed down to 100% sustainable products 
- No mapping between EU SFDR categories & national labels (ex: ISF in France) 

Development of the distinction between Articles 8 and 9 and the existing concepts embedded in them

Detailed new product categories : 1. Positive contribution to sustainability objective ; 2. Sustainable thematic product ; 3. Transition focus ; 4. Exclusion strategy

Product categorization : classification of products into 3 categories : 1. Generic focus on Environmental and/or Social objective ; 2. Transition strategy ; 3. Solutions, Impact and Contribution 



# Overlocking with other Sustainable Finance regulations is messy, when reporting remains overly complex and sometimes redundant



## Limits



## Impacts








## Potential Outputs

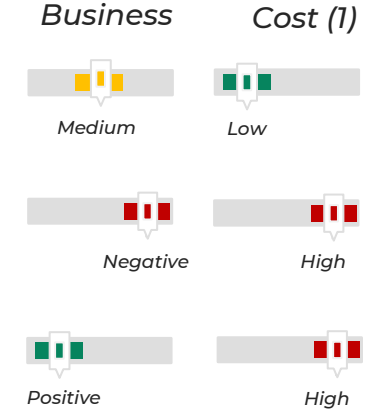
## Impact Assessment

**Principal Adverse Impact and DNSH**

Complex set of indicators covering a large range of data, with no proportionality  
 Lack of clarity of the DNSH

- Lack of reliable data from investee companies to perform a consistent PAI assessment 
- Limited information available on DNSH with gaps between Taxonomy and SFDR 
- Indicators not always pertinent, leading to regrouping or cherry picking by manufacturers 
- Possibility for a product Article 8 with 0% sustainable investment not to consider PAIs 


- Current approach : some indicators are mandatory while other are subject to materiality assessment
- Review indicators' materiality : they would be either considered as entirely mandatory or entirely subject to materiality
- Convergence between DNSH principals of both SFDR and Taxonomy Regulations, with principles of PAI thresholds for the SFDR DNSH 



**Interaction with other sustainable finance legislation**

Loopholes in SFDR, prevent other regulation to be fully up to speed




- Difficulties to provide accurate product data to fulfill MiFID 2 & IDD ESG requirements 

Align the customer sustainability preference questionnaire (MiFID 2 & IDD) with the new categories proposed. 

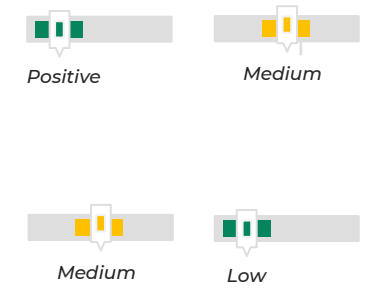


**Reporting**

Heavy SFDR reports to be produced at Entity level with limited usage for end clients

- Redundant information shared in Product reporting (precontractual/periodic documentation vs. Website) 
- No convergence on Product reporting template and core set of KPIs to be shared, and between Product & Entity levels 
- Reporting not including Financial Instruments (e.g. Structured Products) 

- Review of the pertinence and usefulness of :
  - the current breakdown of information between precontractual, periodic documentation and website disclosures at product level
  - the Entity level disclosures for Product distribution
- No proposal to extend the scope of SFDR to all Financial Instruments



# Zoom on Product disclosure : reminder of as-is requirements and new categories proposed

## Current SFDR classifications for financial products subject to SFDR :

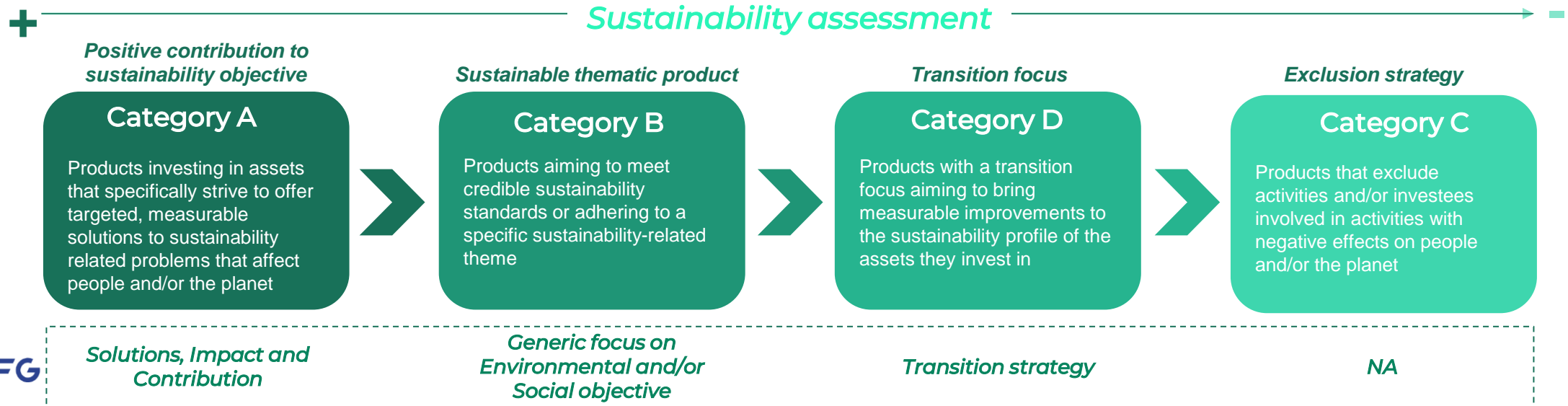
**Article 6**  
Do not promote any ESG characteristic

**Article 8**  
Promote ESG characteristic but do not have sustainable investment as their primary objective

**Article 9**  
Main objective is sustainable investment, product composed exclusively of sustainable investments

## The consultation addresses two Options :

1. The Article 6/8/9 categories may be **replaced or supplemented by more prescriptive categories** (see below) → Categories may be **non-exclusive**, i.e.: financial products can belong to more than one category (Q4.1.8).
2. **No new category** but the development of the distinction between Articles 8 and 9, and the existing concepts embedded in them complemented by additional (minimum) criteria that more clearly define the products falling within the scope of each Article.



However, the revised categories still do not clearly define the sustainable concepts behind. Measures and references should be clarified. For example, the transition focus category may embed a large range of Products with Sustainable ambitions that widely differ.

# Other key points not covered by the SFDR consultation



## Product scope

The entity and product disclosures cover a limited product scope (UCITs, AIF, Insurance-based investment products...) and do not include financial instruments (e.g : structured products, green & social bonds, etc.) which may conduct confusions for the investor and an unlevelled playing field.



## Double materiality

The definition of sustainability risk is not fully clear. SFDR does not clarify how FMPs shall concretely disclose sustainability risks that can affect the value and the return on their investments (single materiality), while it is more specific on the adverse impacts that such investments have on the environment and society (double materiality).



## Remuneration policies

- Whether financial market participants shall disclose how their remuneration policies are consistent with the integration of sustainability risks (Article 5 – single materiality), is still not clear.
- The opportunity to establish incentive remuneration policies linked to the sustainability of investments & PAIs (double materiality) is not covered yet.



## Distributors' role

- Disclosure obligations of distributors under SFDR are not clear :
- at Entity level (format and product scope, coordination with data disclosed by manufacturers)
  - at product level for sustainability risks (Article 6), vs. the product manufacturer's analysis

# Our convictions

There are similarities between the SFDR consultation approach and the UK SDR, especially in the product categorization : a potential transition from a reporting scheme to a labelling setup

## Sustainability Investment definition



With still no definition of sustainable investment, the greenwashing risk remains as well as a lack of comparability between products

## Reporting



A simplified customer documentation, embedded in a single document vs. the 3 existing ones (website, precontractual, periodic) would make much more sense

## Data quality



Major data quality problems until the application of CSRD, with high dependency to ESG Data Providers and open questions on the use of Proxy data. Specific attention point on Private Equity due to lack of data, not solved by CSRD

## DNSH 'Do Not Significant Harm'



A convergence of DNSH methodologies between Taxonomy and SFDR appears more than needed to simplify the assessment of products and realign the 2 regulations

## Product categorization



Whatever the number of categories, the key loophole remains. Without clear cut definitions (e.g. transition) and clear specifications, greenwashing risk remains for the end-investor

## Interaction with other regulation



Including the new SFDR categories in the MiFID 2/IDD ESG suitability questionnaire as proposed by the AFG would be costly for distributors. In addition, such solution would not include all financial instruments (Securities, Structured Products are still out of SFDR scope)

## Product scope



The current scope of SFDR does not cover the full range of packaged products and create a gap on structured products that should be filed



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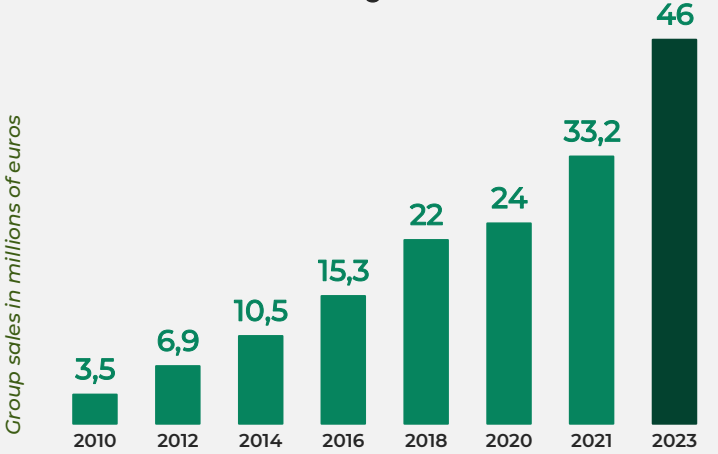
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