FIT FOR FUTURE Platform Opinion

Topic title	Sustainability-related disclosures in the financial services sector	
	AWP 2024	
	Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Sustainable Finance Disclosure Regulation/SFDR) *Legal reference*	
Date of adoption	17 October 2024	
Opinion reference	2024/3	
Policy cycle reference	☒	Contribution to ongoing legislative process
		CWP 2024 *Commission work programme reference*
		The 2024 Commission work programme, adopted on 17 October 2023, puts a strong focus on simplifying rules for citizens and businesses across the European Union. This follows up on President von der Leyen's commitment to reduce burden from reporting requirements by 25%, in line with the Commission's strategy to boost the EU's long-term competitiveness and to provide relief for SMEs. With this programme, the Commission is putting forward rationalisation proposals to reduce administrative burden without lowering social, safety, consumer protection, environmental or economic standards. They will streamline reporting requirements that are of limited use, for example by consolidating overlapping obligations, reducing the number of businesses concerned and increasing digitalisation. The Commission will also put the development of artificial intelligence tools and large language models at the core of this exercise, aiming to allow technology to identify reporting requirements in EU legislation, based on standardised means, and support in analysing their effect in a certain sector. It will also work on the expansion of the use of e-platforms for collecting and sharing data. In addition, the Commission will carry out evaluations and fitness checks to assess how legislation can be simplified and made less burdensome. The evaluations of programmes and funds of the multiannual financial framework, due in 2024, offers another opportunity to assess how to reduce burdens linked to the EU's financial programmes

	☐	Contribution to the (ongoing) evaluation process
		Title of the (ongoing) evaluation
	☐	Included in Annex VI of the Task force for subsidiarity and proportionality
		-
	☒	Other
		The Commission is currently working on an assessment of the SFDR regulation to assess potential shortcomings and to see if the framework is fit for purpose. The Commission is analysing issues such as whether the regulation provides the necessary legal certainty to financial market participants, how user-friendly it is, as well as its ability to play its part in tackling greenwashing. In Q3/Q4 2023, the Commission ran a targeted consultation and a public consultation on the implementation of the SFDR regulation, which were complemented by a high-level event and technical workshops with stakeholders.
Have your say: Simplify!		*No relevant suggestions on this topic have been received from the public.*

SUGGESTIONS SUMMARY

Suggestion 1: Replace de facto product categories in SFDR with a categorisation system on the basis of differences between sustainable investment strategies

Suggestion 2: More meaningful and less cumbersome disclosures through tailored disclosure requirements for the different categories of sustainable financial products

Suggestion 3: Improve terminological coherence through harmonising the definitions used in different, but adjacent EU laws

Suggestion 4: Align where appropriate the approaches to sustainability and do-no-significant-harm in the SFDR and the EU Taxonomy Regulation

Suggestion 5: The F4F Platform endorses the ESAs' recommendation to reduce the frequency of the report required of them under Article 18 SFDR

SHORT DESCRIPTION OF THE LEGISLATION ANALYSED

The EU's sustainable finance policy is designed to attract private investment to support the transition to a sustainable, climate-neutral economy. The SFDR regulation was adopted as part of this framework. It lays down harmonised transparency rules for financial market participants and financial advisers on how they integrate environmental, social and good governance factors into their investment decisions and financial advice and on their overall and product-related sustainability ambition. By setting out how financial market participants have to disclose sustainability information, it helps those investors who seek to put their money into companies and projects supporting sustainability objectives to make informed choices. It is also designed to limit possible greenwashing[1] where financial products marketed as sustainable or climate-friendly, or having claims about financial business' involvement, cannot in practice support these claims with the SFDR disclosures. The regulation complements other initiatives fostering the financial system's transition towards sustainability. The SFDR regulation applies since 10 March 2021[2].

Delegated Regulation (EU) 2022/1288 supplements the SFDR regulation with regard to regulatory technical standards, specifying the content, methodologies and presentation of the information in pre-contractual documents, on websites and in periodic reports relating to sustainability indicators and adverse sustainability impacts, the principle of 'do no significant harm', the promotion of environmental or social characteristics and sustainable investment objectives.

On 31 October 2022, the Commission adopted amendments to the delegated regulation (Delegated Regulation (EU) 2023/363) to require financial market participants to disclose the

[1] Practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants (ESMA);

[2] Except for the rules on the transparency of adverse sustainability impacts, as far as they apply to financial market participants exceeding an average of 500 employees during the financial year or that are parent undertakings of a large group exceeding, on a consolidated basis, 500 employees during the financial year. In these cases, it has applied since 30 June 2021;

extent to which their portfolios are exposed to gas- and nuclear-related activities that comply with the Taxonomy Regulation, as set out in the Complementary Climate Delegated Act. The requirements and standards have applied since 1 January 2023 and the amendments have applied since 20 February 2023.

On 4 December 2023, the three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) sent to the Commission a further set of amendment to the Delegated Regulation on the review of the principal adverse impacts (PAI) and financial product disclosures. It is now subject to the Commission's internal procedures. On 30 November 2023, the three ESAs published an interactive factsheet that provides tips to consumers considering buying financial products with sustainability features, including loans, investments, insurances and pensions.

Sources:

SFDR regulation

Delegated Regulation (EU) 2022/1288

Delegated Regulation (EU) 2023/363

PROBLEM DESCRIPTION

Existing evidence suggests the following issues:

While reporting requirements are necessary to ensure proper implementation, monitoring and evaluation of EU legislation and can also be economically efficient when they replace 27 different requirements from Member States, some reporting requirements can be considered as cumbersome or costly by businesses or Member States. If well designed, the costs of reporting requirements are largely offset by the benefits they bring. (See, for instance, sections 6 and 7 of the Commission Staff Impact Assessment that accompanied the draft for the Corporate Sustainability Reporting Directive (SWD(2021) 150 final).) Such requirements are not only included in primary legislation, but also in implementing or delegated acts or even operational arrangements. The Commission’s efforts focus on **rationalising** them by removing redundant, duplicating, or obsolete obligations, inefficient frequency or timing, inadequate methods of collection accumulated over the years, without undermining the policy objectives.

At the same time, it is important that reporting – or in the case of the SFDR regulation: disclosures – are meaningful. Greenwashing has become a major concern for policymakers around the world. Funds increasingly use ESG-related language[3] in their names and investors consistently prefer funds with ESG words in their name. ESMA has recently published guidelines on funds’ names using ESG or sustainability-related terms[4].

The SFDR regulation introduced definitions and disclosure requirements for financial products promoting environmental and social characteristics (Article 8) and for financial products with a sustainable investment objective (Article 9) but they do not establish standardised

[3] Environmental, social and governance;

[4] “Guidelines on funds’ names using ESG or sustainability-related terms”, ESMA Final Report, 14 May 2024, ESMA34-472-440;

requirements, criteria or thresholds to designate a fund as "ESG compliant". In the absence of EU ESG labels, some financial markets participants have begun to refer to the SFDR designations as proxy ESG labels, which is considered a misuse of legislation and can lead to confusion among investors.

The 2023 Joint ESAs Report on the extent of voluntary disclosure of principal adverse impacts under SFDR shows improved but still significantly diverse extent of compliance with the disclosure requirements. The explanation of non-consideration of the principal adverse impacts were deemed not fully complete and satisfactory while, when considered, the disclosures on the degree of alignment with the Paris Agreement were still vaguely formulated (e.g. without mentioning indicators measuring the decarbonisation path of their investments). The report concluded that the way national competent authorities provide guidance and help financial market participants interact with their supervisors to meet the requirements could be improved. The expertise of consultants who work closely with SMEs and micro-enterprises should be better included in this information and support system. Furthermore, although website disclosures are becoming easier, some national competence authorities still had to search for the voluntary disclosures through search engines, as those were hidden under 'required information' or in the 'download' section.

Sources:
Call for evidence: Rationalisation of reporting requirements

SME Relief package, Communication from the Commission, COM(2023) 535 final

ESG names and claims in the EU fund industry, ESMA Report on Trends, Risks and Vulnerabilities Risk Analysis, 2 October 2023

Guidelines on funds' names using ESG or sustainability-related terms, ESMA Final Report, 14 May 2024

2023 Joint ESAs Report on the extent of voluntary disclosure of principal adverse impacts under SFDR, 28 September 2023

The Fit for Future Platform has acknowledged the issues raised by the legislation concerned as follows:

The SFDR has played a crucial role in the sustainable finance framework by providing a framework for enabling consumers and investors to make informed investment decisions in relation to sustainability factors. The SFDR has therefore increased the comparability and disclosures of financial products on sustainability factors and supports the prevention of greenwashing and allows.

However, SFDR is - in contrast to EU Taxonomy - principle based which has given the financial market participants flexibility in terms of measurement of e.g. sustainable investments but has also led to differences in application of the key parameters of 'sustainable investment'. This has created some challenges both for retail investors (consumers), professional investors as well as the financial market participants offering the sustainable financial products.

Further, SFDR disclosure requirements for investment products leave a lot of discretion to financial firms on their implementation. However, they are in the end broadly similar for all sustainable investment products, inviting to rationalise the disclosure requirements by more meaningful differentiation and ultimately, their quality and user-orientation.

The purpose of the opinion would be to examine and, if found useful, to propose suggestions for a product standardisation and labelling scheme that would give retail and professional investors greater clarity and allow sellers to provide investment products more cost-effectively and with better legal certainty. There seems to be room to streamline the various approaches to sustainability and do-no-significant-harm principle in the SFDR and the EU Taxonomy Regulation as well. Alongside reduction of the frequency of reporting under Article 18 of the SFDR as also recommended in the above mentioned 2023 Joint ESAs Report, these adjustments would contribute to the agenda of rationalisation of reporting obligations in the EU.

SUGGESTIONS

Suggestion 1: Replace de facto product categories in SFDR with a categorisation system on the basis of differences between sustainable investment strategies

Description: The SFDR introduced the distinction between financial products with *environmental or social sustainability characteristics* (Article 8) and financial products with a *sustainable investment objective* (Article 9), without, however, defining in detail what funds must do to qualify for these designations. Nonetheless, the Article 8/9 distinction is used increasingly as a proxy label, in which Article 9 products are also called 'dark-green', because they pursue a sustainable *objective*, while Article 8 products are called 'light-green' because they only have sustainability *features*. 'The fact that Articles 8 and 9 of the SFDR are being used as de facto product labels, together with the proliferation of national ESG/sustainability labels, suggests that there is a market demand for such tools in order to communicate the ESG/sustainability performance of financial products' (European Commission, 'Targeted Consultation Document: Implementation of the Sustainable Finance Disclosures Regulation (SFDR)', p. 30). The misuse of Article 8/9 as de facto product labels also contributes to greenwashing because retail investors believe that products that are sold to them as 'light-' or 'dark-green' comply with products standards (see p. 2f. 'AMF position paper on improving the SFDR', November 2023).

A classification system should be introduced that sets out clear and stringent requirements to define a small and manageable number of categories of products making sustainability investment claims, depending on their approach to sustainable investing. The original aim of the SFDR was to provide sustainability-related disclosures to retail investors. This aim would remain, but it would be complemented by the new aim of standardising financial products that make sustainability claims.

One option for a categorisation system that the Commission might want to consider and submit to an impact assessment would include (i) a 'sustainable' category for financial products that invest in economic activities and/or assets that are already environmentally and/or socially sustainable and (ii) a 'transition' category for financial products that invest in economic activities and/or assets that are not yet sustainable, but which have the ambition to improve over time their sustainability and become environmentally or socially sustainable.. Such a classification system would follow the one recently proposed by the Joint ESAs Opinion on the assessment of the SFDR. It could also be similar to the one recently proposed by AFM (Dutch Financial Markets Authority, see above) or to those introduced by the UK Financial Conduct Authority in late 2023 or floated by the European Commission in its 'Targeted Consultation Document: Implementation of the Sustainable Finance Disclosures Regulation (SFDR)'.

The necessary revision of the sustainable investing rules must respect all the rules of due process, including a proper consultation and impact assessment, so as to avoid overly hasty changes to a framework with which financial market participants have only just begun to familiarise themselves.

Expected benefits: Introducing such a classification would lead to a clear and stable separation between the ESG and the non-ESG segments of the market for retail investment products and to a clear and stable differentiation between types of ESG funds. This would increase clarity and predictability for the buyers as well as the sellers of these products and for everyone else involved in their creation and distribution. As the Dutch Financial Markets Authority puts it: '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' (p. 5). Since the coming-into-force of the SFDR, fund reclassifications have become a fact of life. According to the financial data provider Morningstar, 419 funds were reclassified in the fourth quarter of 2022 (see here). Of those, 108 were upgrades and 307 were downgrades. In the third quarter of 2023, there were 279 reclassifications, of which 250 were upgrades (see here). Upgrades can happen because asset managers improve how their funds integrate sustainability concerns or change investment strategies. Downgrades have happened because of interpretative guidance issued by ESMA (the European Securities and Markets Authority) about the precise meaning of Article 9 that tightened the sustainability requirements for these products (p. 12). Some of the downgrades from Article 9 to 8 that happened in the fourth quarter of 2022 and afterwards could also be connected to the 'Great Green Investment Investigation' of November 2022 that found 388 investment funds that self-classified as Article 9, and thus as 'dark green', had nonetheless invested into fossil fuel extraction and aviation. That a fund's status can change from one day to the next because of guidance, journalistic revelations or modest changes to its strategy creates great uncertainty and concern. Retail investors in particular are faced with the situation that an investment product that was sold to them as 'light-green', or even 'dark green', is suddenly much less sustainable. Product categorisation can also be helpful for recommending products to customers who have no clear sustainability preference and/or are unable to define it.

Suggestion 2: More meaningful and less cumbersome disclosures through tailored disclosure requirements for the different categories of sustainable financial products

Description: Current SFDR disclosure requirements for financial products leave a great deal of discretion to financial market participants about how to operationalise these requirements, but they are broadly similar for all sustainable investment products, regardless of their sustainable investing approach. The categorisation system described in Suggestion 1 should therefore be accompanied by disclosure requirements that are specific and tailored to each product category. For example, a transition product would have to provide detailed disclosures about its engagement strategy, i.e. how it intends to push the management of investee companies to become more sustainable but would only have to comply with the basic disclosure requirements about its exclusion criteria, if applicable.

Articles 6 and 7 of the SFDR currently, under some conditions, require some sustainability-related transparency even for some products that do not make claims to sustainability. This has created a complex and uneven playing field between ESG products and non-ESG products, but also between different categories of non-ESG products. If a categorisation system like the one proposed here is created, the option should be examined of subjecting all financial products that do not fall under any of the labels and are therefore to be considered as not sustainable in the sense of not making any claim to sustainability (which is not the same as being unsustainable in the sense of doing harm) to a limited number of basic sustainability-related disclosure requirements, e.g. whether they follow a greenhouse gas emissions reduction target. (For sake of clarity, that group of financial products can be referred to as 'non-ESG products'.)

Despite the ESAs' best efforts to simplify the disclosure templates, SFDR disclosures are currently hard to understand for retail investors who often do not even read them. Until such time as a product categorisation system as the one proposed here is in place, we call on the ESAs to strive for further simplifications where possible.

Investee companies and companies further up the value chain, in particular SMEs, are already subject to considerable reporting and disclosure requirements. The expectation is that a categorisation and disclosure system like the one proposed here would not add to those requirements because, by the time it would become applicable in practice, a number of EU laws and tools will be in place that satisfy the information requirements of financial market participants without them having to approach investee companies for additional information. First, all listed companies, except for listed micro-enterprises, will have to provide audited sustainability reports under the Corporate Sustainability Reporting Directive (CSRD). The European Financial Reporting Advisory Group is also currently working on a voluntary reporting standard that companies that do not fall under the CSRD can use to reduce the effort they have to make when responding to sustainability data requests from lenders.

Despite efforts to make the standards SME-friendly, the current draft of the voluntary sustainability reporting standard for non-listed SMEs (VSME) still presents significant challenges that have the potential to seriously impact the operations of SMEs. In any case, the draft in its current form is not suitable for SMEs. The language used, including the many abbreviations and references to separate guidance documents, makes it impossible to implement the reporting standards at this stage. Clear regulatory requirements should protect SMEs from such excessive requirements (cumulative burden) and ensure that they do not lead to indirect obligations and disproportionate burdens.

Finally, the European Single Access Point (ESAP) for company-related information will be in place in summer 2027 and will make data gathering even more convenient because companies have to prepare and upload their sustainability reports, prospectuses etc. only once. For these reasons, one can expect the additional effort for investee companies that would result from minimum disclosures for all financial products to be negligible or zero. For the same reasons, the Platform also expects any additional effort for financial markets participants that offer non-ESG financial products to be negligible.

Expected benefits: Differentiated disclosure requirements would rationalise the provision and the use of disclosures and improve their quality. Users of the disclosures will benefit from more meaningful and relevant disclosures and will find it easier to compare how well different products of the same type perform in terms of their sustainability. Those who prepare disclosures will find them less of an effort because they are more focused on the type of product.

Suggestion 3: Improve terminological coherence through harmonising the definitions used in different, but adjacent EU laws

---

Description: The SFDR defines, or simply uses, certain sustainability-related terms in ways that have arguably been superseded by more recent sustainability-related EU laws, especially the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD). The following terms are used in the SFDR, but also appear in similar form in the CSRD and/or the CSDDD.

- ‘Sustainability factors’ (SFDR)/’sustainability matters’ (CSRD): These terms are practically interchangeable, and the CSRD definition even refers to the SFDR definition, but they are not identical. However, they could be made identical without loss of meaning or clarity.
- ‘Sustainability risks and impacts’ (CSRD)/’adverse impacts’ (SFDR/CSDDD): The SFDR uses and defines the term ‘sustainability risks’ and uses, but does not define, the term ‘adverse sustainability impacts’. ‘Risks’ means negative *financial* effects of a sustainability-related event, while the latter refers to negative impacts on people and planet. (To give an example, we are talking about the difference between the physical harm done by an oil spill and the financial harm to the company responsible for it due to lawsuits, damages etc.) The CSRD terms ‘sustainability risks/impact’ connote the same distinction between financial and real-world effects. The CSRD distinction cannot directly replace the SFDR distinction because the latter focuses specifically on the negative effects on the value of an *investment*, but they can be reconciled or harmonised by, for example defining negative effects on the value of an investment as a special case of negative financial effects. The CSDDD defines the terms ‘adverse impact’ and goes into more detail by also defining ‘adverse environmental impact’ and ‘adverse human rights impact’. These terms cannot be directly substituted for each other, but they, too, can be integrated into one harmonised definition.

Terminological consistency is particularly important for information that is available in an electronic format and therefore machine-readable, but not tagged in XBRL. This is the case for a good part of the disclosures required under the SFDR, such as the pre-contractual disclosures for UCITS funds. (‘UCITS’ stands for ‘undertakings for collective investment in transferable securities’. They are the most common investment vehicle for normal retail investors.)

Terminological coherence is also desirable in other areas of regulation that are related to sustainability, e.g. in the case of (draft) laws that determine what constitutes misleading environmental product names and marketing claims (Empowering the Consumers for the Green Transition Directive and Green Claims Directive). Coherence avoids confusion and unnecessary efforts.

Expected benefits: Corporate sustainability due diligence, corporate sustainability reporting and sustainability disclosures by financial market participants are different activities, but they should align as seamlessly as possible and support each other. Using the same terms in the same way makes life easier for everyone because it reduces the scope for misunderstanding and the time needed to procure and process information, whether manually or electronically (online or through the European Single Access Point). In short, it increases the overall efficiency of the sustainable business and finance system.

Suggestion 4: Align where appropriate the approaches to sustainability and do-no-significant-harm in the SFDR and the EU Taxonomy Regulation

Description: The SFDR and the EU Taxonomy Regulation both define sustainability as contribution to the attainment of a sustainability goal plus avoidance of harm to other sustainability goals (*do-no-significant-harm principle*, or DNSH). However, they also differ in crucial aspects. The Taxonomy is focused on environmental sustainability, whereas the SFDR grants (more or less) equal weight to the social dimension. (In principle, a social Taxonomy is planned, but dormant at the moment.

The Taxonomy determines authoritatively which economic activities contribute to environmental sustainability, while the SFDR leaves this to the discretion of financial market participants. The operationalisation of other important concepts in the SFDR, such as DNSH, is also largely left to financial market participants, especially in the case of Article 8 products, (Goldman Sachs Research, 'SFDR, two years on: Trends and Anatomy of Article 8&9 Funds in 2023', p. 19ff.). Accordingly, the SFDR currently requires disclosures about two kinds of sustainable investment content for Article 8 and 9 products: (a) the minimum proportion of sustainable investments as defined in Article 2(17) SFDR and (b) the minimum proportion of EU Taxonomy-aligned investments. The existence of two different approaches to sustainability and DNSH creates complexity and confusion for retail investors and financial market participants. The latter also incur higher costs when preparing the required disclosures. It also forces the European Supervisory Authorities and European Commission to issue ad hoc guidance concerning the interaction between the SFDR and the Taxonomy Regulation, like the so-called 'safe harbour' clause that states that "investments in environmentally sustainable economic activities" as defined in the Taxonomy qualify as "sustainable investment" under the SFDR – but not the other way around. (The joint ESAs' document with the consolidated FAQs about the SFDR and its delegated regulation runs to 60 pages, a considerable part of which concerns the interaction between SFDR and Taxonomy.) Having only one definition of sustainable investments in EU law would be desirable, but the above-mentioned differences make this impossible in the short run. However, both regimes should be aligned. Considering an alignment must not, however, disregard that it is possible to disclose the sustainability of investments made in economic activities that are not (yet) part of the Taxonomy.

Expected benefits:

- For the providers of sustainable financial products, having a better alignment between the approaches to sustainability in the SFDR and the Taxonomy would reduce the effort required in creating those products as well as the disclosure effort connected to them. There would be less of a need for guidance from supervisors or the Commission.
- The benefits for retail investors depend on the scope of any revision of the SFDR. Two scenarios can be considered here: either it continues to use disclosures as the sole means of ensuring the quality of sustainable financial products, or it develops into a product standard in line with Suggestion 1. In the former scenario, the benefits to retail investors would be considerable because product-related disclosures would be shorter, more understandable and easier to compare between different between sustainable financial products. In case of a root-and-branch review of the SFDR, the benefits would be smaller because retail investors could focus on intuitive labels to guide their decisions. However, even in this scenario, there would still be product-level disclosures for retail investors, and those would become more useful, e.g. when choosing between different products from the same category.

Suggestion 5: The F4F Platform endorses the ESAs' recommendation to reduce the frequency of the report required of them under Article 18 SFDR

Description: Article 18 SFDR orders the ESAs to report annually to the European Parliament and Council about the extent and quality of voluntary disclosures by financial market participants about their consideration of negative sustainability impacts (principal adverse impacts). In their 2023 joint report, the ESAs recommend 'reducing the frequency of the Article 18 SFDR Report […] to every two or three years' as it 'would allow more meaningful analysis about longer term trends' (p. 12). The F4F Platform endorses this recommendation in principle and recommends extending the reporting frequency to every two years but is against extending it to three years.

Expected benefits: Reducing the reporting frequency will reduce the ESAs' time spent on a task of medium importance and free up capacity for more important supervisory tasks.

Abstentions

- 2 MS on suggestion 4