

European Commission

SFDR – Finance Finland’s response to the European Commission’s targeted consultation

Finance Finland (FFI) has responded to the European Commission’s targeted consultation on the implementation of the EU’s Sustainable Finance Disclosures Regulation (SFDR). FFI’s key points are the following:

- The SFDR’s objectives are supportable and important, but they are currently not appropriately achieved. The regulation must be developed to better serve end investor.
- The costs of the regulation are disproportionate to its benefits.
- The regulation includes ambiguous concepts and there are data gaps in disclosures, which increases the risk that activities of the financial sector are interpreted as greenwashing. The data gaps are apparent especially in principal adverse impact (PAI) disclosures.
- The SFDR contains too many disclosure requirements, which are also partially overlapping.

The SFDR’s objectives are still relevant, but its benefits in relation to its costs are unclear

FFI considers the SFDR’s objectives to remain relevant. The transition towards a carbon-neutral and fossil-free society must be promoted, and the financial sector plays a key role in driving this transition. The SFDR has successfully increased information about the potential adverse impacts investment decisions have on the environment and people and broadened the range of products that have sustainability characteristics.

However, the SFDR’s original objectives, such as improving investor protection and providing investors with relevant information, are not being fulfilled well enough with end investors. Instead of serving as a disclosure framework as originally intended, the SFDR is being used as a labelling and marketing tool. This is not necessarily an entirely negative development, but it does increase the risk that the activities of the financial sector are interpreted as greenwashing. At the moment, the amount of data to report is excessive and the disclosures fail to adequately serve investors. The SFDR templates could also be shortened and streamlined.

The SFDR has become too expensive to implement in relation to its benefits, and the costs it creates are disproportionate to the benefits it yields. The difficulties in interpretation only serve to increase the framework’s implementation costs. It is particularly important to take into account the rise in expenses for those financial market participants that provide services on a cross-border basis, for instance in the United Kingdom market. Should there be major differences in disclosure regimes

between different jurisdictions, the operators would have to invest significant resources in adapting to both systems.

In FFI's opinion, sustainable finance disclosures regulation, just as all sustainable finance, should fall under EU regulation instead of national legislation also in the future. Creating a more integrated capital markets union requires uniform regulation across Europe, also in terms of sustainable finance.

Data gaps and conceptual discrepancies increase the risk of misguided interpretations

The SFDR contains ambiguous concepts and includes disclosure requirements that are not useful in all aspects. In terms of concepts, particularly problematic is 'sustainable investment', which has different definitions in the SFDR and the Taxonomy Regulation. The unclear treatment of transition assets under the SFDR also adds uncertainty to the interpretation of terminology. FFI encourages the Commission to harmonise the definitions of these concepts. The Commission should also consider clarifying the transition asset framework under the SFDR when it assesses whether to include the concept of transition finance in European sustainability legislation.

FFI welcomes the fact that the Commission and European supervisors are making an effort to explain difficult concepts and thus offering their help in implementing and applying the SFDR. Ensuring the SFDR's practical application should be made a priority in future regulatory solutions.

In terms of disclosures, the data being reported under the SFDR is too complex for end investors. Another problem with disclosures is that there simply is not sufficient data available. Problems with the availability of data should be solved before financial market participants are mandated via regulatory means to acquire it. There is a lack of data on entity-level principal adverse impacts and especially on the taxonomy alignment of investment products. Conceptual ambiguities and data gaps also increase the risk of the activities of the financial sector being interpreted as greenwashing. FFI hopes that instead of drafting new legislation to prevent greenwashing, the Commission would seek to identify factors that create a risk of greenwashing in the existing frameworks. In this work, one of the main targets to consider is the SFDR. For the data obtained from financial sector stakeholders to be of use, the stakeholder reporting cycle should also be similar enough to the financial sector's reporting cycle.

Disclosure requirements are excessive and partially overlapping with each other or with other regulation

The SFDR has disclosure requirements at both product and entity levels. While entity-level disclosures are important, they are important particularly to institutional investors, and retail investors benefit more from product-level information. In entity-level requirements, especially PAI disclosures should be assessed critically: they are mostly an administrative burden because their benefits remain unclear. In general, the necessity of disclosures should be examined in terms of the benefits they create for end investors. FFI is of the opinion that in the future, entity-level disclosures should be centralised under another sustainable finance framework, for example in the sustainability reports required under the Corporate Sustainability Reporting Directive (CSRD).

Even if entity-level disclosures remain under the SFDR, the interdependence of different-level disclosures should be minimised. Having to ensure that product-level and entity-level disclosures correspond with each other generates a great deal of costs in relation to the benefits. Product-level disclosures are the most important disclosures under the SFDR framework, and their reporting burden must be pared down by removing the requirement to cross-reference them with entity-level disclosures.

The SFDR's product-level disclosures should also be streamlined to lighten the regulatory burden. For example, SFDR Article 8 requires financial market participants to offer certain precontractual information to their clients, while SFDR Article 10 states that financial market participants must publish and maintain on their website certain information for each financial product. These requirements are at least partially overlapping. For end investors, it would be easier to look up all up-to-date information on the website rather than have to also search for additional information in product-specific brochures. It would also be more cost-efficient for the financial sector to update information regularly in one place only, to the website, rather than include SFDR data of a changing nature in a brochure.

Financial sector is facing challenges in disclosing principal adverse impacts

The SFDR's requirement for financial market participants to publish sustainability data about the company and its financial products at the level of principal adverse impacts (PAIs) is proving challenging to the financial sector. At the moment, data gaps make it hard to use PAI indicators in a way that would genuinely benefit end investors. The costs of obtaining PAI data are disproportionate to the benefits generated by the data. FFI considers it particularly problematic that the PAI analysis serves as the basis for meeting the 'do no significant harm' (DNSH) criteria for sustainable investments under the SFDR. The lack of clarity in PAI assessment makes it considerably harder to determine whether an investment is considered sustainable, thus putting the SFDR's main goal at risk.

FFI considers the most useful PAI indicators to be the ones that best lend themselves to gathering reliable data. This means that, for example, violations of guidelines or international commitments and dependence on fossil fuels are indicators that are worthwhile and possible to monitor. At the moment, the least useful indicators include those that have poor data availability and reliability (e.g. biodiversity-related parameters and gender pay gap). It is also problematic that some PAI indicators are mandatory to disclose for all financial market participants. Sustainability risks relevant to one market participant may be irrelevant to another. Monitoring and disclosing sustainability risks is important, but not all the tools available for this work can be fully used.

FFI considers particularly entity-level PAI disclosures to be uninformative. If PAI disclosures continue to be included under the SFDR, they should only be reported at product level.

Sustainable finance disclosure regulation must be built to better serve the interests of end investors

In its targeted consultation, the Commission proposed two different approaches to developing sustainable finance disclosures regulation. In the first approach, product categorisation would be focused on the type of investment strategy rather than the

current distinction between Articles 8 and 9. An example of such product categories could be investments that promote the green transition. In the second approach, Articles 8 and 9 would be converted into formal product categories, complemented by additional criteria that more clearly define the products falling within the scope of each article.

In FFI's opinion, the latter approach is more suitable. Creating formal product categories for products falling within the scope of Articles 8 and 9 would probably also better serve end investors because this approach is clearer and offers a continuation of current regulation. Creating a new system could confuse end investors. However, FFI emphasises that even the second approach should be clarified and specified especially in terms of the concepts and criteria embedded in it.

In the long term, however, FFI believes that a categorisation system based on investment strategies could potentially be easier to explain to *retail investors*. If the Commission chooses the first approach to go forward with, financial market participants must be given plenty of time and support to carry out the transition. It is also integral to pay attention to the formulation, clarity and criteria of the categories. In its current form, for instance the excluded investments category is unclear because exclusion as a categorisation strategy can produce highly varying results, and does not necessarily result in sustainable investments. FFI also emphasises that the deciding factor should be the outcome, not the methodology. The most important thing would be for the financial sector to be able to choose a method that is fit for purpose.

The Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) require financial advisors to take into account clients' sustainability preferences when conducting a suitability assessment. However, there have been challenges in applying the SFDR and the MiFID II/IDD in the financial sector. The definitions of sustainability preferences and SFDR Article 8 and 9 products are discrepant, which is causing companies problems especially in sales.

In FFI's opinion, the SFDR's scope of application currently covers a wide enough range of financial products. Broadening the scope by extending the sustainability information disclosure requirement to financial instruments beyond the current range is not sensible. For example, derivatives do not contain the kind of sustainability characteristics whose disclosure would promote the achievement of the EU's sustainability goals. The SFDR's disclosure requirements must first and foremost serve the interests of retail investors. In laying down new regulation, it is important to bear in mind that large institutional investors can effectively obtain ESG data on their investments also outside the scope of the SFDR.

In addition to the SFDR's product-specific scope of application, it is enough to build the SFDR's internal scope of application on disclosures on its current elements. The number of disclosed datapoints should at any rate not grow from the current number. If in the future it is considered best for disclosures to also cover matters like fine-grained information about the sector or geographical breakdown, the overall reporting burden should not grow in proportion. This notion is connected to the wider theme of reporting obligations growing steadily in the financial sector – especially in terms of ESG data – and increasingly burdening the sector. In the consultation document, the Commission proposed distinguishing between products with environmental and social

characteristics when creating product categories based on Articles 8 and 9. This would not be a welcome change.

Going forward with the SFDR, attention must be paid to ensuring that disclosure requirements do not force companies to reveal their trade secrets. FFI considers it problematic that the same disclosure requirements apply both to financial products marketed to the general public and to products tailored specifically to institutional investors that have a more limited publicity.

FFI also sees no reason to impose a requirement for investment products under the SFDR to include information about how sustainable products are compared to other similar products in the market. It is sufficient to provide the sustainability characteristics information required by law.

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