Targeted Consultation: Implementation of the Sustainable Finance Disclosures Regulation (SFDR)

A public consultation issued by the European Commission
Comments from ACCA and CISI to the European Commission

15 December 2023

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About ACCA:

ACCA (the Association of Chartered Certified Accountants) is the global professional body for professional accountants.

We're a thriving global community of **247,000** members and **526,000** future members based in **181** countries and regions, who work across a wide range of sectors and industries. We uphold the highest professional and ethical values.

We offer everyone everywhere the opportunity to experience a rewarding career in Accountancy, finance, and management. Our qualifications and learning opportunities develop strategic business leaders, forward-thinking professionals with the financial, business, and digital expertise essential for the creation of sustainable organisations and flourishing societies.

Since 1904, being a force for public good has been embedded in our purpose. We believe that Accountancy is a cornerstone profession of society and is vital in helping economies, organisations, and individuals to grow and prosper. It does this by creating robust trusted financial and business management, combating corruption, ensuring organisations are managed ethically, driving sustainability, and providing rewarding career opportunities. And through our cutting-edge research, we lead the profession by answering today's questions and preparing for the future. We're a not-for-profit organisation. Find out more at accaglobal.com.

About CISI:

The CISI's (the Chartered Institute for Securities & Investment) mission is to help members attain, maintain and develop their knowledge and skills and to promote the highest standards of ethics and integrity in the securities and investment industry. Based in the City of London, the

CISI is a global organisation with representative offices in financial centres such as Dublin, Barcelona, Singapore, Hong Kong, Manila, Dubai, Mumbai and Colombo. We work in close cooperation with regulators, firms and other professional bodies worldwide and over 40,000 examinations were sat in 80 countries in the last twelve months. With 45,000 members in 104 countries the CISI is the professional body which sets examinations and offers qualifications for those working or looking to establish a career in the financial planning, wealth management and capital markets industry. Consequently, the proposals to introduce a pensions dashboard are of interest to a large number of our members.

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GENERAL COMMENTS

This is a co-authored response to the European Commission's (EC) Targeted Consultation Document: Implementation of the Sustainable Finance Disclosures Regulation (SFDR) by the ACCA and CISI. This response has been informed through our policy positions, sustainability focused engagement across the EU and UK and roundtable discussion. This work has found that guidance and clarification on and within the regulation is crucial to effective implementation moving forward.

Both ACCA and CISI are of the belief that the EC has an opportunity to influence wider global regulations including SEC greenwashing rules, through utilising the lessons learnt from the SFDR and other jurisdictions regulatory successes within this space.

"Make the important measurable and not the measurable important" Roundtable Participant.

We recognise that SFDR has driven increased transparency for investors, enabling them to make informed decisions based on the sustainability practices of asset managers and the environmental, social, and governance (ESG) characteristics of investments. It has led to greater accountability for asset managers and a stronger emphasis on ESG integration in investment decision-making processes. As we shift to genuine impact investment, asset managers are now recognising the value of impact investing as a means to fulfil their fiduciary duty to investors while also contributing to societal and environmental progress. However, ACCA and CISI question the extent of positive impact that the SFDR's mandatory disclosure requirements have had. We believe that in many ways the nature of the regulation has hindered some firms as opposed to inspiring better practice and investment. Despite its positive impacts, the SFDR has also been met with some criticism and concerns as detailed in this response.

Adhering to the SFDR's extensive disclosure requirements can be costly for asset managers, as it necessitates gathering and analysing vast amounts of ESG data, developing and implementing new reporting systems, and training staff on the regulation's intricacies. This can put a strain on asset managers' budgets and limit their resources for other critical initiatives. In some scenarios this has led to sustainability being the first area to cut.

The SFDR relies on the availability of high-quality, consistent ESG data to effectively inform investor decision-making and evaluate asset managers' sustainability practices. However, the current state of ESG data is often fragmented, inconsistent, and lacking standardised definitions. This can make it difficult for asset managers to accurately assess their ESG exposure and report on their performance. We recognise that this will improve over time and the introduction of the

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Corporate Sustainability Reporting Directive (CSRD) will assist in taking significant strides in the right direction. However, there will continue to be a heavy reliance on estimates and challenge will remain in gathering, measuring and analysing non-financial data. This translates across the non-financial reporting sphere and both ACCA and CISI recognise our role in assisting our members through this transition to ensure relevant capacity building and upskilling.

We believe that the current SFDR transparency requirements are not sufficient. The UK SDR's four-tier labelling system could be considered more effective in distinguishing between different types of sustainable investments. The SFDR's labelling system for sustainable investments, which distinguishes between Article 8 and Article 9 funds, was highlighted by roundtable participants as being stringent to the point of a barrier to entry in its bid to prevent greenwashing. It also comes with a considerable administrative cost, including for finance teams. Despite the intention of the regulation to prevent mislabelling by those asset managers tempted to label their funds as sustainable without fully integrating ESG considerations into their investment strategies or achieving meaningful positive impacts, this outcome may not be achieved.

The SFDR has played a role in accelerating the transition towards a more sustainable financial system. By promoting transparency, encouraging impact investment, and fostering a culture of ESG integration, the regulation has set a high standard for asset managers and encouraged them to incorporate sustainability considerations into their investment strategies. This, in turn, has contributed to the growing demand for sustainable investments and the development of innovative ESG products. However, the SFDR's 'do no significant harm' test is not clear enough and is not being effectively enforced. While the SFDR mandates certain disclosures and reporting requirements, it lacks strong enforcement mechanisms. This has led to concerns that some asset managers may not fully comply with the regulation, potentially undermining its effectiveness in promoting sustainable practices. We recognise that asset owners need to be held more accountable for their sustainability practices. The SFDR's applicability to large asset managers has been criticised for leaving smaller firms with limited resources to comply with the regulation's requirements. This can hinder the adoption of ESG integration and impact investing practices among smaller firms, which may have a disproportionate impact on the overall sustainability of the financial system. In order to combat this effect, the EC should recognise that successful stewardship within firms can be seen as a measure of the regulation’s success. As it ensures integration of sustainability related considerations.

The SFDR's focus on environmental sustainability is seen by some as being out of balance with its attention to social factors. We need to support the right discussions and decision-making at Board and Executive levels so as not to prioritise financial performance in the short term over the non-financial performance and risks to society in the long-term. The Target Product Identifiers should cover a broader range of sectors. There is a call for the regulation to recognise the interconnectedness of environmental and social issues and provide more guidance on how to assess and address social impacts in investment strategies. In this regard we consider whether the labelling criteria for Article 9 funds could be strengthened to better reflect the long-term social and environmental impacts of investments.

The current SFDR has been a first mover in establishing criteria to combat greenwashing. However, it is not at present fulfilling its potential to be effective in promoting sustainable finance. The uncertainty and stringent nature of the rules has led to classification downgrades from Article 9. Article 8 is now the dominant class, with its much broader scope. The regulatory requirements are too granular and too complex.

The European Commission should consider steps to improve the regulation such as:

- Adopt a transition-focused approach.
- Place an emphasis on clear consistent labelling which is understandable, potentially looking to additional labels.
- Phase in the implementation.
- Create more flexibility.
- Reassess the hierarchy of the labels.
- Move beyond climate-focused sustainability.

This could enable a more sustainable financial system that aligns with the Paris Agreement and the Sustainable Development Goals.