

Consultation of the EU Commission on the “Sustainable Finance Disclosure Regulation (assessment)”, as opened on 14 September and with the response deadline set initially for 15 December 2023

Response letter submitted by EUSIPA (European Structured Investment Products Association), registered in the transparency register of the EU under number 37488345650-13.

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EUSIPA RESPONSE

Introduction

By way of responding to this consultation, EUSIPA, the European Structured Investment Products Association representing the major ten European markets of this product type with an invested volume of around 500 billion Euros, firstly wishes to markup the commitment of its members to contribute to the allocation of financial assets to the attainment of societal targets regarding environmental, social and governance purposes, in a transparent and meaningful manner.

As mentioned, EUSIPA and its member associations focus on **structured investment products** (also known as “Zertifikate”/“certificates”/“certificati” in some EU markets).

Structured investment products are composed of at least two financial assets. These are usually a bond component coupled with a derivative (referenced to an underlying asset). In practice, structured investment products are financial debt instruments generally issued by a bank. They offer the possibility of obtaining a return/gain, both at maturity and/or during the product’s lifetime, depending on the achievement of a predetermined market scenario. When sold to retail investors our products are often capital protected.

Structured investment products are manufactured for distribution to retail clients across the EU’s internal market by all major retail banks. The following comments though exclusively relate to structured investment products sold to retail investors. They do **not** extend to structured leverage (non-investment) products. An overview of all structured product types is available under the EUSIPA product categorisation website ([link](#)).

General comment

EUSIPA thanks the EU Commission for initiating the full review of the SFDR, brought forward by way of this consultation at a good moment in time, enabling the Union to create/recast a regulatory landscape which, if done in an appropriate manner, should provide regulatory stability to all stakeholders for a substantial number of years, something particularly important given the cost and efforts required for complying with any rules in the ESG area.

EUSIPA further welcomes the fact that over the last couple of years, the European Union has globally been at the forefront for creating a comprehensive regulatory framework for sustainable finance, notably including rules for relevant investment products. Indeed, without directing the capital of investors for investments promoting the EU economy's sustainable transformation, that transformation appears bound to fail. The EU's regulatory framework rightly comprises both rules relating to the products themselves, namely disclosure under the SFDR, and to their distribution at the point-of-sale.

Unfortunately, however, the SFDR and other rules relevant for products in the sustainable finance space currently lack substantive alignment and partly have too narrow a focus (as is set out in detail in this paper).

EUSIPA firstly wishes to markup that it is of crucial importance that this SFDR review is seen as an opportunity for taking a truly holistic look at sustainable finance regulation, particularly regarding relevant investment products. Product-related rules are the ones that mostly decide about the success on the objective of mobilising sufficient capital for the sustainable transformation of the EU's economy.

The current product-related rules though do not allow the sustainable transformation to have its full potential, as is also demonstrated by a rather low degree of "sustainable preferences" being currently voiced at the point-of-sale taking it from rather low numbers in the real-life distribution of financial products with sustainable features.

In EUSIPA's view, the major deficiencies of the current SFDR are rooted in the fact that:

- The SFDR currently only looks at relevant products from a disclosure perspective,
- The SFDR in its current format leaves some product formats/asset types completely unregulated (following its restricted product scope),
- The SFDR rules and practical application are not harmonised with other major rulesets governing the distribution of financial products at the point-of-sale.

In the following chapter ("Detailed comments") we will specify our concerns with regard to the above three headline statements and will, in a final section (titled "Recommendations"), mark up specific areas to look at.

Detailed comments

Firstly, EUSIPA agrees that any appropriate disclosure on the sustainable characteristics of products is of high importance for mobilising private capital for the sustainable transformation. However, EUSIPA also wishes to state that the degree to which disclosure of all relevant information by itself can trigger a shift to "sustainable" investments, or even ensure the selection of the product best suited to the investor's individual sustainability-related objectives and preferences, needs to be looked at with a realistic and sober perspective.

In line with observations regarding the actual use even of key information documents (as also mentioned by the EU Commission itself in its recently published draft Retail Investment Strategy), practical experience shows that only a small percentage of investors make use of the detailed information provided under the SFDR for their investment decision.

The rules governing distribution at the point-of-sale are far more important in deciding whether or not clients are buying a product with sustainable characteristics and which product exactly.

Secondly, as confirmed by the EU Commission's own assessment of the current situation, practical experience also shows that the only information prescribed under the SFDR currently receiving a high degree of attention is the categorisation of products according to Articles 6, 8 and 9 SFDR. Although originally intended only to bring clarity on what must be disclosed, these articles were increasingly seen as a classification of what the product is about (in ESG terms).

It should be noted that this simplification, albeit unwanted, has won a huge traction in the marketplace while it of course is not an adequate tool to ensure that products are sold to investors according their (potentially very broad) ESG preferences, nor is the *de-facto* categorisation a regulatory mechanism to effectively stop greenwashing.

However, while at the point-of-sale in practice all relevant financial instruments are competing for investments and are all subject to the sustainability-related rules based on MiFID, the classification based on Articles 6, 8 and 9 SFDR only applies to "financial products" as defined by the SFDR, in practice mainly investment funds.

The absence of a consistent classification approach covering all relevant types of products not only creates an uneven playing field across the whole product universe, but it can also confuse investors, making them potentially refrain from deciding for a product with sustainable characteristics, at all.

Thirdly, in addition to the lack of a comprehensive classification system applying to all products covered by the rules at the point-of-sale, the latter also refer back to terms and concepts introduced by the SFDR, resulting in practical problems and uncertainties for products not in scope of the SFDR. Such issues have been clearly addressed by ESMA last year in its consultation on Product Governance Guidelines. They include the interpretation of "minimum percentage of sustainable investments" for products, albeit without product rules providing for a fixed minimum percentage of sustainable investments.

EUSIPA considers it a regulatory shortcoming of first order that the interplay of both rulesets is not clarified. Against this background and in light of the SFDR recast presenting an ideal opportunity to remedy this shortcoming, our industry is surprised that the SFDR consultation paper only mentions the interaction with MiFID in general terms, and that also briefly and in abstract only.

It is not understandable to us that it is simply not taken into account in this consultation that on the distribution side (at the point of sale), many more investment types are effectively competing for the capital of retail investors with sustainability preferences than are currently covered by the SFDR – namely, in addition to mutual funds, various types of securities (not just structured investment products as the ones represented by EUSIPA).

In practice, retail investors will regularly decide between various investment solutions, for example between investment funds and structured investment products. The current non-inclusion of structured investment products in the SFDR's scope creates a structural disadvantage for structured investment products, making it difficult for sustainability-oriented investors to choose from a wider range of sustainable products, which clearly runs counter to the objective of increasing sustainable investments.

Recommendations

In EUSIPA's view, it is of crucial importance that the current deficiencies of the SFDR and the overall regulatory approach are addressed as part of the upcoming SFDR review prepared by this consultation. A revised regulatory approach should notably include changes regarding the following aspects:

- 1) Fundamental adaptation of the SFDR approach:** The current SFDR disclosure requirements have been, unsurprisingly, developed specifically for the products for which the SFDR applies today. These are products for which investment decisions are made on an ongoing basis or for which advice is provided on behalf of clients.

Most of the required information though would not fit for other product types, such as structured investment products, where no ongoing investment decisions are being made. Structured investment products, in particular, are firmly linked to an underlying asset specified at the time of issuance, and do not provide for any ongoing investment decisions (see on structured products also our comments above in the introduction part).

Accordingly, conceptual differences between the current SFDR in-scope products and other relevant products do, at the moment, not allow for extending the scope of the SFDR's disclosure requirements to all relevant products.

This needs to change as a universal regime for sustainability-related information is of high importance for ensuring a level playing field, also to allow investors to compare relevant products. In so far, practical experience with the actual use of provided information (as mentioned) demonstrates that less often is more in terms of disclosure. Short-form key information presented in a concise and understandable format has the potential to increase practical use of the information by clients.

On this basis, short and consistent information on sustainability characteristics should be required for all financial instruments, namely information on the classification of the product and the three categories of MiFID sustainability preferences.

- 2) Extension of scope of application:** As part of introducing both a truly holistic and integrated regulatory approach notably aligning and binding together product-focussed and point-of-sales rules, and a level playing field between all relevant products, a new product scope needs to be defined, applying in all cases unless relevant differences between product types require divergent rules.

In addition to the products currently covered by the SFDR, this product scope needs to include all securities to be distributed to private clients which either have a sustainability claim or are to be distributed to clients with sustainability preferences.

- 3) Product classification:** As part of the mentioned holistic and integrated regulatory approach, also a comprehensive new product classification system is required, which needs to apply to the full product scope as just described.

As mentioned, clients are in practice mostly interested in the SFDR's *de-facto* product classification based on Articles 6, 8 and 9. This was not intended by the legislator, but clearly demonstrates the need for a proper classification approach.

However, the current classification does not cover products outside of the SFDR' scope, notably any kind of securities (incl. structured investment products), which means that there are no legal rules on how to label them as sustainable. Accordingly, there currently is no level playing field in this regard for all products competing at the point-of-sale.

- Classification approach

Any new product classification approach in above sense needs to be as clear and understandable as possible. Most retail investors lack an in-depth ESG knowledge, making it difficult to grasp and weigh the specific value proposition of products with regard to "sustainability preferences." A consistent categorisation approach thus needs at least to integrate the three MiFID categories of sustainability preferences¹ to be investor-friendly and easy to administer.

Under any new categorisation approach, any minimum criteria must be compatible with the entire product universe subject to the classification system – which needs to encompass all relevant financial instruments with sustainability claims (i.e. also securities, not just investment funds), including those without continuous active investment management.

Also, both qualitative and quantitative characteristics should be reflected in the final product categorisation, so that clients can take both aspects into account for their investment decision. This approach might ultimately allow for contextualizing the quantitative element within the qualitative categorisation in a useful manner.

- 4) Product naming rules:** Product naming rules are by their nature closely related to a product classification for the same products – both have the objective of providing guidance to investors regarding the sustainable characteristics of a product. There is a need for such rules, as in their absence (as is the case currently), product providers lack legal certainty regarding the question which sustainable characteristics can be mentioned in product names, and under which conditions.

Accordingly, the required new product classification should be introduced together with materially corresponding product naming rules.

¹ MIFID Delegated Act on the ESG target market specifications introducing what is commonly referred to as "7a-7c" and its IDD equivalent for insurance products.

- 5) **Greater conceptual clarity:** The current SFDR's very high level of detail, exceeding in our eyes what retail investors realistically can absorb, is compounded by conceptual ambiguities. While terms like "sustainable investment" and "consideration" of PAIs lack clarity, the intricate nature of legal constructs like PAIs hinder client comprehension. A reformed regime needs to improve the clarity and understandability of relevant terms and concepts.
- 6) **No new disclosure obligations for non-sustainable products:** Mandating new ESG disclosures for products that do not claim to be sustainable would be a clear case of regulatory overreach. The objective of new disclosure requirements would be to "shame" certain products by dissuading non-ESG-focused investors from investing in them, by highlighting their negative ESG characteristics. However, given the limited interest in existing ESG information, it is highly unlikely that this strategy would have a significant practical impact. Rather, it would come along with substantial compliance costs and efforts while delivering no added value.
- 7) **Voluntary adoption of new standards:** Given the anticipated SFDR review timeline, certain new requirements, such as any new product classification, should ideally be introduced on a voluntarily basis as recommendations or left to be specified by means of industry self-governance, e.g. self-set (such as association-backed) standards.
- 8) **Implementing / phase-in:** While realistically any new SFDR rules on level 1 are unlikely to take effect before several years, the transition to a new regulatory framework requires adequate transitional rules, particularly for products already offered (read being available on the market) when the new rules take effect. Failure to do so could lead to significant practical issues that could disrupt ESG product distribution for an extended period.

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EUSIPA is listed in the transparency register of the EU under number 37488345650-13.
For further information, please visit our website www.eusipa.org.