Summary of ShareAction's response to the 2023 European Commission SFDR public consultation

The Sustainable Finance Disclosure Regulation[1] (SFDR), introduced as part of the EU's Green Deal in 2019, requires financial firms to provide data on the adverse impacts of their investments on people and planet for financial products claiming sustainability. The adoption of the SFDR represented a groundbreaking moment for sustainable finance at the EU level and beyond, paving the way for enhanced transparency and sustainable investment choices. However, certain flaws emerged during its implementation, with the SFDR being widely misapplied as a labelling regime by the industry, leading to accusations of greenwashing. To tackle these shortcomings, the European Commission initiated a consultation in September 2023 to assess the effectiveness of the SFDR and identify potential areas for improvements.[2]

ShareAction's consultation response underscores the critical significance of the SFDR within the EU's sustainable finance framework, highlighting its strengths and offering recommendations for addressing weaknesses. ShareAction's positions on key elements of the review are below.

Overall effectiveness

ShareAction strongly supports the SFDR's overarching objective but raises concerns about its effectiveness in achieving key goals, such as greater transparency, protection for end investors, and integration of ESG considerations into investment processes. While the SFDR has been successful in raising awareness of the negative impacts of investments on people and the planet, criticism persists about its potential to make financial market participants integrate sustainability considerations into their investment practices. Relatedly, ShareAction also stresses the importance of robust enforcement mechanisms to enhance the regulation's effectiveness.

Principle Adverse Impact (PAI) indicators

ShareAction believes that the disclosure of Principle Adverse Impacts is crucial for accountability in financial markets and supports retaining existing indicators while advocating for new ones. For

[1] Regulation - 2019/2088 - EN - sfdr - EUR-Lex (europa.eu)
[2] https://ec.europa.eu/eusurvey/pdf/pubsurvey/644841?lang=EN&unique=

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example, in our response to ESMA's consultation on SFDR Regulatory Technical Standards (RTS),[3] we proposed additional indicators, including those to "describe the risks, impacts and opportunities that may affect the company's workforce as a result of the transition to a climate-neutral economy." Furthermore, to preserve comparability, we assert that a set of PAI should be mandatory, and not subject to materiality assessments or exceptions.

ShareAction supports the notion of making sustainability reporting mandatory for all financial products, rather than limiting it to products with sustainability ambitions. This broader approach eliminates the disproportionate burden on sustainability-seeking products and fosters greater transparency and accountability in the financial industry. It informs retail investors, consumers and civil society about the extent to which adverse impacts are funded through financial products. Overall, ShareAction advocates for robust and inclusive sustainability reporting practices to drive positive change and promote responsible investing.

Engagement

The consultation investigates investors' engagement regarding missing data. Based on ShareAction's research, investors are not using engagement tools to retrieve such data in a consistent manner. ShareAction thus supports new disclosure requirements on engagement objectives and escalation plans, specifically.

Entity-Level reporting

ShareAction underscores the significance of the SFDR as an important platform for consistent entity-level disclosures, highlighting their substantial value for end users. Without such disclosures, retail investors lack the means to assess whether a product provider's philosophy and overall behavior align with the sustainability objectives of a specific product. Consistency between disclosures at both product and entity levels is essential to facilitate comparisons between the Principle Adverse Impacts of a product and those of the organisation offering it. Therefore, we contended that while some overlap may exist between the SFDR entity-level reporting and the Corporate Sustainability Reporting Directive (CSRD), this overlap is not sufficient to warrant adjustments to SFDR's entity-level reporting requirements.

[3] https://www.esma.europa.eu/system/files/webform/200622/94877/ESMA_CP_SFDR_Review_ShareAction.docx

New product categories

Overall, ShareAction strongly supports the development of a product categorization system, as the industry's current use of the SFDR as a labelling regime has clearly demonstrated the need for such a system. In this context, ShareAction suggests creating such a system from scratch, rather than basing it on SFDR's Article 8 and 9, as has been de facto applied thus far. This approach would delineate the areas of sustainability disclosure and labelling more effectively. In response to the four categories proposed by the European Commission in its public consultation: A) Positive Impact; B) Credible sustainability standards; C) Excluding negative impacts; D) Transition, ShareAction recommends having three sustainable products categories and one fallback category for products without sustainability ambition.

In this sense, ShareAction advises merging category B and C into one. Specifically, regarding Category C, ShareAction emphasises that a product category designed to exclude investments with negative impacts should not be labelled as "value-based" or "value-aligned." Such terminology implies subjectivity in sustainability objectives and less rigorous criteria compared to other categories (e.g., Product A), which could be misleading. The exclusion of harmful activities is typically grounded in universal norms or global conventions.

Regarding the Transition category, ShareAction proposes its introduction only if it's accompanied by science-based criteria for 'transition' to prevent lock-in and avoid celebrating every insignificant progress or plan as 'transition'. Reference is made to the FCA's new SDR requirements, which explicitly acknowledge the need to "help mitigate concerns of it becoming a 'catch-all' label."[4]

Regarding the interpretation of 'promotion of environmental/social characteristics,' ShareAction underscores the importance of a credible and plausible theory of change integrated into the investment process. This ensures transparency and clarity in asset selection throughout the investment portfolio. Consequently, product providers should be mandated to outline how investment choices are influenced by the chosen theory of change, as well as the Key Performance Indicators (KPIs) derived from it.

Finally, ShareAction advocates for the need for mandatory third-party verification of categories.

[4] PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels (fca.org.uk)