BlackRock

**15 December 2023**

European Commission, DG FISMA
Rue de Spa 2, 1000
Brussels, Belgium

**RE: European Commission targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR)**

BlackRock is pleased to have the opportunity to provide feedback to the European Commission's (EC) Consultation on the implementation of the Sustainable Finance Disclosures Regulation (SFDR).

As an asset manager, BlackRock is a fiduciary that manages investment on behalf of retail and institutional investors across a range of markets and asset classes. The money we manage is not our own – it belongs to our clients, the asset owners, who choose their own investment strategies and products from our broad range of offerings.

BlackRock's investment approach is rooted in our fiduciary duty: we start with our client's objectives, seeking the best risk-adjusted returns, underpinned by research, data, and analytics. We apply that same approach to sustainability:  we create investment solutions that meet the diverse needs of our clients and seek optimal risk-adjusted returns and outcomes in line with their individual investment choices.

The growth of sustainable investment and the emergence and implementation of policy and regulatory frameworks surrounding it at both European Union (EU) and national levels have been key drivers of the investment considerations of European end-investors and asset owners in recent years. Sustainable investing and navigating the transition to a low-carbon economy are a priority for many of our clients in Europe and globally, and we therefore welcome the opportunity to comment on the issues raised by this targeted consultation. We will continue to contribute to the policy dialogue on this and other topics in the best interests of our clients, the end-investors, and asset owners.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

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**Introduction**

The Sustainable Finance Disclosure Regulation (SFDR) has catalysed meaningful – and generally positive – changes in how European end-investors consider sustainability-related factors within their asset allocation and investment decision-making. At the same time, with the full suite of rules implemented, it is clear that clarifications and further streamlining can improve the functioning of the framework.

We recognise that the many different stakeholder groups have a range of objectives for the SFDR and the broader EU policy agenda in sustainable finance. From our perspective, **it is critical that the SFDR brings greater clarity and consistency across investment products, sustainability characteristics, and investment objectives in a way that facilitates meaningful choice and provides decision-useful information for end-investors**.

While we believe that the SFDR can be further improved to advance this aim, we also believe that any adjustments to the framework need to consider the balance of the costs likely to be incurred in making significant changes versus any real improvement in outcomes for end-investors.

Both the industry and end-investors have faced challenges in implementing and using the current framework given its complexity. This has been partly driven by the multiple implementation deadlines and additional layers of national-level and EU-wide guidance which supplement the SFDR and continue to evolve. We hear from clients that this is in some cases is putting them off from moving towards sustainable investment, particularly as the long-term stability of the framework remains an open question and further changes are expected down the line. This risks the opposite effect to that intended in the EU Sustainable Finance Action Plan.

While an EU-wide disclosure framework should have led to consistency and a level playing field across the EU, in practice, the lack of clear definitions has contributed to the creation of different frameworks and labeling regimes across Member States. This fragmentation has created additional legal uncertainty for asset managers and a lack of clarity for end-investors.

This is why the EC's efforts to gather comprehensive feedback on the regulation from across the ecosystem are critical.

With this context, **we would urge the European Commission to ensure that any changes to the SFDR framework, first and foremost, support asset owners and end-investors in selecting investment products** (we believe there is a strong argument for separately managed portfolios to be taken out of scope of the Regulation) **and simplify the way investors choose products.** This would also facilitate capital flows towards the economic activities that support policymakers' efforts to advance the transition towards a sustainable EU economy.

Our feedback is based on our ongoing dialogue with clients over the last three years. This dialogue has informed our product strategy to provide the choice investors desire to meet their unique investment objectives. There are **three headline areas explored in the consultation paper where the SFDR could potentially be changed or supplemented**. We provide below an evaluation of the benefits and shortfalls of the main suggestions for refining the framework.

1. Amendments to the required disclosures to improve consistency and decision-utility (including the possibility of extending them to all products regardless of whether they make a sustainability claim or not). In our mind, **simplification of disclosures is critical** to ensure they better support investors' decision-making. While we can see a use case for extending disclosures across all products (e.g. there are asset owners who look at sustainability on a whole-portfolio level), it is at the same time important to ensure that product disclosure requirements remain proportionate to the sustainability-related claims they are making.

2. A broader product classification framework to complement the Article 8/9 categories, or to replace the existing categories altogether. **We believe that a well-calibrated product categorisation framework can help investors better understand** the sustainability-related features or objectives of a range of available products. These categories should be anchored in what an investment product is trying to achieve, and the framework should cater to the current and evolving universe of sustainable investment products and strategies designed for investors who have different preferences and investment objectives. However, it is important to stress that we see a classification framework primarily as a disclosure tool, not as an anchor for a labelling regime.

3. The possible introduction of minimum standards for sustainable products. We recognise that there are segments of the European investor base for whom minimum standards or outright labels can be valuable tools. However, **we see difficulty in designing and calibrating minimum standards that can be applied across a wide range of products offering different investment strategies to meet an equally diverse set of legitimate end-investor objectives**.

Each of these respective approaches to introducing fundamental changes to the SFDR framework can have positive effects if well-designed and appropriately targeted. However, it is equally possible that merely adding extra layers to the framework results in less useable disclosures or a meaningful restriction of the investment choices available to end-investors to meet their sustainable investment objectives. We would consider this outcome a poor result for European asset owners.

**Finally, any potential changes to the SFDR need to be accommodated within the broader EU sustainable finance framework.** SFDR has been interconnected with other pieces of EU legislation from the start and by design. Changes to fundamental aspects of SFDR need to be carefully aligned and sequenced with changes across other files such as the Corporate Sustainability Reporting Directive (CSRD), the EU Taxonomy, and the Markets in Financial Services Directive (MiFID) and Insurance Distribution Directive (IDD) to avoid being confronted with the same implementation challenges that have led to investor confusion and fragmentation of the EU market.

The way future iterations of the SFDR interact with the UK's Sustainability Disclosure Requirements (SDR) is also an important consideration. The UK remains an important distribution market for many EU-domiciled funds, and significant divergences between the two regimes can add extra layers of cost which could make EU funds less attractive to UK-based investors.

We develop each theme in more detail below.

## 1. Simplification of disclosure requirements for financial market participants

We see an opportunity to streamline entity- and product-level disclosures to focus on those metrics that can help end-investors make better-informed decisions.

- *End-investor utility and the availability and relevance of data should be the guiding principles in determining how to streamline disclosures.*

- *Extending disclosures to all products – whether or not they claim to be sustainable - could be valuable for some investors but the pursuit of this option will also need to ensure a proportionate reporting burden, as this could effectively require products to substantiate sustainability-related claims that they are not making.*

- *Aggregating quantitative product-level portfolio disclosures into entity-level disclosures for asset managers does not provide decision-useful data for investors. Asset managers are fiduciaries to investors and, therefore, such disclosures merely reflect investor choice. Entity-level disclosures should focus on those qualitative disclosures that help end-investors better understand asset managers' policies and procedures.*

### *Product level disclosures*

The introduction of SFDR's disclosure requirements has resulted in greater transparency to investors, by requiring product providers to clearly articulate which elements and indicators of their sustainability-related investment policy are binding (and how) in the management of an investment product, and how well the product has delivered against those objectives.

The challenges and potential for confusion arise from the design of these disclosures. Namely, the existing SFDR pre-contractual disclosure (PCD) templates were introduced for a range of financial products and did not acknowledge the differing levels of pre-existing disclosures. Moreover, they have been formatted as "annexes" where the sustainability features are split from the rest of the narrative of what a product is trying to achieve. This has resulted in duplication and repetition, significant additional administrative burden, and operational risk but, equally importantly, risks perpetuating the notion that sustainability features are an "add-on" instead of an inseparable part of the investment strategy and process. **The disclosures could, therefore, be streamlined to incorporate existing prospectus disclosures, and provide clearer and more succinct information to investors.**

In addition, we believe the relevant information can be conveyed through a common disclosure framework that does not necessitate a distinction between Articles 8 and 9. This might additionally reduce these articles, which were designed to define only the disclosures, being used as labels.

Investors might also benefit from further clarity on some of the key concepts underpinning the SFDR framework. For example, further guidance on what constitutes an environmental or social objective could encourage greater consistency and reduce uncertainty.
Many of the quantitative disclosures on portfolio-level indicators are calibrated around the sometimes-flawed assumption that exposures in a portfolio are largely to companies or project-related investments. We would also welcome guidance on how portfolio disclosures can better reflect a wider range of asset classes, for example, the treatment of sovereign debt and non-corporate fixed-income securities.

***Entity level disclosures***

Regarding entity-level disclosures for asset managers, we see merits in keeping some qualitative disclosures such as those that relate to remuneration, broader policies, and commitments. Yet we would support the removal of quantitative disclosures, as the experience with the entity-level disclosures this year has shown that:

- They aggregate metrics across products that target specific outcomes for some of those metrics and products where those metrics are not relevant to the investment process.

- There is limited comparability due to different asset class exposures (e.g., a firm specialising in emerging markets or private assets vs. a firm that invests globally or across all asset classes) and the use of different data[1].

In our view, **end-investors can make better-informed decisions when product providers present a clear picture of how they are managing material risks and opportunities in pursuit of a fund's objectives to which each investor is invested, including, when appropriate, any material sustainability-related risks and opportunities**.

## 2. Objective-driven categorisation system for financial products

We believe that a clearer framework for describing the different sustainability-related characteristics or objectives would help investors better understand the range of ways that products incorporate sustainability into their investment strategies.

- *Hence any categorisation regime should have meaningful objective-based categories – that reflect investor allocation principles and are flexible enough to capture the current and evolving universe of sustainable investment products, ensuring we accommodate where investors are on their sustainable investment journey.*

- *A combination of categories aligned to investment outcomes and simplified, consistent disclosures - but not prescriptive minimum standards - is more likely to provide the framework needed for SFDR successfully to meet its policy objectives.*

- *More clarity is required on the definition of 'transition' – transition can be an investment theme or a portfolio outcome. A workable definition will also need to ensure it spans the spectrum of sustainability factors, not just climate.*

- *More clarity is needed on what 'exclusions' would capture – exclusions must be client-orientated, acknowledging the myriad of preferences they express.*

An effective fund categorisation regime would provide a means for investors to navigate towards clear and transparent disclosures in their search for products that meet their sustainable objectives.

Central to any categorisation must be an acknowledgment that investors have a wide range of views on sustainability which would make any prescriptive criteria a limiting factor on

[1] See SFDR_Article_8_and_Article_9_Funds_Q2_2023_in_Review_080823.pdf (contentstack.io) for further context. Page 32, "PAIs provide a useful framework for disclosing the effects of investments on sustainability factors, promoting harmonisation and comparability. However, at this stage, the implementation of PAIs at entity-level for asset managers is subject to a number of challenges that make like-for-like comparisons across entities almost impossible."

investor choice. At the same time, investors' sustainability preferences as well as the industry's understanding of sustainability factors are continually evolving in response to the transition to a low-carbon economy, for example, and the growing availability of relevant data all set in the context of broader macroeconomic factors. Hence any categorisation regime needs to be able to adapt to this changing environment if it is to continue to be useful to all investors and in the long term.

It is critical that further changes to SFDR are definitive and do not lead to further waves of product 'reclassification' without tangible benefit to end-investors. This would have the perverse effect of further accentuating existing fatigue and confusion among investors.

Regarding some of the categories proposed within the consultation:

- **Transition:** while we recognise the need for a category that captures "transition" products, given the growing interest from end-investors, this is by nature a forward-looking concept that continues to evolve. Investment interest in the transition to a low-carbon economy can take a variety of forms: from strategies that seek to capture investment opportunities from anticipated technological changes, to specific investments that can potentially help accelerate the energy transition in certain sectors or areas. Depending on the approach, this could take the form of a thematic investment strategy or a sustainability outcome/impact investment strategy. And the concept of improvement may take place over time (e.g., net zero alignment or decarbonisation pathways). We would therefore urge against introducing specific provisions that might have the unintended effect of limiting the diversity of approaches to transition investing that are developing.

- **Exclusions**: it is clear that exclusions can and do play an important part in many products that deliver an ESG- or sustainability-related strategy or objective to investors. As such, we would be supportive of an additional requirement for products that use exclusions to achieve part or all of their ESG- or sustainability-related investment objectives to clearly explain how those exclusion policies work and contribute to the objective of the fund. It is important to consider that not all investors want to exclude the same type of companies or sectors from their portfolios. Therefore, while we see some benefits in having a category for products that include exclusions, we would advise against setting a harmonised set of minimum exclusion criteria across products.

It is important to stress that **we see a product classification scheme as a way to help clearly describe a product's sustainability-related characteristics or objectives – that is, primarily as a disclosure tool.** Were they to be the starting point for specific product labels, it would be necessary to consider how to treat the range of products that might not fit within these labels or categories yet are fundamentally making a sustainability-related claim and thus should be subject to the requirement to clearly explain and substantiate that claim.

## 3. Considerations relating to the introduction of minimum standards

While we recognise that some segments of the European investor base would value the introduction of some label or product subset with minimum standards set at the regulatory level, we see challenges in setting out minimum standards across a wide range of products.

- *Minimum standards have a role – but are incredibly difficult to calibrate across the range of different asset classes, geographies and investment objectives of different investors.*

- *Enshrining prescriptive requirements in legislation is likely to be slow to adapt to evolving practices, emerging sustainable investment themes and data which is likely to stifle innovation and limit investor-choice.*

The wide range of sustainable objectives pursued by clients across asset classes and regional investment universes makes establishing quantitative/prescriptive minimum standards corresponding to proposed categories challenging. Such thresholds are unlikely to be relevant or appropriate for a broad spectrum of strategies and could therefore restrict the availability of labelled products for certain asset classes or exposures (e.g. emerging markets) thus reducing choice for investors.

For the reasons above, we believe the categories of a future regime should be based on sustainability objectives with clear and transparent disclosure of the standards adopted and the indicators used to measure sustainable performance, rather than prescriptive minimum criteria as they need to be flexible to adapt to the different product universe as well as to the different ways in which end-investors express sustainability preferences.

In the development of any specific labels, we would support a system that considers not only individual holding-level requirements as qualifying criteria, but also allows for products that pursue portfolio-level sustainability objectives. Otherwise, the criteria risk being too narrow and fail to reflect the breadth of credible sustainable solutions in the market today, many of which commit to sustainable portfolio outcomes, in particular products tracking Paris-Aligned and Climate-Transition Benchmarks.

The Consultation Paper also asks how criteria should interact with any new categorisation system if new ESG Benchmarks were developed (e.g., PAB and CTB benchmarks). In our response to the Commission's exploratory work on ESG Benchmarks and Labels, we cautioned against introducing prescriptive criteria that may stifle innovation, reduce investor choice and disproportionately penalise sustainable indexing (e.g., by introducing prescriptive min. standards for products tracking an ESG benchmark, where equivalent restrictions may not be imposed consistently on actively managed products.) As noted above, existing sustainable products come in many flavours, in response to investor demand.

## **Interaction with other sustainable finance regulation**

For the SFDR to function as fully intended, alignment among different legislation pieces is crucial, not only in terms of content but also timing. To avoid legal uncertainty, we believe regulation needs to be phased in a more systematic order going forward in a way that maximises the industry's ability to absorb and implement it, while also taking data limitations into account.

As an example, we believe any changes to SFDR must see corresponding changes to the MiFID II regime. Currently, to meet their MiFID requirements to assess end-investors' sustainability preferences, financial intermediaries have created product assessment frameworks built on the key SFDR concepts of Sustainable Investments (SI) and Principal Adverse Impact indicators (PAIs). Given this interaction, and the disruption that further changes would cause, we would propose to retain such concepts. If these concepts are not part of a future SFDR regime, a review of the MiFID II framework would be necessary.

Equally, if the future SFDR framework does not rest on Article 8 and 9 product differentiation, but rather on categories such as those proposed in Section 4 of the consultation, then we would expect that the MiFID II rules adapt accordingly and the sustainability preferences assessment is done based on the new product categories.

There is also ongoing work by ESMA that might soon introduce guidelines for minimum standards and criteria regarding fund names of investment products that are marketed as sustainable[2]. Any changes on that front should be considered in tandem with new requirements that might emerge as part of the revamped SFDR framework.

**Products that would not qualify for a sustainable investment label under this regime, but nevertheless have sustainability-related characteristics may still meet the needs of many end investors**. Accordingly, we would caution against introducing any naming and marketing rules constraining consumers from receiving the information they need to understand the sustainability-related features of such products, while ensuring that these products cannot be misrepresented to consumers as something they are not[3].

**Coordinating holistic change across the various pieces of EU legislation in this space is critical to maintain the credibility of the overall regime with investors.** The influx of regulatory proposals and new rules in recent years, both at the EU and national level, has imposed a significant regulatory burden. Further changes, especially poorly coordinated changes across frameworks, risk exacerbating this burden and adding to the confusion that many end-investors today feel with a framework that is perceived to be undergoing frequent substantial change.

As a final point, we would note that the review of the SFDR offers the chance to consider how changes may align with the UK's recent Sustainability Disclosure Requirements (SDR) to minimise potential duplication of rules and increased cross-border frictions arising from material differences between the two regimes. The UK remains an important market for many EU-domiciled investment funds (in particular), and the additional cost of complying with two distinctly different regimes may make EU funds less attractive in the UK market in future.

[2] See here ESMA consultation paper on fund name guidelines for sustainable products https://www.esma.europa.eu/sites/default/files/library/esma34-472-373_guidelines_on_funds_names.pdf

[3] See BlackRock's response to ESMA's consultation on Guidelines on funds' names using ESG or sustainability-related terms: https://www.blackrock.com/corporate/literature/publication/esma-consultation-on-guidelines-for-the-use-of-esg-in-fund-names-022023.pdf