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A consumer-oriented approach to enhancing sustainable finance legislation

Sustainability is one of the key priorities of the AFM supervisory strategy. Adequate and clear information on sustainability is essential for both the functioning of the sustainable finance market, and the objective to reorient capital flows towards sustainable investment. To ensure investor protection, maintain trust in sustainable investments and avoid unfair competition, greenwashing is an important risk that needs to be addressed.

Fortunately, existing rules that all information shall be fair, clear and not misleading also apply to sustainability claims. In addition, the disclosure obligations of the SFDR, CSRD and the EU Taxonomy will provide investors, supervisors, and market players with much-needed substantiation of sustainability claims.

Much focus has understandably been on these new mandatory sustainability disclosures. The standardized disclosure templates will allow stakeholders to compare and monitor progress, putting a strong check on the claims that are being made.

However, we should take note that the SFDR and CSRD are disclosure regimes. They do not stipulate what is sustainable and what is not. Nor do they provide limitations to usage of certain sustainability terms in marketing of products.

There is a persistent misconception among market participants that SFDR classifications, articles 8 and 9, can be used as a proxy ESG label for investment products. The SFDR, however, is not a labelling regime, nor was it intended as such. As such, SFDR classifications by itself are not a helpful guide for investors. And retail investors seem to agree. In a 2022 AFM consumer study, we found that only 3% of retail investors that seek to invest sustainably use SFDR classifications to guide their investment decisions.

When selecting sustainable investment products, most retail investors are primarily guided by marketing communication, prominent website information, or naming of products, the same study showed. Only a limited number of retail investors take the time to truly scrutinize mandatory disclosure documents. The study also found that consumer expectations on sustainable investments vary and often differ from most sustainable investments strategies offered, and that consumers find it difficult to select products that match their objectives.

We found that the most important objectives for sustainable investors are, in this order: 1) impact; investors want to make impact by bringing about positive sustainable change with their investment that would otherwise not have happened, also referred to as 'additionality'; 2) ethical; investors want to invest in companies that are in line with their personal norms and values, also referred to as 'value alignment' and; 3) return; investors regard sustainability as a way of achieving a better risk-return ratio.

To bridge the gap between the mandatory disclosures on sustainability, the expectations of sustainable investors, and the different sustainability approaches that are available in the market, there is a clear need for better consumer-oriented guidance. The need to provide clarity on the distinction between different sustainable investment approaches is heightened because the SFDR definition of sustainable investments leaves room for a broad interpretation of sustainability. We therefore need to introduce better, consumer-friendly classifications or labels.

The AFM strongly advocates a consumer-oriented approach towards better classifications and labels. This means taking into account their expectations and objectives. Much of the current legislative framework is geared towards value alignment strategies: investments in products that consist of companies that are already sustainable. Most sustainable investors, however, seek positive real-world impact.

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Classifications or labels should allow investors to recognize products that have an impact approach, either by investing new capital (direct impact), or through engagement strategies (transition). Moreover, they should allow investors to identify the distinction between these two approaches. This implies that market players should relate to these objectives when offering retail products and should make a convincing case that their product indeed suits these objectives.

To combat greenwashing and put a check on sustainability claims, the mandatory sustainability disclosure requirements of the SFDR, CSRD and the EU Taxonomy will be an important factor. However, to maintain trust in the market for sustainable finance, the AFM believes the legislative framework needs to be complemented by better, consumer-oriented categorization of products that takes into account the expectations and objectives of sustainable investors.