Report

SFDR in practice: continuing attention required

First review of SFDR requirements and Taxonomy requirements among banks, investment firms and insurers

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Contents

Key points

Banks, investment firms and insurers have been required to comply with the SFDR since 10 March 2021. This European regulation requires them to be transparent about the sustainability of their investment policies and products. In addition, part of the Taxonomy has been in force since 1 January 2022.

The AFM carried out a review among banks, investment firms and insurers of the implementation of the SFDR and the Taxonomy. They have taken steps to be transparent about the sustainability of their investment policies and products. At the same time, the AFM also sees quite a few areas for improvement. The AFM shares its findings with the market to enable financial market participants that are subject to the SFDR and Taxonomy to improve their sustainability-related disclosures.

The transition to a sustainable economy is one of the greatest challenges of our time. Financial institutions have an important role in this sustainability transition, for example by mobilising capital for sustainable investments. To enable this, it is important to provide clear information about the sustainability of products to investors. The Sustainable Finance Disclosure Regulation[1] (SFDR) and the Taxonomy Regulation[2] (Taxonomy) were drawn up to promote those disclosures.

The aims of the SFDR include giving investors more insight into the sustainability of institutions' investment policies and financial products. This will better enable investors to compare products in terms of their sustainability characteristics. The Taxonomy, which is applicable in part as from 1 January 2022, stipulates when investments can be considered to be 'environmentally sustainable'.

In its review, the AFM looked at banks and investment firms that provide portfolio management and at insurance undertakings insofar as they market insurance-based investment products, to assess how they have implemented the requirements under the SFDR and the Taxonomy. To that end, the AFM assessed the information on the websites of the parties included in the review that is required to be published pursuant to the SFDR.

Principal conclusions from review of compliance with SFDR and Taxonomy

The key points below have been formulated in generic terms. Accordingly, they do not always apply (to the same extent) to the banks, the investment firms as well as the insurers. We explain this in more detail in the report.

- **Sustainability disclosures should be easier to understand**

The information published on the website pursuant to the SFDR is often difficult to understand. This is often partly attributable to the use of unclear language and repetition of the same texts. Also, the information is often generic and therefore does not make clear what the sustainability information means for the entity or for the product. In addition, sustainability-related and other disclosures about the product are not always clear, and sometimes contradictory. It is important for parties to check whether the information they provide is correct, clear and not misleading for investors.

- **Sustainability disclosures about investment policies should be more specific**

The information ('policies') intended to disclose how banks, investment firms and insurers consider sustainability risks in their investment process within their organisation is sometimes not specific enough. For instance, it is not always clear how financial market participants integrate sustainability risks in their

[1] Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector.
[2] Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

investment process and what steps they do or do not take to manage sustainability risks. In addition, the way in which sustainability risks are specifically considered in the remuneration policiespolicies is often not clear. For instance, it is not clear how financial market participants ensure that their remuneration policies do not encourage taking sustainability risks.

Moreover, in some cases no explicit statement is provided as to whether a financial market participant considers adverse sustainability impacts in investment decisions. Where such a statement is provided, it does not always contain a description of the principal adverse impacts on sustainability factors or of how the financial market participant identifies and prioritises the principal adverse impacts. What also stood out is that some parties do not differentiate clearly between the terms sustainability risks (the way in which events relating to sustainability, such as floods and heat waves, can have a negative impact on the value of the investments) and adverse impacts on sustainability factors (which concern the way in which the investments have an adverse impact on sustainability factors, for instance the environment).

- **Pre-contractual information should be more specific and be provided at the financial product level**

It should be clear to investors from the pre-contractual information for products how sustainability risks are integrated in the investment decisions. The likely impacts of sustainability risks on the returns of the financial products should also be clear. This (mandatory) information was often not available on the website. Where the AFM did find information, this often concerned generic descriptions that were not specific to the products.

In addition, if a product promotes sustainable characteristics or has sustainable investments as an objective, it must be clear from the pre-contractual information what those sustainable characteristics or objectives are and how they are pursued. The AFM has found that in several cases, the sustainable characteristics or objectives of products are described in very general terms and are not specified. Also, parties are often not transparent about the sustainable characteristics at the level of the asset management portfolio or unit-linked insurance, but for instance only at the level of the underlying funds of the product. As a result, investors do not gain a full understanding of the sustainability of the asset management portfolio or unit-linked insurance as a whole. Further, the AFM did not find periodic reports with the prescribed sustainability disclosures on any of the websites reviewed, although this has already been mandatory since 2022.

- **Information about the Taxonomy should be more detailed**

Generally, little or no information under the Taxonomy was found on the websites of the parties reviewed. In a number of cases, it is clear that products have environmental characteristics, but that parties do not report to which environmental objectives under the Taxonomy the underlying investments contribute and to what degree they are aligned with the Taxonomy. In other cases, the AFM was unable to determine on the basis of the information on the website whether a product has environmental characteristics or environmental objectives. Parties that do report about environmental objectives often state that they are not (yet) able to determine to what extent these align with the Taxonomy.

Next steps

The AFM is aware that it has not already been clear since the entry into force of the SFDR how banks, investment firms and insurers are to implement the SFDR requirements. The same applies to the applicable requirements under the Taxonomy. The AFM understands this and realises that there is therefore room for improvement in the implementation of the requirements. Additionally, the AFM is also aware that the necessary (quantitative) information is not (yet) always available. The AFM is eager to continue its dialogue with the sector in 2023 about the further implementation of the SFDR and Taxonomy.

At the same time, clarification is increasingly being provided on the interpretation of the SFDR and Taxonomy requirements. The AFM assumes that the parties will continue to do as much as they can to comply with all requirements of the SFDR and the Taxonomy. It is important to give investors insight into the sustainability characteristics or sustainability objectives of products, so as to improve the alignment of investments with their sustainability preferences.

The AFM expects banks, investment firms and insurers to study the findings in this report and to assess to what extent they apply to them. Those insights must be applied in the further implementation of the SFDR and the Taxonomy and the underlying technical standards (RTS). The AFM expects future reviews to show that the parties have taken clear steps in this regard.

Introduction

The SFDR has been in force as from 10 March 2021. This regulation contains requirements for disclosures on sustainability in the financial sector based on the 'ESG' factors ('Environmental, Social and Governance'). In principle, the SFDR applies to all financial market participants. This includes managers of alternative investment funds (AIF's), managers of undertakings for collective investment in transferable securities (UCITS), credit institutions (**banks**) that provide portfolio management, investment firms that provide portfolio management, insurance undertakings insofar as they market insurance-based investment products (**insurers**), pension funds and premium pension institutions (PPIs)[3]

The aims of the SFDR include giving investors more insight into the sustainability of financial products. End investors can use that information to assess the sustainability of their product. It also allows them to compare the product with their own sustainability preferences. The SFDR supplements existing disclosure requirements, such as the requirement for information to be correct, clear and not misleading.[4]

In addition, part of the Taxonomy has been in force as from 1 January 2022. This regulation, briefly put, stipulates when investments can be considered to be 'environmentally sustainable'. In order to gain insight into how, among others, Dutch banks and investment firms that provide portfolio management[5] and insurers have implemented the requirements under the SFDR and the Taxonomy, the AFM carried out a review among a selection of these institutions.[6] In this review, the information on the websites of the institutions reviewed was assessed. This report contains the results of that review. The AFM also carried out a review of compliance with SFDR requirements and Taxonomy requirements among pension funds, premium pension institutions and managers of AIF's and UCITS. The results of those reviews are presented on the AFM's SFDR website.[7]

The Sustainable Finance Disclosure Regulation and the Taxonomy Regulation

Under these regulations, financial market participants are required to provide disclosures at both the entity level and product level about their approach to sustainability. This means they need to be transparent about:

- The way in which they consider the principal adverse impacts of investment decisions on sustainability factors in their due diligence policies. This must be done both at the level of the entity and at the level of the financial product (Articles 4 and 7 of the SFDR);
- The way in which sustainability risks are considered in the policies, the remuneration policies and pre-contractual information (Articles 3, 5 and 6 of the SFDR) [8];
- The way in which sustainable objectives or sustainable characteristics of financial products are implemented, both pre-contractual and on a periodic basis (Articles 8, 9, 10, and 11 of the SFDR);
- The extent to which the underlying investments of the financial products contribute to the two environmental objectives that are already applicable (Articles 5, 6 and 7 of the Taxonomy).[9]

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[3] The SFDR also applies to financial advisers that provide investment advice or insurance advice regarding insurance-based investment products.
[4] Section 4:19(2) of the Dutch Financial Supervision Act (Wet op het financieel toezicht, or Wft).
[5] This report applies the terminology of the SFDR. In Article 2(1) of the SFDR, banks that provide individual portfolio management and investment firms that provide individual portfolio management are designated as different categories. This differs from the Dutch Financial Supervision Act (Wet op het financieel toezicht) and MiFID II in which banks that provide individual portfolio management are designated as investment firms.
[6] The review does not cover activities that are outside the scope of the SFDR. Activities that are not covered by the review include, for instance, the provision of loans by banks, the acceptance and passing on of orders by investment firms and the marketing of non-life insurance by insurers.
[7] https://www.afm.nl/nl-nl/sector/themas/duurzaamheid/sfdr/verwachting
[8] Under the SFDR, "sustainability risk" means an environmental, social or governance event or condition that, if it occurs, could cause a material negative impact on the value of the investment, as specified in sectoral legislation, in particular in Directives 2009/65/EC, 2009/138/EC, 2011/61/EU, 2013/36/EU, 2014/65/EU, (EU) 2016/97, (EU) 2016/2341, or delegated acts and regulatory technical standards adopted pursuant to them.
[9] Articles 5, 6 and 7 of the Taxonomy have been included in the review insofar as they concern the environmental objectives: climate change mitigation and climate change adaptation. The other environmental objectives of the Taxonomy are applicable as from 1 January 2023.

The requirements arising from Articles 3, 4 and 5 of the SFDR concern the transparency of the sustainability policies of the institution and apply to all financial market participants. The information they must additionally provide depends on what level of sustainability the financial product they are offering aspires to. The transparency requirements applying to financial products that promote sustainable characteristics or have sustainable investments as an objective are more extensive than those for products for which sustainable investments are not promoted. For banks and investment firms, the asset management portfolio is the financial product to which the transparency requirements apply.[10] The transparency requirements apply to insurers at the level of the insurance-based investment product (IBIP).[11]

[10] See point 12a of Article 2 of the SFDR.
[11] See point 12c of Article 2 of the SFDR.

The review

In April 2022, the AFM commenced its review of compliance with the requirements under the SFDR and the Taxonomy. A total of 22 financial market participants, comprising seven (groups of) banks, ten investment firms and five (groups of) insurers, were covered in the review. The review focuses on compliance with the SFDR requirements at the entity level (Articles 3, 4 and 5 of the SFDR) and at the product level (Articles 6[12], 8, 9, 10 and 11 of the SFDR).[13] The review also focuses on compliance with the Taxonomy insofar as it concerns the two environmental objectives that are already applicable (Articles 5, 6 and 7 of the Taxonomy).

The AFM has reviewed the information which the SFDR and Taxonomy require to be published on the financial market participant's website. The information reviewed is the same information that investors can find on the financial market participants' websites. For its review, the AFM selected the banks, investment firms and insurers on the basis of their market reach within their sector. The AFM opted for this selection because these financial market participants jointly have the majority of Dutch retail investors as customers. Therefore they provide a good reflection of the way in which the market complies with the requirements of the SFDR and Taxonomy. In this case, the AFM decided against sending a request for information, because assessment of the information on the website provides a sufficiently representative view, given the review population.

In its assessment, the AFM considered whether, and, if so, how the transparency requirements under the SFDR and the Taxonomy are complied with. In this review, the AFM carried out its own assessment to determine which transparency requirement applies to the products of the parties reviewed. In those cases where it is clear from the information on the website that the product promotes sustainable characteristics or has sustainable investments as an objective, for instance because it is unmistakably evident from the sustainability and other characteristics of the product to which Article it corresponds, the AFM assessed compliance with the transparency requirements under that Article. Where the information on the website is not clear or not unambiguous about the sustainability and other characteristics of the product, it was not possible to determine unambiguously which transparency requirements need to be complied with. The AFM expects that the disclosures about those products will be clarified. In addition, the AFM considered in its assessment whether the information is comprehensible. The AFM explains its findings in the next section.

Technical Standards under SFDR and the Taxonomy
The SFDR and the Taxonomy are further specified in technical standards, which are referred to as Regulatory Technical Standards (RTS). The RTS detail the standards the sustainability-related disclosures to be provided as referred to in Articles 4, 8, 9, 10 and 11 of the SFDR and Articles 5 and 6 of the Taxonomy must meet. The RTS are applicable as from 1 January 2023. Since the RTS are not yet applicable at the time of the review, compliance with the RTS is not part of this review.

This means that banks, investment firms and insurers will again have to consider when implementing the RTS whether they meet all transparency requirements and whether it is necessary to provide additional information or to present information in a different manner. The AFM expects banks, investment firms and insurers to take account, when implementing the RTS, of the AFM's findings arising from this review as well.

Financial advisers

[12] While Article 6 of the SFDR must be complied with for non-sustainable products, there is no requirement under the SFDR to publish the pre-contractual information document on the website. The AFM therefore excluded this from the scope of its review. The AFM was able to assess compliance with Article 6 of the SFDR for products that promote sustainable characteristics or have sustainable investments as an objective, since the pre-contractual information document for those products must be published on the website pursuant to Article 10(1)(c) of the SFDR.
[13] Article 7 of the SFDR is outside the scope of this review. The provisions of that Article apply as from 30 December 2022.

In this survey, the AFM did not consider the disclosures by financial advisers. Nonetheless, the findings from this review may also be relevant for financial advisers to which the SFDR applies. The AFM encourages financial advisers to evaluate, where relevant, their disclosures against the findings in this report.

Findings

This section describes the findings of the AFM arising from its review of the transparency requirements pursuant to Articles 3 to 6 and 8 to 11 of the SFDR and Article 5 to 7 of the Taxonomy. First, the findings regarding the comprehensibility of the disclosures are discussed. Then we will discuss the findings regarding the transparency requirements at the entity level and at the product level. Lastly, the findings on the Taxonomy will be discussed.

Comprehensibility of sustainability disclosures

The SFDR includes requirements concerning the comprehensibility and the place on the website of pre-contractual and periodic information. Thus the pre-contractual and periodic information for products that have sustainable investments as an objective or promote environmental and/or social characteristics must be accurate, fair, clear, not misleading, simple and concise and be published in a prominent easily accessible area of the website (Article 10(1) of the SFDR). In addition, a general requirement under the Dutch Financial Supervision Act (Wet op het financieel toezicht)[14] is that information that is provided to investors must be correct, clear and not misleading.

The information published on websites pursuant to the SFDR is often difficult to understand. This is partly attributable to the use of unclear language and much repetition of the same texts. Also, the information is often generic and therefore does not make clear what the sustainability information means for the entity or for the product. In addition, sustainability-related and other disclosures about the product are not always clear, and sometimes contradictory. Investors may be misled by this. The AFM calls on parties to verify whether the information is correct, clear and not misleading for investors.

Lastly, the AFM notes that in general information at entity level is still not always easy to find. For instance, in some cases the remuneration policies are placed on a part of the website that is not focused on the client but on the investor (shareholder or bondholder) of the bank or insurer. This means the information is less readily findable for the client. In addition, insurers covered by the review often refer to the website of another entity in the group or of asset managers with which they work for some of the information required pursuant to the SFDR. The AFM also expects this information to be easy to find for end investors.

Transparency requirements at the entity level (Articles 3 to 5 of the SFDR)

Disclosures about considering sustainability risks in investment decisions
Financial market participants are required on the basis of various EU directives[15] to integrate relevant financial risks as well as relevant sustainability risks[16] in their procedures (including their “due diligence” procedures) and to continually assess them. Sustainability risks concern sustainability aspects that can have a relevant material negative impact on the financial returns of an investment. Financial market participants are required to state in their public policies how they integrate those risks. It is important for investors to know how the financial market participant addresses sustainability risks, since these can have a negative impact on the value of investments. Examples of such sustainability risks are: exposure to sudden and extreme weather conditions (such as floods and heat waves), problematic social conditions (such as bad working conditions and child labour) or problematic staff or management conditions (such as tax evasion and bribery).

[14] Section 4:19(2) of the Dutch Financial Supervision Act (Wet op het financieel toezicht, or Wft).
[15] See recital 12 of the SFDR.
[16] Pursuant to Article 2(22) of the SFDR, a sustainability risk is defined as “an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment”.

Most banks have published policies on their website about how they consider sustainability risks in the investment process. For example, parties state that they periodically ask managers of funds in which they invest about the sustainability risks to which they are exposed and how they manage them. Banks then integrate the outcomes in their investment process. They also use ESG risk ratings to determine the extent of sustainability risks to which a business is exposed.

Fewer than half of the investment firms reviewed have published information about how they consider sustainability risks in the investment process. The investment firms that have not published policies on the website often state that they are unable to examine (adequately) to what sustainability risks their entity is exposed and therefore do not consider sustainability risks in their investment process. However, this is mandatory under the SFDR.. The investment firms that have posted information about sustainability risks on their website are often not specific about the way in which these are considered. For instance, some parties provide a generic description of various sustainability risks but do not state specifically how they consider sustainability risks in their investment process and how they manage sustainability risks.

Most of the insurers state that they consider sustainability risks but often do not provide any (specific) information about how they do so. Thus several parties state that the investment policies ensure that risks are managed but only provide a very general description of how they consider sustainability risks in the investment process. Nor is it clear what steps they do or do not take to manage sustainability risks. It is also notable that some insurers do not have policies of their own on considering sustainability risks. For example, they refer on their website to the policies of the asset managers with which they work. Insurers are required to publish policies of their own. When drawing up their own policies, insurers can take account of the policies of the asset managers with which they work.

Statement on adverse impact on sustainability factors
Pursuant to Article 4 of the SFDR, financial market participants are required to publish on their websites a statement in which they declare whether they consider the adverse sustainability impacts (‘principal adverse impacts’) of their investment decisions. An example of an adverse impact of an investment decision is an investment in a CO_2-intensive business or in a business that harms biodiversity through its activities. If a financial market participant considers the adverse impact on sustainability factors in its investment decisions, it must include a statement on this on the website and include additional information in the corresponding due diligence policies. For instance, it must include, among other things, a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned. If a financial market participant does not consider the adverse sustainability impacts of its investment decisions, it must publish a statement with clear reasons for why it does not consider adverse sustainability impacts, including, where relevant, when it does intend to do so (‘comply or explain’). Financial market participants with more than 500 employees are required to include a statement that they consider the principal adverse sustainability impacts. Accordingly, the ‘explain’ option does not apply to them. It is important for investors to know whether and, if so, how financial market participants consider adverse impacts of investment decisions on sustainability factors and what measures they take to reduce this further. That information enables investors to select entities and products that are aligned with their sustainability preferences.

All banks and insurers included in the review state that they consider adverse impacts. Most of them have included additional information in accordance with Article 4(2) of the SFDR in their policies. However, a number of parties do not provide a description of the principal adverse impacts on sustainability factors or of the way in which the principal adverse impacts are identified and prioritised.

At half of investment firms reviewed, no (positive or negative) statement about whether the principal adverse impacts are considered was found on the website. The information on the website shows that several of them exclude certain non-sustainable sectors in their investment policies. Moreover it is clear in some cases that they offer products that promote sustainable characteristics or have sustainable investments as an objective. This gives rise to the impression that these parties do consider adverse impacts in practice but do not provide an explicit statement on this. A statement is mandatory pursuant to the SFDR. The AFM would expect parties that state that they consider adverse impacts on sustainability factors in their investment decisions also to offer a financial product that promotes sustainable characteristics or has sustainable investments as an objective.

Among the other half of the investment firms, one party states that it considers the principal adverse impacts, whereas the other parties state that they do not (yet) do so. The investment firms that state that they do not (yet) consider adverse sustainability impacts do not always give a reason for this, although this is a requirement under the SFDR. When reasons are stated, these include, for example, that they have not yet had sufficient time or do not yet have sufficient means and knowledge or that the adverse sustainability impact cannot be properly measured. Notably, one party specifies in this connection when it does plan to consider adverse impacts. No information was found at the other parties on whether and when they plan to consider adverse impacts.

The AFM also notes that transparency on policies for considering sustainability risks in investment decisions (Article 3 of the SFDR) is not always clearly differentiated from transparency on how the principal adverse impacts of investment decisions on sustainability factors (Article 4 of the SFDR) are considered. Transparency on considering sustainability risks under Article 3 of the SFDR concerns the financial risk to which the investment portfolio is exposed as a result of floods, for example. Transparency on adverse impacts of investment decisions on sustainability factors under Article 4 of the SFDR requires institutions to be transparent about the adverse impact of their investments on the environment, for example. The AFM expects parties to be alert to this differentiation and where necessary to adjust their information relating to those articles.

Considering sustainability risks in remuneration policies
Financial market participants are required pursuant to Article 5 of the SFDR to include information in their remuneration policies on how sustainability risks are considered in the remuneration policies. They must publish this on their website. It is important that the remuneration policies do not encourage excessive risk-taking with respect to sustainability risks.

Almost all banks and insurers reviewed have included information about sustainability risks in their remuneration policies. The same applies to half of the investment firms reviewed. This information is not always specific and therefore provides insufficient insight to investors on the way in which sustainability risks are considered in the remuneration policies. For instance, a number of parties state that the remuneration policies do not encourage excessive risk-taking with respect to sustainability risks, but do not specify how they ensure this by means of the remuneration policies. Some parties are clearer about this. Some parties, for example, state in this connection that they do not grant bonuses or that they base remuneration not only on performance criteria but also consider to what extent the criteria set for taking sustainability risks were adhered to for that purpose.

In the remuneration policies of the other half of the investment firms reviewed, either no information on sustainability risks was found or a statement that sustainability risks were not considered in the remuneration policies. The latter occurred at parties that also stated that they do not integrate sustainability risks in their investment decision-making process. It is a requirement under the SFDR to publish information about how sustainability risks are considered on the website. The way in which that policies correspond to the integration of sustainability risks is required to be included in the remuneration policies.

The AFM calls on financial market participants to check whether the way in which sustainability risks are considered in the remuneration policies is sufficiently specified.

Transparency requirements at the product level (Articles 6 and 8 to 11 of the SFDR)

The SFDR requires financial market participants to publish on their websites both pre-contractual information and periodic reports about the sustainability characteristics and sustainability objectives of their financial products.

The exact transparency requirements depend on the categorisation of the type of product. The SFDR distinguishes between 1) financial products that promote environmental and/or social characteristics and 2) financial products that have sustainable investments as an objective. A third category comprises the financial products that are not promoted as sustainable. It is the responsibility of financial market participants to assess to what category their product belongs. If a product is not promoted as sustainable, financial market participants are only required to state in the pre-contractual information how they integrate sustainability risks in the investment policies pursuant to Article 6 of the SFDR. If a product has environmental and/or social characteristics, the information required under Article of the 8 SFDR must also be provided. If a product has sustainable investments as an objective, the information under Article 9 of the SFDR is required to be included in the pre-contractual information. The sustainable objectives or characteristics of the product are therefore important in assessing whether products match clients' preferences and expectations.

Categorisation of products reviewed
As described in the section about the review, the AFM carried out its own assessment on the basis of information on the websites to determine the category to which the products of the parties reviewed belong.

The review shows that all banks reviewed and virtually all insurers reviewed offer one or more products that promote sustainable characteristics or have sustainable investments as an objective. The information about the sustainability characteristics of the financial product (or underlying funds) leads the AFM to conclude that these are primarily products that promote sustainable characteristics. Three banks offer products with sustainable investments as an objective. In addition, some banks and insurers also offer products that have no sustainability characteristics.

At three of the investment firms reviewed, it is evident that they offer products that promote sustainable characteristics. At three investment firms, it is evident that they do not offer sustainable products. At one investment firm, it can be concluded from the information that it offers a product with sustainable investments as an objective, but it is not clear whether it also offers products that promote sustainable characteristics. For the other three investment firms, it is not clear whether they offer products that promote sustainable characteristics, and therefore it is not clear what transparency requirements need to be complied with. An example where this is not clear is a party that states that it considers sustainability criteria in selecting investments, but that it is not focused on putting together a portfolio with sustainable characteristics. This may create confusion among investors about the sustainability of their portfolio and may be misleading for them. It is undesirable that financial market participants are not clear about the sustainability of their products. Investors are then unable to make balanced choices in their investments as regards sustainability.

General transparency requirements
Article 6(1)(a) of the SFDR sets out the transparency requirements that apply to all financial market participants, regardless of the sustainability characteristics of the products they offer. Firstly, they must describe for their products the manner in which sustainability risks are integrated into their investment decisions. Examples of sustainability risks are exposure to sudden and extreme weather conditions (such as floods and heat waves), problematic social conditions (such as bad working conditions and child labour) or problematic staff or management conditions (such as tax evasion and bribery). Secondly, they must publish the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available. Where financial market participants deem sustainability risks not to be relevant, they must explain the reasons therefor. This information must be included in the pre-contractual information document in accordance with Article 6(3) of the SFDR. In the case of a product that promotes sustainable characteristics or has sustainable investments as an objective, this document must also be published on the website pursuant to Article 10(1)(c) of the SFDR.

Considering sustainability risks in investment decisions
At the majority of the parties reviewed, the AFM was unable to determine on the basis of the information on the website in what way sustainability risks are integrated into investment decisions for the products that

promote sustainable characteristics or have sustainable investments as an objective. Sometimes that information was not provided at all or only a reference was provided to the policies on sustainability risks (which does not relate specifically to the product). In the cases where information was available, this was often insufficiently specific. The AFM expects parties to provide specific information for their products on the way in which they integrate sustainability risks.

The AFM notes in this connection that there is a significant difference between the transparency requirement under Article 3 of the SFDR and that under Article 6(1)(a) of the SFDR. The former Article concerns considering sustainability risks in investment decisions at the entity level, whereas the latter concerns considering sustainability risks in investment decisions at the product level. The AFM wishes to point out to financial market participants that the information about considering sustainability risks in investment decisions at the product level is required to be included in the pre-contractual (product) information. It was usually not clear to the AFM how sustainability risks are considered specifically at the product level by the parties reviewed in the investment decisions.

Impact on returns
At the majority of the parties reviewed, the AFM found no information on the website about the results of the assessment of likely impacts of sustainability risks on the returns of the financial products. At the parties where the AFM did find information on this, it varied in depth. Many parties provided generic descriptions that were not specific to the products. For example, some do state that sustainability risks can affect the returns of the portfolios, but do not make clear which sustainability risks are relevant for the product and what the (likely) impact on the returns of the investments is. One party does provide insight into the extent of the exposure to certain sustainability risks of its products but is not specific about the likely impact of those risks on the returns of the product.

On the basis of Article 6 of the SFDR, the AFM expects that, as a minimum, a direct connection is presented in the pre-contractual information between sustainability risks to which the investments are exposed and their (likely) impact on the returns of the investments. This can for instance be done by identifying sustainability risks to which the investments of the product are or might be exposed, and estimating the potential impact for each risk. Depending on the available data, this can be disclosed in a quantitative estimate or in qualitative terms. An example of this is a bank that provides insight on what the most significant sustainability risks are to which the portfolio is exposed and what their potential financial impact could be. A generic statement that could apply to any of the products will therefore not suffice.

Transparency requirements for products that promote sustainable characteristics
Article 8(1) and (2) of the SFDR describe the additional transparency requirements for financial products that promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics. This is subject to the condition that the companies in which the investments are made follow good governance practices. The term ‘promote environmental or social characteristics’ needs to be interpreted broadly in this context.[17] The financial market participant must provide information on how these characteristics are met. If an index has been designated as a reference benchmark, information must also be provided on whether and how this index is consistent with those characteristics, and where the methodology used for the calculation of that index is to be found. For banks and investment firms, the asset management portfolio is the financial product to which the transparency requirements apply. For insurers, the transparency requirements apply to insurance-based investment products (IBIP). Where parties use model portfolios, the transparency requirements can be met by publishing information about these model portfolios.[18]

Specific environmental and/or social characteristics

[17] Q&A EC 17 July 2021 about SFDR, page 8
[18] https://www.afm.nl/nl-nl/sector/themas/duurzaamheid/sfdr/toelichting

The AFM found that in several cases the environmental and social characteristics of products are described in very general terms. Parties state, for example, that they offer products with an ESG rating in the portfolio, but do not explain which sustainable characteristics apply and how those characteristics are met. The AFM was also not able to determine, for the majority of the parties reviewed, whether they ensure that the companies in which they invest follow good governance practices. The condition that companies in which they invest follow good governance practices is a requirement for investments in products that promote sustainable characteristics.

With regard to products with environmental and/or social characteristics, the AFM expects financial market participants at the minimum to disclose which environmental and/or social characteristics the product promotes and how those environmental and/or social characteristics are met. That enables investors to actually gain an understanding of the sustainable characteristics of the product, on the basis of the available information.

Financial product level

The sustainability information must be presented at the level of the financial product, i.e. the asset management portfolio or the IBIP, for example. The parties reviewed are often not transparent about the sustainable characteristics of the product at the level of the asset management portfolio or the IBIP. A number of banks, for example, do state the sustainability characteristics of the asset management approach, but do not present any model portfolios, and it is therefore not clear on the basis of which proportions of the investment mix this is based. Another example is an investment firm that states that it invests solely in products that promote sustainable characteristics or have sustainable investments as an objective, without explaining what this means for the asset management portfolio as a whole. This means that investors will not gain a full understanding of the sustainability of the asset management portfolio.

The AFM finds that insurers in the review usually only refer to the website of the fund managers of underlying funds for sustainability information about the IBIP. The AFM understands that it can be a challenge for insurers to provide sustainability information at the level of the IBIP. That is the case if, for example, clients themselves decide in which funds to invest, meaning that the sustainability characteristics of the IBIP depend on which underlying funds are selected by the investor. Each investor can have a unique investment mix in that case. The insurer can then opt to present in the pre-contractual information an overview of funds that the investor can select, with the associated sustainability information. In other situations, additional sustainability information is required. That will apply, for example, if the insurer applies the method of 'lifecycle' investment and clients therefore do not themselves decide in which funds they invest. A further complicating factor is that within a lifecycle the investment mix, and hence the sustainability characteristics of the IBIP, can vary depending on the age of the investor. The AFM understands why insurers see challenges in these areas and therefore seeks to continue its dialogue with the sector. The use of model portfolios may offer a way to describe the sustainability characteristics of the IBIP. Although none were found in the review, the use of model portfolios in 'lifecycle' investment may also be relevant for banks and investment firms.

Existing insurances

Existing IBIPs, which are no longer offered to new clients since the SFDR entered into force, are also subject to the SFDR.[19] The AFM notes that in those cases where an IBIP promotes sustainable characteristics or has sustainable investments as an objective, the transparency requirements under Articles 10 and 11 of the SFDR apply. One of the consequences is that the extent to which the sustainability characteristics or the sustainability objective of the product have been met must be described for these existing IBIPs in periodic reports. The AFM did not find this kind of information on websites in its review.

[19] Q&A EC 30 May 2022, page 6

Transparency requirements for products that have sustainable investments as an objective

Article 9(1) to (4) of the SFDR describes the additional transparency requirements for financial products that have sustainable investments as an objective. An index can be designated as a reference benchmark. For products for which an index has been designated, the financial market participant must provide information on how the designated index is aligned with that objective, and an explanation as to why and how that designated index differs from a broad market index. For products for which no index has been designated as reference benchmark, it must provide an explanation on how that objective is to be attained.

The AFM found in its review that, in any case, four parties offer a product with sustainable investments as an objective. Owing to this limited basis of the observations, findings concerning the observations cannot be generically extrapolated to the entire market. For further areas for attention concerning products with sustainable investments as an objective, the AFM refers to its earlier publication about the implementation of the SFDR in the asset management sector.[20]

Specific and measurable objective

The review shows that the sustainable objective of products is sometimes formulated in very general terms. A sustainable objective is referred to without specifying the objective concerned. An example is a product that has the objective to invest in positive societal change. The AFM expects financial market participants to describe specifically what objectives are pursued and how the objectives are met. In that connection, it is also important to translate the sustainable ambitions of the financial market participant into a measurable result. On the basis of this measurable objective, the product can also provide periodic reports on the result attained compared with the objective. The investment universe can be demarcated to attain this objective. Such a demarcation, for instance the exclusion of companies that engage in activities such as tobacco, alcohol or fossil fuels in the investment policies, does not in itself suffice as an objective.

Periodic reports

Article 11 of the SFDR describes what information financial market participants are required to include in periodic reports. For products that promote sustainable characteristics this is the extent to which the environmental or social characteristics are met. For products that have sustainable investments as an objective this is the general sustainability-related impact of the financial product based on relevant sustainability indicators. For products that have sustainable investments as an objective for which an index has been designated as reference benchmark, this is a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators.

This means that the financial market participant presents to investors the results that have been attained compared with the stated sustainability claims or sustainability ambitions. Pursuant to Article 10(1)(d) of the SFDR, the information concerned is required to be placed on the website. Pursuant to Article 10(1)(b) of the SFDR, information must then be included on the website on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the scheme.

The AFM did not find the periodic information on the website of any of the parties reviewed. Moreover, the AFM was unable to determine at some of the parties reviewed that offer products that promote sustainable characteristics or have sustainable investments as an objective what method is used to assess, measure and monitor the sustainable characteristics or the impact of the sustainable investments selected. This is however mandatory under the SFDR. The outcomes of this assessment must then be included in the periodic reports.

[20] https://www.afm.nl/nl-nl/nieuws/2021/september/beleggers-beter-informeren-duurzaamheid

Taxonomy

The Taxonomy contains a classification system to determine whether activities are environmentally sustainable ('green'). The Taxonomy describes when an activity substantially contributes to one of the environmental objectives. The Taxonomy establishes six environmental objectives. Two environmental objectives relate to climate change, i.e. climate change mitigation and climate change adaptation. The other four objectives are the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.

Financial market participants are required to state, for products that promote sustainable characteristics or have sustainable investments as an objective[21], to which environmental objective(s) as described in the Taxonomy the underlying investment of the product contributes.

In addition, they are required to report how and to what extent the underlying investments invest in economic activities that are qualified as environmentally sustainable in the Taxonomy. This must be included in both pre-contractual disclosures and periodic information. This gives investors insight into the environmental sustainability of their product and enables them to readily compare this with other products.

As from 1 January 2022, reporting on two of the six environmental objectives in the Taxonomy, i.e. climate change mitigation and climate change adaptation, is mandatory. This means that parties must calculate to what extent the underlying investments of the product invest in activities that are within the scope of these two environmental objectives. The obligation to report on the other four environmental objectives of the Taxonomy will apply from 1 January 2023. The principle is that financial market participants collect data that enables them to report on how and to what extent they invest in activities that fall within the two environmental objectives in the Taxonomy that concern climate change. If parties are unable to carry out that calculation they are required, according to the European Commission, to report that they invest 0% in activities that are environmentally sustainable.[22] Any qualitative disclosures on the percentage must not leave any room for ambiguity among investors about the extent of conformity with the Taxonomy ('alignment'), nor should a lack of alignment be explained by a lack of data.

Economic activities that comply with the Taxonomy to a certain extent must do no significant harm to the other environmental objectives in the Taxonomy. This is intended to ensure that activities qualified as environmentally sustainable do not at the same time harm another environmental objective. This requirement does not apply for investments in activities that are not aligned with the Taxonomy. For products that promote sustainable characteristics, Article 6 of the Taxonomy therefore requires financial market participants to include a prescribed statement both in pre-contractual information and in periodic reports. This states that the "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. Article 7 of the Taxonomy requires financial market participants to include the following prescribed statement in pre-contractual disclosures and in periodic reports for products that are not subject to Articles 8 or 9 of the SFDR: 'The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.'.

Reporting on environmentally sustainable investments[23]
The AFM has noted that in general, no information under the Taxonomy was found on the websites of the

[21] Within the meaning of point 17 of Article 2 of the SFDR.
[22] Q&A EC 30 May 2022, page 10: https://www.esma.europa.eu/sites/default/files/library/c_2022_3051_f1_annex_en_v3_p1_1930070.pdf
[23] For products that are not within the scope of Articles 8 or 9 of the SFDR, the AFM has been unable to determine whether the pre-contractual information contains the mandatory sentence 'the underlying investments of this financial product do not take into account the EU criteria for environmentally

parties reviewed. In a number of cases, it is clear that products have environmental characteristics, but that parties do not report to which environmental objectives under the Taxonomy the underlying investments contribute and to what degree they are aligned with the Taxonomy. In other cases, the AFM was unable to determine on the basis of the information on the website whether a product has environmental characteristics or environmental objectives.

Some parties do provide information about the Taxonomy, for instance which of the environmental objectives in the Taxonomy their products contribute to. At the same time, they state that they are not (yet) able to calculate the degree of alignment with the Taxonomy. Some also state that development of the criteria that can be used to determine the extent to which an economic activity can be qualified as environmentally sustainable is still ongoing and that the calculation cannot be performed yet for that reason. A few state 0% alignment.

The AFM is aware that substantial effort is required by financial market participants to collect all relevant data to calculate the percentage of underlying activities that contribute to an environmental objective, as referred to in the Taxonomy. However, this regulation has already entered into force for two of the six environmental objectives. This will also apply for the other environmental objectives as from 1 January 2023. The AFM accordingly assumes that financial market participants will continue to do as much as they can to check which underlying investments of their products comply with the Taxonomy.

sustainable economic activities.' By contrast to what applies for products that promote sustainable characteristics or have sustainable investments as an objective, it is not mandatory to publish this pre-contractual information on the website.

Next steps

In its review, the AFM sees that financial market participants have taken steps to comply with the requirements under the SFDR and the Taxonomy. Nonetheless, the AFM sees that quite a few steps towards improvement still need to be taken.

The AFM understands that compliance with the sustainability regulations is complex and entails challenges for the market. The necessary changes in operations clearly require a significant effort. Moreover, the (quantitative) data that is necessary to meet the transparency requirements in full is not (yet) always available. The AFM also understands that a financial market participant is a link in the production chain and may therefore be dependent on other parties. The AFM takes this into account in its supervision.

At the same time, the AFM continues to attach great importance to compliance with the SFDR and the Taxonomy. The transition to a sustainable economy is one of the greatest challenges of our time. Financial institutions have an important role in this sustainability transition, for example by mobilising capital for sustainable investments. To enable this, it is necessary to provide sound information about the sustainability of products to investors. The Q&As of the European Commission, the clarifications provided by European Supervisory Authorities on the RTS and the publication of the finalised RTS have now resulted in greater clarity on the implementation of the requirements under the SFDR and the Taxonomy Regulation.

The AFM expects banks, investment firms and insurers to study closely the findings in this review and, where necessary, to take them into account in their disclosures. In this report, the AFM is providing generic feedback to the market. The parties reviewed will also receive individual feedback later in the year.

Other sustainability regulations
The framework of sustainability regulations is still under development. For example, the RTS and parts of the Taxonomy will apply as from 2023. Moreover, the framework of sustainability regulations comprises more than just transparency requirements. The requirements for the suitability test[24] and for the product development and distribution process[25] were changed in the second half of 2022, for instance. As a consequence, banks, investment firms, insurers and financial advisers must also take their clients' sustainability objectives and preferences into account in their operations and service. It is important for words to be backed up by actions. A developer of a product that takes no account of environmental characteristics and that is not aligned with the environmental objectives of a target group should for instance have to ensure that the product does not end up with an investor that does have environmental objectives.

Future review
The present review has given the AFM an insight into the extent to which banks, insurers and investment firms comply with the SFDR and the Taxonomy. In 2023, the AFM will carry out another review of compliance with the SFDR, Taxonomy and other sustainability-related requirements. The AFM expects financial market participants to continue their efforts to improve compliance with sustainability regulations, so as to better enable end investors to understand which products are aligned with their sustainability preferences, and so that financing flows are increasingly directed towards a sustainable and circular economy. This means in practice that the AFM expects to find in its future review that clear steps have been taken in further

[24] Commission Delegated Regulation (EU 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms.
[25] Commission Delegated Directive (EU) 2021/1269 of 21 April 2021 amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the product governance obligations and Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products.

implementing the sustainability regulations and will verify to what extent the findings of this review have been followed up.

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