European Securities and Markets Authority
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3 July 2023

Reply on the Joint Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures (JC 2023 09; ESMA34-45-1218)

Dear Sir/Madam

In this reply on the Joint Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures (JC 2023 09; ESMA34-45-1218) ("the **Consultation Paper**"), Wigge & Partners Advokat KB will provide some high-level observations based on the Enabling Act, Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector ("**SFDR**" or "**Enabling Act**").

It is our firm understanding that many practical issues that have appeared in the past year as to the interpretation and application of the SFDR Delegated Act partly stem from a failure of the legislator to fully adapt that act to the Enabling Act.

A failure to observe the delegated powers and their limits in the Enabling Act increase the legal uncertainty surrounding the SFDR Delegated Act. It could potentially be argued that parts of the SFDR Delegated Act are open to a legal challenge as to their validity and applicability.

In order to provide what we hope is useful feedback, which may help increase the legal certainty and useability of the SFDR Delegated Act, we will first present Article 290 of the Treaty of the Functioning of the European Union ("**TFEU**") and the relevant case law from the European Court of Justice ("ECJ"). After this we will take a closer look at the delegated powers in the Enabling Act, while indicating any specific points to which the comments relate, provide a rationale, provide examples of the views expressed, and describe alternative regulatory choices that the European Supervisory Authorities ("**ESAs**") and the Commission should consider.

1 Introduction

1.1 Article 290 TFEU

According to Article 290(1) TFEU, a legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power shall be explicitly defined in the legislative act. The essential elements of an area shall be reserved for the legislative act and accordingly shall not be the subject of a delegation of power.

In addition, according to Article 290(2) TFEU, the act shall explicitly lay down the conditions to which the delegation is subject. That requirement implies that the purpose of granting a delegated power is to achieve the adoption of rules coming within the regulatory framework as defined by the basic legislative act (see judgment of 18 March 2014, Commission v Parliament and Council, C-427/12, EU:C:2014:170, paragraph 38).

Articles 2a(3), 4(6), 4(7), 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR, covered by the Consultation Paper, delegate power to the Commission to supplement the Regulation by adopting regulatory technical standards in accordance with Articles 10 to 14 of Regulations 1093/2010, 1094/2010 and 1095/2010 (the "**ESA Regulations**").[1]

The provisions also empower the ESAs, through the Joint Committee, to develop drafts of the acts.

According to Article 10, second paragraph, of the ESA Regulations, those delegated acts shall, inter alia, not imply strategic decisions or policy choices and their content shall be delimited by the legislative acts on which they are based (in this case the SFDR).

1.2 Case-law of the ECJ

According to the case-law of the ECJ, the possibility of delegating powers provided for in Article 290 TFEU aims to enable the legislature to concentrate on the essential elements of a piece of legislation and on the non-essential elements in respect of which it finds it appropriate to legislate, while entrusting the Commission with the task of 'supplementing' certain non-essential elements of the legislative act adopted or 'amending' such elements within the framework of the power delegated to it (see judgment of 11 May 2017, Dyson v Commission, C-44/16 P, EU:C:2017:357, paragraph 58 and the case-law cited).

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/79/EC, and Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.

It follows that the essential rules on the matter in question must be laid down in the basic legislation and cannot be delegated (see judgment of 11 May 2017, Dyson v Commission, C-44/16 P, EU:C:2017:357, paragraph 59 and the case-law cited).

An element is essential within the meaning of the second sentence of the second subparagraph of Article 290(1) TFEU in particular if, in order to be adopted, it requires political choices falling within the responsibilities of the EU legislature, in that it requires the conflicting interests at issue to be weighed up on the basis of a number of assessments, or if it means that the fundamental rights of the persons concerned may be interfered with to such an extent that the involvement of the EU legislature is required (see, to that effect, judgment of 5 September 2012, Parliament v Council, C-355/10, EU:C:2012:516, paragraphs 65, 76 and 77).

It is apparent from the case-law that the essential elements of basic legislation are those which, in order to be adopted, require political choices falling within the responsibilities of the EU legislature (see judgment of 11 May 2017, Dyson v Commission, C-44/16 P, EU:C:2017:357, paragraph 61 and the case-law cited).

Identifying the elements of a matter which must be categorised as essential must be based on objective factors amenable to judicial review and requires account to be taken of the characteristics and particular features of the field concerned (see judgment of 11 May 2017, Dyson v Commission, C-44/16 P, EU:C:2017:357, paragraph 62 and the case-law cited).

Moreover, it follows from the wording 'to supplement or amend' that the two categories of delegated powers laid down in Article 290(1) TFEU are clearly distinguished. The delegation of a power to 'supplement' a legislative act is meant only to authorise the Commission to flesh out that act. Where the Commission exercises that power, its authority is limited, in compliance with the entirety of the legislative act, adopted by the legislature, to development in detail of non-essential elements of the legislation in question that the legislature has not specified. By contrast, the delegation of a power to 'amend' a legislative act aims to authorise the Commission to modify or repeal non-essential elements laid down by the legislature in that act. In cases where the Commission exercises that power, it is not required to act in compliance with the elements that the authority conferred on it aims precisely to 'amend' (see judgment of 17 March 2016, Parliament v Commission, C-286/14, EU:C:2016:183, paragraphs 40-42).

1.3 Better Regulation

According to Article 8(1) of the ESA Regulations, the ESAs shall contribute to the establishment of high-quality common regulatory and supervisory standards and practices, inter alia by developing draft regulatory and implementing technical standards. This element is crucial, since the Commission's guidelines on better regulation do not apply to delegated acts drafted by the ESAs.

Further, under Article 8(3) ESA Regulations the ESAs, when carrying out this task, shall act based on and within the limits of the legislative framework and shall have due regard to the principle of proportionality, where relevant, and better regulation, including the results of cost-benefit analyses.

The principle of better regulation also applies to the Commission as a legislator.[2] The Commission has issued Guidelines on better regulation.[3] However, they are not directly applicable in the present process.

2 Comments on the Consultation paper and rationale

2.1 Powers conferred on the Commission

The SFDR as an Enabling Act only confers powers on the Commission to supplement the SFDR. It does not confer any power on the Commission to modify or change the SFDR. See Articles 2a(3), 4(6), 4(7), 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR.

However, it is crucial that the enabling provisions do not provide identical conditions to which the delegation is subject, while the SFDR Delegated Act does not differentiate between different types of Financial Market Participants ("**FMPs**") and only distinguishes between a few types of financial products. The enabling provisions could be grouped as follows.

2.2 Simple enabling provisions (Articles 2a(3), 4(6), 4(7) SFDR)

Articles 2a(3), 4(6), 4(7) SFDR delegate powers on the Commission to adopt details of the content and presentation of the information in those provisions. However, these provisions do not provide further limits or indicators on the scope of the delegated powers.

According to Article 2a(3) SFDR this should be consistent with the content, methodologies, and presentation in respect of the sustainability indicators in relation to the adverse impacts referred to in Articles 4(6) and 4(7) SFDR.

It can be added that according to Article 4(6) SFDR the ESAs shall, where relevant, seek input from the European Environment Agency and the Joint Research Centre of the European Commission.

2.3 Qualified enabling provisions (Articles 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR)

Articles 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR delegate more detailed powers on the Commission to specify the details of the content and presentation of the information to be disclosed.

From these provisions it also follows that when developing the draft regulatory technical standards referred to in the first subparagraph, the ESAs shall take into account *the various types of financial products, their characteristics and the differences between them* (emphasis added).

The ESAs shall also take into account the objective that disclosures are to be accurate, fair, clear, not misleading, simple and concise.

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[2] https://commission.europa.eu/law/law-making-process/planning-and-proposing-law/better-regulation_en

[3] SWD(2021) 305 final.

However, nowhere is there a requirement that the draft regulatory technical standards should be adapted to consumers. Firstly, the Enabling Act does not contain financial products which are marketed exclusively to non-professional retail clients (i.e. consumers). Second, the Enabling Act only requires a distinction between different types of financial products, not the clients.

2.4 Obligation to take into account the various types of financial products (i.e. point 45 of the consultation paper)

One of the key objectives of SFDR is to promote comparable sustainability related disclosures (see recital 9 of the SFDR). However, these disclosures should be comparable within specific types of financial products, not necessarily between them.

There are at most seven types of financial products defined in Article 2(12) SFDR.

However, there is no distinction made in the Consultation Paper between different types of financial products beyond those financial products with underlying investment options (which, incidentally, do not exist as a separate category in the Enabling Act). As a result, it cannot be determined whether the proposed changes are necessary, suitable, or if they go further than is required.

Moreover, as illustrated by point 45 of the Consultation Paper, there also seems to be a general presumption with the ESAs that there is a perfect substitutability between investments in a financial product and an investment in an economic activity. This substitutability is not explained other than by possible discrepancies in the disclosures that follow. However, as should be clear from the legal framework, there is no requirement to make such a comparison in order to determine the fitness of the proposed amendments.

However, the Consultation Paper does not contain any reference to the various types of financial products.

For the purpose of the draft delegated act in the Consultation Paper, any failure to take into account the various types of financial products may entail a violation of the conditions in the Enabling Act and thus constitute a violation of Article 290 TFEU.

2.5 The characteristics of financial products

The financial products covered by the SFDR have very different characteristics. The financial products defined in Article 2(12) SFDR are very different. Some can be marketed and sold to non-professional investors (UCITS funds), some cannot (AIF-funds). Some are free to choose to buy, such as funds, some are mandatory such as pension schemes.

The Consultation Paper does not take into account the various types of financial products, nor does it mention the characteristics of different financial products.

Any failure to take into account the various types of financial products may entail a violation of the conditions in the Enabling Act and thus constitute a violation of Article 290 TFEU.

2.6 Differences between financial products

The Enabling Act, SFDR, requires that account shall be taken to differences between financial products.

SFDR covers a wide variety of financial products with a wide range of characteristics. However, the Discussion Paper clearly fails to explain how these differences between the financial products have been taken into account.

There is no doubt that the consultation will uncover numerous other examples where the Delegated Act is unsuitable for specific types of financial products, but suitable to others. This is due to the differences between the financial products.

One such omission is the failure to provide a useful template for disclosures made by FMPs who offer a portfolio managed in accordance with MiFID II (cf. Article 2(12)(a) SFDR). Those FMPs should disclose their information according to Article 24(4) MiFID II, which does not entail any public disclosures. Yet, Article 11 SFDR provides that only the information in Article 11(1) SFDR be disclosed, while the delegated act contains provisions which clearly state more information should be published on the website of the FMP, including information that may lead to the identification of the owner of the financial product. The Commission has tried to solve this problem for pre-contractual disclosures in a Q&A, but from a legal standpoint this is highly unsatisfactory and most likely insufficient from a legal point of view. As is clear from the case law from the ECJ above, it is unlikely that it is lawful to require, through a delegated act, that private information should be rendered publicly available. Moreover, since the material rules are found in MiFID II, they are not part of the Enabling Act. For the Delegated Act to comply with the constitutional constraints of Article 290 TFEU and fundamental rights, an adaptation in this regard would be necessary in the final version of the Delegated Act.

A failure to distinguish between public and non-public information in the website disclosures section constitutes one of the most serious omissions in respect of the differences between the financial products covered by the SFDR, together with a failure to distinguish between those that cater to professional investors and non-professional investors.

Any failure to take into account the differences between financial products may entail a violation of the conditions in the Enabling Act and thus constitute a violation of Article 290(2) TFEU.

2.7 Better regulation

One of the key aspects of the principle of better regulation is that unnecessary regulatory burdens should be avoided. To put it simple, this would mean that double disclosures should be avoided and that the Delegated Act should not require disclosures not required under the Enabling Act, that is the SFDR.

One such example is Article 24(j) and (k), 34 and 35 of the Delegated Act which require Article 10 SFDR disclosures for Due diligence and shareholder policies. However, these disclosures are not required under Article 10(1) SFDR. It could be argued whether these disclosures are unlawful, but under any circumstance they seem superfluous, since they are already rendered public under Article 4 SFDR as well as Article 4(1) of the Delegated Act.

3 Regulatory considerations

3.1 Substitutability assessment as a guiding principle

Ever since the classic judgment of the ECJ of 14 February 1978, United Brands v Commission, 27-76, EU:C:1978:22, substitutability has been a key concept to determine a relevant market. This concept is a useful tool to determine whether a single set of disclosures is necessary for all financial products regulated by the SFDR, since the Enabling Act explicitly requires that differences between various types of financial products shall be taken into account in the drafting of the delegated act.

Inter alia according to paragraphs 12 to 35 of the judgment, substitutability in a product market such as fruit, can be established by comparing apples and pears – and bananas. A similar test should be applied to financial products. A financial product could be regarded as forming a market sufficiently differentiated from other markets for financial products if it can be singled out by such special features distinguishing it from other financial products that it is only to a limited extent interchangeable with them and is only exposed to their competition in a way that is hardly perceptible.

Any lack of substitutability between different financial products would mean that there is no overriding interest to use a single, uniform format for disclosures for all types of financial products. Moreover, it would also indicate that there is no legal rationale to ignore the various types of financial products, their characteristics and the differences between them when adopting a delegated act based on Articles 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR.

3.2 Using substitutability as a tool to enhance the useability of the Delegated Act

There are numerous indications that there are issues with the useability of the Delegate Act. A proper analysis of the substitutability between financial products in the SFDR may contribute to enhance the useability of the Act without sacrificing the general purpose of the Act to enhance the comparability between financial products.

Moreover, the principle of proportionality and the toolbox of better regulation, will provide useful regulatory guidance in the subsequent drafting process.

In particular, the Impact Assessment lacks any reference as to why it is necessary to deviate from the requirements adapted disclosures as set out in Articles 8(3), 8(4), 9(5), 9(6), 10(2), 11(4) and 11(5) SFDR.

The Impact Assessment should explain why a one size fits all approach was chosen, if this is the case, in particular if many concerns are raised during the consultation.

3.3 Using the law, including the Enabling Act, as a tool to enhance the useability of the Delegated Act

Another consideration that is put forward here, is that the ESAs should consider using the mandate in the Enabling Act, together with the requirements of Article 290 TFEU and Article 8(1)

of the ESA Regulations, to adapt the disclosures to the different types of financial products' information documents in Article 6(3) SFDR.

Finally, any assessment of the Delegated Act should be accompanied by a proper assessment of the legality of the chosen solutions for the disclosures required under the Delegated Act. Any consideration in this regard should be included in the Impact Assessment.

If no adaptations are made by the Joint Committee to the proposals in the Consultation Paper, or the impact assessment does not mention why, we would strongly encourage the Commission to make use of the possibility in Article 10(1) ESA Regulations to send the draft regulatory technical standard back to the Authority.

3.4 Possible adaptations

Of a more practical nature, there are several distinctions that can be made in the final process of adopting the Delegated Act. The issues that can be addressed include, but are of course not limited to (rationale in brackets):

- Size of the FMP (principle of proportionality and better regulation)
- Type of financial product (Enabling Act and sector specific legislation, principle of better regulation)
- Type of customers, i.e. professional or non-professional (Enabling Act and sector specific legislation, principle of proportionality)
- Public or private information in Article 6(3) SFDR documents (Enabling Act and sector specific legislation, fundamental right of privacy)

In the case the ESAs make the policy choice of not using any of the possibilities to adapt the Delegated Act, any reasoned conclusion on these concerns would greatly enhance the quality and credibility of the Impact Assessment.

Finally we would encourage the ESAs to abandon the ambition to turn the Enabling Act and the Delegated Act into a labelling scheme. This is better achieved by finalizing the EcoLabel for financial products, which caters explicitly to retail clients.[4] The current design is more suitable for transaction-based financing.

4 About

4.1 About the author

Magnus Schmauch is Senior counsel at the law firm Wigge & Partners Advokat KB, where he is head of the firm's Financial Regulation practice, as well as the firm's Sustainable Finance and Risk Management practice. He has worked many years at Finansinspektionen, the Swedish FSA, with legal issues concerning sustainable finance, the European Court of Justice and the EFTA

[4] Regulation (EC) No 66/2010 of the European Parliament and of the Council of 25 November 2009 on the EU Ecolabel.

Court, inter alia as a legal secretary. He has an LL.M. in law and a B.Sc. in political science from Lund University (Sweden), and a PhD in EU law from University of St Gallen (Switzerland). He has published three books and more than 50 articles, mostly concerning financial markets law and constitutional EU law.

4.2 About the firm

Wigge & Partners Advokat KB is a leading commercial boutique law firm with focus on transactions. The firm is based in Stockholm, Sweden. It is ranked in Chambers, Legal 500 and other rankings. Our mission is to assist our clients in making considered and sound business decisions and ensure that the legal aspects of the decisions are formalised through an efficient negotiation process and wisely drafted agreements.

Yours sincerely,

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