July 4, 2023

European Insurance and Occupational Pensions Authority (EIOPA)

European Banking Authority (EBA)

European Securities and Markets Authority (ESMA)

Joint Committee of the European Supervisory Authorities

**Re: Joint Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures**

Cboe Europe appreciates the opportunity to respond to the European Supervisory Authorities (“ESAs”) joint consultation on the review of Regulation (EU) 2019/2088 known as the Sustainable Finance Disclosure Regulation (SFDR). Like many governments, business leaders, and investors, Cboe believes that one of the surest ways to achieve sustainability goals is to enable the flow of capital toward sustainable activities by improving disclosures and ensuring market integrity. However, in our zeal to provide investors with high quality and comparable information, we must not discourage the use of investment tools that aid investors, such as exchange-traded options and futures (“exchange-traded derivatives” or “ETDs).

Cboe Europe is a pan-European operator of market infrastructure, including a Netherlands-based Regulated Market, MTF, APA, CCP (Cboe Clear Europe), and options and futures exchange (Cboe Europe Derivatives Exchange or “CEDX”). CEDX was launched in 2021 and follows our sister exchanges in the U.S., which have long been leaders in global exchange-traded, centrally cleared options and financial futures.

Cboe’s products and clients are at the forefront of global risk management, and Cboe is also committed to its own sustainability efforts. Cboe, among other things, is a member of the UN Sustainable Stock Exchange (“SSE”) Initiative, a founding member of the SSE’s Derivatives Exchanges Advisory Group, a member of the Sustainable Trading Initiative, and a signatory to the Net Zero Financial Service Providers Alliance. Given our expertise in exchange-traded options and futures and our commitment to advancing sustainability efforts, Cboe is well-suited to provide comments on the instant consultation, specifically as it relates to the treatment of non-commodity ETDs.

SFDR

The SFDR came into effect on March 10, 2021, alongside other regulations implemented under the EU’s 2018 Action Plan on Sustainable Finance. By imposing disclosure requirements across a broad range of environmental, social, and governance (“ESG”) metrics at both an entity and product level, SFDR aims to improve transparency and prevent greenwashing around sustainability investment claims.

Cboe is fully supportive of efforts to help investors identify funds linked to sustainability or other ESG factors. As others have stated in recent years, however, a key concern of the SFDR Delegated Regulation is the treatment of derivatives. SFDR requires financial market participants and advisors to determine and disclose the proportion of Taxonomy-aligned investments of a financial product, the proportion of sustainable investments of a financial product, and information on principal adverse impacts (“PAIs”). With respect to Taxonomy-aligned and sustainable investments, the methodology requires long derivatives positions to be excluded from the numerator and short derivatives positions to be included in the numerator; yet the denominators must include all derivatives positions. The PAI ratio generally requires long derivatives positions to be included in the numerator. In effect, this means ETD positions will lead to a high adverse impact ratio, and a low taxonomy-aligned and sustainability ratio, giving the false impression that a fund that uses ETDs is less taxonomy-aligned or sustainable than a fund that uses no ETDs. This fails to recognize the utility of ETDs.

ETDs

Exchange-traded, centrally cleared options and futures are important risk-management tools that are used to hedge a portfolio’s risk or for income generation (among other use cases). Funds are increasingly utilizing ETDs to optimize their portfolios, and this benefits investors. Funds that would be subject to the ratio disclosures should not be unnecessarily discouraged from incorporating ETDs into their portfolios. Most ETDs positions do not result in an ultimate ownership position in a company, and some derivatives structurally cannot result in an ownership interest (e.g., cash-settled derivatives). Beyond this it is not evident how derivatives positions can, for example, negatively impact the sustainability objective of a particular fund. Financial derivatives positions do not, for example, finance emissions or directly result in negative real-world environmental impacts.

For example, an investor invests in a company that has a sustainable objective. The investor buys a put to protect the investment. This in no way harms the company or the sustainable objective. The same logic applies to funds use of derivatives. For example, a target outcome or buffer protect ETF that seeks to provide investors returns matching an underlying sustainability index is no less sustainable because the fund utilizes short options/futures positions to create downside protection within the fund in a manner easily accessible to retail investors. Yet, the calculation methodology for determining the taxonomy alignment; sustainability; or PAIs of these SFDR funds (expressed as a ratio) suggests such strategies or other commons strategies, such as a protective put strategy, would reduce the taxonomy-alignment ratio; reduce the taxonomy alignment ration; and potentially increase the PAI ratio. In effect, this would place relevant SFDR funds that utilize risk management strategies at a disadvantage as the disclosed ratio is increased/decreased in negative manner. This is unfortunate given that the use of ETDs is unlikely to have a negative impact on the non-financial objective of the fund. Thus, such a requirement simply becomes a structural bias that discourages investors from funds that utilize risk-management tools such as ETDs.

We understand there are greenwashing concerns, but it is important to recognize that investing brings risk; investing in sustainability/social objectives may bring additional risk; and that if policymakers want to empower investors to pursue non-financial investing objectives it is important that we allow funds to simultaneously address financial, risk-management objectives. Ultimately, a healthy ETD market contributes to the broader financial ecosystem and can help mature the nascent SFDR fund industry.

**Our recommendations to enable funds to utilize ETDs in an effective manner**:

* Exclude derivatives from the ratios (from both the numerator and the denominator): The purpose of the ratios is to help investors compare sustainability objectives/impacts of different investments (i.e., non-financial objectives). Currently, the ratios discourage the use of derivatives because there is no accepted methodology for determining whether derivatives exposures are exposures to environmentally sustainable economic activities. In other words, the current standard errs on the side of including ETDs in the calculations but discouraging their use. We recommend erring on the side of excluding ETDs in order to promote the ability of ETDs to serve financial objectives, at least until such time as there is more consensus on the impact of ETD exposures on non-financial objectives. As previously noted, investing brings risk; investing in sustainability/social objectives may bring additional risk; and that if policymakers want to empower investors to pursue non-financial investing objectives it is important that we allow funds to simultaneously address financial, risk-management objectives.
* No physical investment: To the extent derivatives continue to be included in the ratios, cash-settled derivatives should be excluded as they cannot result in a position in the underlying company. The Consultation suggests that with respect to the PAI ratio, where it can be shown that the derivative does not result in a physical investment in the underlying security that the position does not result in adverse impacts and thus should be excluded from the numerator. We agree. This should also apply to the Taxonomy-alignment and sustainability ratios. Otherwise, we are concerned that the status quo will remain (i.e., exclusion of derivatives exposures from the numerator of the Taxonomy-aligned and sustainable investment ratios but inclusion of derivatives exposures in the denominator, which will continue discouraging the use of listed options and futures).
* Delta-weighting: To the extent derivatives continue to be included in the ratios, derivatives positions are to be converted into an equivalent position in the underlying in order to calculate the ratios. The positions should certainly be delta-weighted so as to not give a false sense of the derivatives’ contribution to the ratio.
* Hedging Exemption: To the extent derivatives continue to be included in the ratios, we recommend pursuing an exemption from the ratios for derivatives positions that are specifically designed to hedge the underlying portfolio of the fund.

Sincerely,

/s/ Iouri Saroukhanov

Iouri Saroukhanov

Head of European Derivatives

Cboe Europe