FIA EPTA
EUROPEAN PRINCIPAL TRADERS ASSOCIATION

4 July 2023

FIA EPTA response to the ESA's Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures

Introduction	The FIA European Principal Traders Association (FIA EPTA) represents Europe's leading Principal Trading Firms. Our members are independent market makers and providers of liquidity and risk-transfer for markets and end-investors across Europe. FIA EPTA works constructively with policy-makers, regulators and other market stakeholders to ensure efficient, resilient and trusted financial markets in Europe. FIA EPTA's members are based in the Czech Republic, Germany, Ireland, The Netherlands, and the UK. FIA EPTA members welcome the opportunity to respond to the ESA's Consultation Paper on the Review of SFDR Delegated Regulation regarding PAI and financial product disclosures. FIA EPTA members believe that exchange-traded derivatives (ETDs) are a key component of mature secondary markets. The recent growth in demand for listed ESG derivatives demonstrates that these products are a core component of sustainable investment strategies, especially since the availability of liquid and transparent derivatives significantly reduces funding and financing costs for equity and bond issuers in primary markets. The proposed approach by the ESAs would unduly disincentivise the use of derivatives in the affected financial products since any exposures to derivatives could not be counted toward the Taxonomy-alignment ratio. This would make it more difficult for end-users to use ETDs for managing their financial risks and in the process undermine the goal of having safe, liquid, and efficient markets that can support the green transition.

	Portfolio managers have a critical role in the economic transition. Their core fiduciary duty is to achieve appropriate returns for their end-beneficiaries. Effective risk management is key for asset managers to deliver on these objectives. ETDs also have a critical information function in financial markets in providing transparency on asset pricing and risk. An effective price formation process inherently brings together market participants with different investment horizons and risk-return expectations. FIA EPTA members appreciate ESA's consideration of our comments herein and welcome the opportunity to discuss further and provide additional input as required.

3. Background analysis

Question	**FIA EPTA Response**
Question 14: Do you agree with the proposed treatment of derivatives in the PAI indicators or would you suggest any other method?	FIA EPTA members welcome the review of the ESAs on the treatment of derivatives in the SFDR, the objectives of the ESAs to give tools to investors to compare and give clarity around direct investments are important and welcomed. However, FIA EPTA members believe that the role of exchange-traded derivatives (ETDs) in the development of sustainable investments is not recognised by the ESAs. ETDs are part of the broader market infrastructure and are important for the uptake and trust in the financial markets; e.g. used to hedge a portfolio's risks. ETDs are used by all kinds of FMPs and are needed for the financial ecosystem to function well. FIA EPTA members believe that ETDs should be viewed comprehensively, i.e. also with respect to their positive contributions to risk management and for the uptake of sustainable products and the green transition. The proposed approach by the ESAs would unduly disincentivise the use of derivatives in the affected financial products since any exposures to derivatives could not be counted toward the Taxonomy-alignment ratio. This would make it more difficult for end-users to use ETDs for managing their financial risks and in the process undermine the goal of having safe, liquid, and efficient markets that can support the green transition.

	FIA EPTA members believe that the ESAs have a too narrow view of the use case and benefits of ETDs for market participants and we believe that the ratios around derivatives in sustainable investment should be viewed in an equal manner and by including derivatives in both the numerator and the denominator of the relevant ratios in which they are recognised as contributing to taxonomy aligned investments. In addition, FIA EPTA members believe that the ESAs should not focus only on 'net long positions' to be included in the ratios, both net- long and short positions are used by FMPs to risk manage their positions and are part of a healthy financial market ecosystem. FIA EPTA members would suggest consulting further with market participants on this as netting is complex, and FMPs would need more time distinguishing between long and short positions. Portfolio managers have a critical role in the economic transition. Their core fiduciary duty is to achieve appropriate returns for their end-beneficiaries. Effective risk management is key for asset managers to deliver on these objectives. Introducing maximum turnover ratios or minimum holding periods would artificially reduce their ability to manage risks. In addition, we would point to the critical information function financial markets play in providing transparency on asset pricing and risk. An effective price formation process inherently brings together market participants with different investment horizons and risk-return expectations (e.g., long vs. short). A market where investors were to be subject to minimum holding periods or maximum turnover ratios will likely be less efficient and liquidity will be rare. FIA EPTA members recognise that the ESAs have greenwashing concerns, however, it is important to acknowledge that investing creates risk; investing in sustainability/social objectives may bring additional risk. If policymakers want to enable investors to pursue non-financial investing objectives, funds must be allowed to simultaneously address financial and risk-management objectives. Ultimately, a healthy ETD market contributes to the broader financial ecosystem and can help mature the developing SFDR fund industry. In addition, physical ownership does not necessarily demonstrate sustainable impacts and should, therefore, not be considered as the criterion for inclusion/exclusion. Hence, FIA EPTA members believe that derivatives should be included in the PAI indicators, both in the numerator and the denominator if ETDs are recognised as contributing to taxonomy-aligned investments. Otherwise, FIA EPTA members believe it preferable to exclude ETDs from both the numerator and the denominator. Considering that ETDs have a limited positive (or negative) direct impact on those specific non-financial objectives we believe, that

	in that case, it would be appropriate to exclude ETDs from the ratios. When the ESAs would continue to include ETDs in the ratios, FIA EPTA members would recommend pursuing an exemption from the ratios for ETD positions that are specifically designed to hedge the underlying portfolio of the fund; making sure investors can continue to use ETDs as a risk management tool. In addition, FIA EPTA members believe that if to the extent the above recommendations are not adopted, ETD 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 ETD's contribution to the ratio.
Question 15: What are your views with regard to the treatment of derivatives in general (Taxonomyalignment, share of sustainable investments and PAI calculations)? Should the netting provision of Article 17(1)(g) be applied to sustainable investment calculations?	FIA EPTA members believe listed exchange-traded derivatives (ETDs) are a key component of mature secondary markets. The recent growth in demand for listed ESG derivatives demonstrates that these products are a core component of sustainable investment strategies, especially since the availability of liquid and transparent derivatives significantly reduces funding and financing costs for equity and bond issuers in primary markets. In addition, derivatives products enable asset holders to manage their financial risks, which is crucial for discharging their fiduciary duty and for appropriately managing their long-term investments. This makes listed and cleared derivatives an important component of long-termism in financial markets. FIA EPTA members believe that ETDs and net long/short positions are part of a healthy secondary market ecosystem. FIA EPTA members believe that there should not be made a distinction between net long or short positions as both contribute to transparency and risk management in capital markets. This is also echoed by the European Securities and Markets Authority[1] (ESMA), stating that short selling is key to price discovery and market liquidity. Short selling assists with the incorporation of negative information into market prices more quickly, reducing the risk of price bubbles. The evidence suggests that restricting short selling reduces liquidity as well as significantly increases the costs of liquidity which in turn will delay and make the transition more costly. FIA EPTA members believe that including only net long positions or both net long or short positions of derivatives into the numerators of sustainable investment ratios should be further scrutinized and tested. Once, a conclusion is reached, ideally, the same approach should be reflected for both PAIs, taxonomy-alignment ratios and sustainable investment ratios for harmonization and equal treatment. Hence, the current artificial gap

[1] ESMA (2019), Report on undue short-term pressure on corporations ESMA30-22-762, para. 308.

	created between the approaches taken towards the negatively and positively contributing derivatives could be closed. This would mean that under the ESAs proposal, ETDs would not be recognised as contributing to Taxonomy-aligned investment activities, and yet would still need to be included in the denominator as part of the total assets of the product or portfolio. This proposed approach would unduly disincentivise the use of derivatives in the affected financial products since any exposures to derivatives could only ever contribute negatively to the Taxonomyalignment ratio. This would make it more difficult for end-users to use ETDs for managing their financial risks and in the process undermine the goal of having safe, liquid, and efficient markets that can support the green transition.
Questions 16: Do you see the need to extend the scope of the provisions of point (g) of paragraph 1 of Article 17 of the SFDR Delegated Regulation to asset classes other than equity and sovereign exposures?	As also mentioned in our response to questions 14 and 15; FIA EPTA members believe that ETDs and net long/short positions are part of a healthy secondary market ecosystem. FIA EPTA members believe that there should not be made a distinction between net long or short positions as both contribute to transparency and risk management in capital markets. This is also echoed by the European Securities and Markets Authority[2] (ESMA), stating that short selling is key to price discovery and market liquidity. Short selling assists with the incorporation of negative information into market prices more quickly, reducing the risk of price bubbles. The evidence suggests that restricting short selling reduces liquidity as well as significantly increases the costs of liquidity which in turn will delay and make the transition more costly. Provisions of point g of paragraph 1 of Article 17 of the SFDR Delegated Regulation is cross-referencing the Short-Selling Regulation ((EU) 236/2012) where netting methodologies for short positions are laid out. Before determining the appropriate legal cross-references to the Short Selling Regulation, FIA EPTA members would suggest first focusing on deciding on the final netting methodology once more details have been clarified. Once it has crystallized which direction on netting to take, it then makes sense to refer to the appropriate laws and regulations. FIA EPTA members believe that the SFDR-aligned fund market should be developed and treated equally to established products as artificial barriers will create less trust and liquidity in the market.

[2] ESMA (2019), Report on undue short-term pressure on corporations ESMA30-22-762, para. 308.