IMPACT OF THE SUSTAINABLE FINANCE DISCLOSURE REGULATION (SFDR) ON INFORMATION ASYMMETRY BETWEEN INVESTMENT SERVICE PROVIDERS AND END INVESTORS

Lappeenranta–Lahti University of Technology LUT

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ABSTRACT

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Impact of the Sustainable Finance Disclosure Regulation (SFDR) on information asymmetry between investment service providers and end investors

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Keywords: Sustainable Finance Disclosure Regulation, SFDR, information asymmetry, principal-agent theory, sustainable investing.

The aim of this thesis is to examine how EU’s Sustainable Finance Disclosure Regulation reaches it goal to reduce information asymmetry between investment service providers and end investors. This research aims to find the advantages and challenges of the regulation, and identify how these affect the goal of the regulation to create more comparable and transparent sustainability-related information. The first level of regulation came into effect on 10th of March 2021, but due to the length and details of regulatory technical standards, the second level of regulation has been delayed.

The research was done by using qualitative research approach. The data collection was accomplished with semi-structured interviews and interviewees were selected from different investment service provider companies from Finland. As SFDR aims to reduce information asymmetry between investment service providers and end investor, and in that way improve investors protection, the information asymmetry in principal-agent relationship constructs the theoretical framework of this study.

The empirical findings of this study show that the regulation is welcome, and it already resolves some main problems in information asymmetry between investment service providers and end investors. First level of SFDR seems to bring some formality to the sustainability-related reporting, but based on findings, true benefits to the comparability and transparency of these sustainability-related reports will be seen only when the level 2 of regulation will come into effect.

TIIVISTELMÄ

Lappeenrannan–Lahden teknillinen yliopisto LUT

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Kestävän rahoituksen tiedonantoasetuksen (SFDR) vaikutus informaation epäsymmetriaan sijoituspalveluiden tarjoajien ja loppusijoittajien välillä

Pro gradu -tutkielma

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Tämän tutkielman tavoitteena on tutkia, miten EU:n kestävän rahoituksen tiedonantoasetus (SFDR) onnistuu sen tavoitteessa vähentää tiedon epäsymmetriaa sijoituspalveluiden tarjoajien ja loppusijoittajien välillä. Tutkimus pyrkii löytämään asetuksen hyötyjä ja haasteita, ja tunnistamaan millainen vaikutus niillä on asetuksen tavoitteeseen luoda läpinäkyvämpää ja vertailukelpoisempaa kestävyyteen liittyvää tietoa. Asetuksen ensimmäinen taso astui voimaan 10. Maaliskuuta 2021. Asetuksen toinen taso, joka pitää sisällään sääntelyteknisiä standardeja, on kuitenkin viivästynyt.

Tutkimus toteutettiin kvalitatiivisena tutkimuksena. Tutkimusaineisto kerättiin puolistrukturoiduilla haastatteluilla ja haastateltavat valittiin eri sijoituspalveluita tarjoavista yrityksistä Suomessa. Koska SFDRn tavoitteena on vähentää informaation epäsymmetriaa sijoituspalveluntarjoajien ja loppusijoittajien välillä, ja siten parantaa sijoittajansuojaa, tämän tutkimuksen teoreettinen viitekehys muodostuu päämies-agenttiteoriasta ja heidän välillänsä vaikuttavasta informaation epäsymmetriasta.

Tutkimuksen tulokset osoittavat, että asetusta pidetään hyvänä uudistuksena, joka osittain ratkaisee suurimpia informaation epäsymmetriaan liittyviä ongelmia sijoituspalvelun tarjoajien ja loppusijoittajien välillä. Asetuksen ensimmäinen taso näyttäisi tuovan kestävyysraportointiin jonkin verran muodollisuutta. Tutkimusten tulosten perusteella voidaan kuitenkin todeta, että asetuksen tuomat todelliset hyödyt kestävyysraportoinnin läpinäkyvyyteen ja vertailukelpoisuuteen, nähdään vasta sitten, kun asetuksen toinen taso astuu voimaan.

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In Helsinki, 19th April 2022

Ida Piispa

ABBREVIATIONS

EBA	European Banking Authority
EIOPA	European Insurance and Occupational Pensions Authority
ESA	The European Supervisory Authorities
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
IBIB	Insurance-based investment product
PAI	Principal Adverse Impacts
PEPP	Pan-European Personal Pension Product
RTS	Regulatory Technical Standards
SDG	Sustainable Development Goal
SEC	The United States Securities and Exchange Commission
SFDR	Sustainable Finance Disclosure Regulation
SRI	Socially Responsible Investment
UCITS	Undertaking Collective Investment in Transferable Securities

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1. Introduction

This paper examines the impact of Sustainable Finance Disclosure Regulation (SFDR) on financial market, and how the regulation reaches its goal to reduce information asymmetry, by providing more transparent and comparable information about sustainability profiles of financial products and investments. The research aims to find the advantages and challenges of the regulation, and identify, what kind of effects these advantages and challenges have on the information provided about financial products and on the end investor. The empirical part of the study is carried out by interviewing investment service providers which are affected by SFDR. The introduction chapter is divided into sub-chapters. In these sub-chapters the background of the research, the aim of the research and the research questions are presented. Also, theoretical background, research methodology, definitions of the key concepts, delimitations, and the structure of this thesis are described in this introduction chapter.

1.1. Background of the research

In the past decades, sustainability has started to play a greater role in the financial market. The demand for sustainable financial products has grown rapidly and investors are searching for financial products that are not only profitable, but also reflect investors' values and beliefs and therefore have a positive impact on our world. The term "sustainable investment" has become an established concept on the financial market and many financial operators are using investment strategies incorporating sustainability, ranging from the exclusion of certain sectors and products to the ESG engagement. However, the significant growth in investors demand, the numerous definitions of sustainable investment and the large number of different kinds of sustainable financial products have created a confusing environment, and makes the investors decision-making process difficult, and may lead companies to give misleading information about their sustainability.

As a part of the ongoing transition towards a low-carbon, more sustainable and resource efficient economy, the European Commission has put into practice various new regulations. The European Commission's Sustainable Finance Action Plan intends to decrease greenwashing and help direct capital towards more sustainable activities (European Commission 2018). Its cornerstone, Sustainable Finance Disclosure Regulation (SFDR), aims to make sustainability profiles of financial products more comparable, transparent and easier to understand for end investors. The first level of SFDR came into action on 10th of March 2021. The regulation sets obligation for financial market participants to disclose in pre-contract information, how sustainable development has been considered in the investment activities of financial products. Changing regulation has already changed the requirements for financial sector, and it will still increase the responsibilities, as additional deadlines are spread across the next years.

The motivation behind the new regulation is the absence of harmonized rules in sustainable finance. Without consistent rules, comparing different financial products in different member states of EU is difficult for end investors (Regulation (EU) 2019/2088). Therefore, it has been necessary to pay attention to existing barriers, create common frameworks and in that way improve the comparability and transparency of financial products. One of the most visible and impactful elements in the SFDR for the end investor, is the classification of financial products. Classifications of financial products are done accordance with how sustainability risks have been considered in investment decisions (Regulation (EU) 2019/2088). Roughly, the financial products can be classified in three categories depending on the goals of its investments. To Article 8 and Article 9 financial products can be classified those products, which have met certain ESG criteria in their investment processes and objectives. Other products, that do not meet certain criterion about sustainability or do not consider sustainability risks to be relevant in their investments, must be classified as Article 6 products.

The new regulation has caused debate in investment service providers, and especially some Articles and definitions of SFDR have raised a lot of questions towards European Commission. A wide range of different practices and interpretations regarding SFDR have been highlighted, and according to Morningstar (2021) some asset managers tend to classify their mutual funds more easily as "green" than others. In June 2021 overall 23-24% of mutual funds in Europe considered themselves as green, which was a lot higher

than expected before the regulation came into effect (Morningstar 2021). This might be a consequence of absence of clarity on the definitions and classifications in regulation. As SFDR has caused a lot of questions, and the interpretability of regulation has been raised into conversations, it is important to research the regulation more.

According to Silvola & Landau (2021, 13) information provided by companies is not often comparable, even within sectors, and that has an effect to the quality of sustainability analysis. Because there has not been standardized or statutory minimum requirements for sustainable investments, the suspicion of greenwashing has aroused among end investors. Silvola & Landau (2021, 13) mentioned in their book a concern that some financial products may be marketed as sustainable, even when no changes have done to the investment portfolio of them. According to Lashitew (2021), new measurement frameworks and disclosure regulation would improve transparency and trustworthiness of sustainable investing and reporting. As the SFDR is new and some extensions are still coming, there is not much existing research about the regulation and its effects, but according to Hartzmark & Sussmann (2019) when the information about sustainability of the mutual funds is available to everyone, the asset managers of mutual funds are more likely to do more sustainable investments. Taking that finding into account, the new regulation might increase the money flows towards more sustainable investment targets and in that way support the broader 2018 EU Sustainable Finance Action Plan.

Becker, Martin & Walter (2021), examined in their paper, how mutual funds' asset managers and end investors reacted to the new regulation. They investigated whether SFDR made individual investors allocate more capital to more sustainable mutual funds and how change in regulation affected to ESG mutual fund scores and mutual fund net inflows. They found in the study, that after the regulation came into effect, mutual funds increased their sustainability ratings and good ESG label resulted in better fund net inflows. According to them, because investors are looking for more sustainable funds, asset managers should increase their sustainability efforts. (Becker et al. 2021) Same kind of findings about fund flows were made by Alda (2020) and Ghoul & Karoui (2021) who found that better sustainability ratings and sustainability-related names increased the fund flows. Furthermore, Hartzmark & Sussmann (2019) noticed in their study, that being categorized as high sustainability, resulted in inflows, while being categorized as low sustainability resulted in net outflows. As these findings pointed out, sustainability label

might have an impact to the fund flows. Since the sustainability of the mutual fund seems to be an advantage when attracting new possible investors, the transparency and comparability of the pre-contractual information must be emphasized. In the investors' point of view, more important than the regulatory obligation of providing this pre-contractual information, is the quality of the information. That is why it is important to research the advantages and shortcomings of the regulation and how these affect the information provided.

According to Zimmer (2009), the best way to improve investor confidence and protection, is to combine improved disclosure information with securities regulation. Instead that each party have their own formula for disclosure information, Zimmer (2009) suggested that it would be better to create one disclosure document that end investors can rely, when they are making an investment decision. The first level of SFDR requires financial market participants to report on 'principal adverse sustainability impacts' caused by their investment decisions, but the second level of SFDR will give further regulatory technical standards (RTS), additional reporting requirements and templates. Originally it was intended that both levels of SFDR would take effect at the same time, but in a letter to the European Parliament, John Berrigan, the head of the European Commission's financial services unit said, that because of the length and technical details of RTS, the level 2 of regulation will be delayed (European Commission 2021a).

Previous research about the regulatory changes in disclosure obligations focuses mainly to the changes in the fund flows and performance of mutual funds. That is why qualitative research on how the regulation fulfils its goals is valuable. Many papers, as Richardson (2009), Candelon, Hasse & Lajaunie, (2021) and Lashitew (2021) have highlighted the importance of regulation in terms of consistent and comparable sustainability reports, which is why it is important to investigate the true impacts of the introduction of regulation. Because the regulation is new and there are still extensions coming further, it is necessary to investigate how investment service provider has interpreted and put into practise this first level of regulation. As the purpose of the regulation is to reduce information asymmetry and greenwashing between the end investors and financial market participants, the research should pay attention on how the regulation is interpreted by investment service providers and is there any potential challenges in regulation, which may have an unwanted effect regarding its goals. As the levels of regulation come into effect in

different times, it is also necessary to consider, how this two-phasing affects the credibility of regulation and what are its effects to the end investors.

1.2. The aim of the research and the research questions

The aim of this study is to research how well the EU Sustainable Finance Disclosure Regulation (SFDR) meets its goals to reduce information asymmetry and greenwashing, by providing more comparable and transparent information about sustainability profiles of financial products. According to Rhodes (2009), end investors are facing information asymmetry problem, when they are using investment service providers in sustainable investing. Therefore, the investigation, how the regulation decreases information asymmetry between investment service provider and end investor is important.

The study seeks to gain an insight into the factors that influence how the objectives of the SFDR are achieved. The research approaches the issue from the perspective of the investment service providers, as they play a key role in how the regulation is interpreted and what information is provided to the end investor.

The research question of this paper is the following:

> *How does the Sustainable Finance Disclosure Regulation (SFDR) reach its goal to reduce information asymmetry in sustainable investing between investment service providers and end investors?*

The following sub-questions are helping to fulfil the answer for the first research question:

> *What are the advantages and challenges of SFDR?*
>
> *How does these advantages and challenges affect the information provided about financial products? And what are the effects to the end investor?*

1.3. Theoretical framework

The principal-agent theory is behind the investor protection, which is why it represents the theoretical part of this research. According to Sunit (2014), potential principal-agent

problem occurs in situations, where some individuals act on behalf of others and the information between these parties is not perfect. For example, investment service providers act on behalf end investors, as they do the investment decisions. Investment service providers have more information about the risks and costs of their investments and financial products than their clients have, which is why information asymmetry occurs in this relationship. SFDR aims to reduce information asymmetry between investment service providers and end investor, and improve investors protection, by providing more transparent and comparable information about the sustainability of the investments. As the principal–agent problem arises when the principal-agent relationship involves incomplete information, the theoretical framework focuses mainly to the information asymmetry that occurs between principal and agent. (Crockett, Harris, Mishkin & White 2003, 5-7). As SFDR is still new, there is very little academic research about this topic. The concepts of information asymmetry and greenwashing have been studied in sustainable finance but there is no previous research about all these concepts together with SFDR. Therefore, the research between these concepts is much needed.

According to Lashitew (2021), inaccurate and non-transparent information about financial products may lead to information asymmetry that distort investors' decision-making. That is why, it is important to consider the gaps, which may contribute to the emergence of asymmetric information. In the figure 1 is presented the relationship between the investment service provider and the end investor, and how the regulation aims to reduce the information asymmetry between those parties. In the figure 1 the gaps, where the information asymmetry can form, are presented between the regulation and the investment service provider, and between the investment service provider and the end investor. The first gap is related to, how investment service providers interpret the regulation and what kind of investments decisions they do within the regulatory framework. If different investment service providers interpret regulation in a different way, it may have an impact to the investment decisions or classification of financial products and in that way to the goal of the regulation about the transparent and comparable information. The second gap where the information asymmetry can form is on how investment service providers disclose the information about their investments to the end investors. The quality of the information provided about the financial products have an impact to the end investor's decision-making, which is why the quality of it matters.

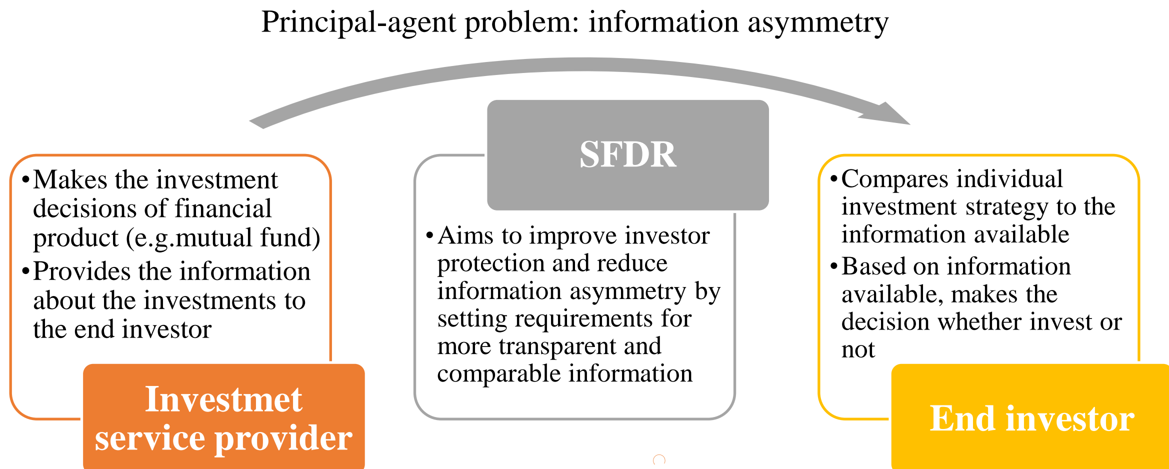

Figure 1. Theoretical framework of this study.

1.4. Research methodology

This study has been conducted by using qualitative research method. As this research tries to find out, how SFDR manage to achieve its goals about more transparent and comparable sustainability-related information, the qualitative method fit perfectly to this research. Juuti & Puusa (2020) mention that qualitative research tries to understand the phenomenon under investigation from the perspective of the subjects. As investment service providers play a key role on how the regulation is implemented to the business, the qualitative research method is a justified choice for this research. Instead of numbers, qualitative research uses text as an empirical material (Flick 2007, 2). This means being interested in experiences, thoughts, feelings, and meanings that people give to the subject under study (Juuti & Puusa 2020). Since this study is especially interested about the advantages of SFDR, and whether there are any challenges regarding the new regulation, which may have an effect to the goals of the regulation, the qualitative research supports well this study.

In this research a multiple case study has been used as a research method. Yin (2013) describes that case study tries to analyse complex phenomenon in its real-world context and Johannesson & Perjons (2021, 47) divided purposes of case study to the exploratory,

descriptive, and explanatory ones. Case study is an optimal strategy to be used in this thesis because it focuses on one instance of the phenomenon to be investigated and it offers a fundamental description about that instance (Johannesson & Perjons 2021, 46)

The data collection will be accomplished with semi-structured interviews. According to Juuti & Puusa (2020) in a semi-structured interview, the research questions are pre-defined, and they are constructed based on a theoretical framework. The advantage of a semi-structured interview is that interviewer receives the views of the interviewees for the pre-defined questions in their own words (Juuti & Puusa 2020). As the goal of this research is to get understanding about advantages and challenges of the regulation and whether the regulation leaves a room for interpretation, it is necessary to give interviewees a possibility to answer in their own words instead of giving them predefined options.

Interviewees were chosen from different investment service provider companies in Finland. In this way the results of this study will represent a wider range of views on regulation and its effects to the sustainable disclosure information. All the interviewees have been involved in the integration of regulation into the day-to-day work of the company they are representing. All the interviews have done via video calls, and they have been transcribed in Finnish.

1.5. Definitions of the key concepts

Definitions of key concepts are presented in this chapter. All the definitions are based on the academic literature and concepts defined in EU regulation. The purpose of this chapter is to introduce shortly the author's perspective on each key concept. This aims to give reader a better understanding about the key concepts and phenomena of this research.

Financial adviser means insurance intermediary or undertaking which provide insurance advice regarding insurance-based investment products (IBIPs). It also means credit institutions and investment firms, and alternative investment fund managers and UCITS management companies, that provide investment advice regarding financial products. (Regulation (EU) 2019/2088, Art. 2(11)).

Financial market participants mean investments firms which provide portfolio management and insurance undertakings which provide investment products. It also means institutions for occupational retirement provision, manufacturers of pension products and providers of pan-European personal pension products (PEPP), alternative investment fund managers, managers of qualifying venture capital funds and social entrepreneurship funds, and UCITS management companies. (Regulation (EU) 2019/2088, Art. 2(1)).

Financial product means alternative investment funds, IBIBs, pension products, pension schemes, UCITS, PEPPs, and portfolios managed in accordance with mandates given by clients, if such portfolios include one or more financial instruments (Regulation (EU) 2019/2088, Art. 2(12)), Directive 2014/65/EU, Art 4(1) point 8)

Investment service providers means investment firms, banks and fund management companies which have been authorised to provide investment services such as portfolio management, investment advice and services regarding to financial products. (Finnish Financial Supervisory Authority 2022) In this research investment service providers refers to the *financial market participants* and *financial advisors* which are affected the SFDR and presented earlier.

Pre-contractual information means qualitative, or quantitative information provided to the end investors, to ensure clarity of investment strategies and investment objectives (The European Supervisory Authorities 2021).

Sustainable Finance Disclosure Regulation (SFDR) sets out disclosure requirements for the financial market participants, financial advisers, and financial products, and complements existing sector-specific rules. (Regulation (EU) 2019/2088).

Sustainable investing is an investment strategy that integrates environmental, social and governance (ESG) criteria to its investments, in order to generate long-term competitive financial returns and positive societal impact (USsif 2021). It means that in addition to traditional financial figures, investment decisions are also based on ESG information that is essential for each company (Silvola & Landau 2021, 3).

Sustainability risk means event related to environmental, social or governance factors, that could cause negative impact on the value of the investment (Regulation (EU) 2019/2088, Art. 2(22)).

1.6. Delimitations

This study focuses on investment service providers operating in Finland. All of them have implemented the first level of SFDR into their existing business, and as the additional reporting requirements are still coming, the questions about the level 2 implementation are under consideration. Because of that, the results of the study must take into account the incompleteness of the regulation.

Although the aim of the regulation is improving the investor protection and enhance information provided about financial products, this study is carried out only from the investment service providers point of view and it does not consider the end investor's opinion to the topic. As there has been interpretability in some definitions and articles of the regulation, it is important to make sure that the interviewer and the representors of the investment service providers understand each other's well enough to avoid miss-communication. Regardless of that the study tries to understand the effects of the regulation to the end investor, it must be remembered that the results are derived from the perspective of the investment service provider, and do not take into account the experience of the end investor.

1.7. Structure of the thesis

This thesis contains overall six different main chapters, and each of them contains sub-sections to make this research easier to read. The purpose of the first chapter, is to introduce shortly the topic of this research. It presents the background and aim of this research and introduces the theoretical framework. Research methodology and delimitations are also reviewed briefly in the first chapter.

The theoretical part of this research is divided into two different chapters. Chapter two presents the theory of principal-agent problem and concept of information asymmetry. The concept of greenwashing is also presented as a part of the information asymmetry. The third chapter focuses only on the regulation and SFDR is explained in detail.

In chapter four, before empirical part of this study, the research design and methods are explained. The chapter five introduces findings of this research and chapter six summarises

the research and conclusions. In the end of the sixth chapter the limitations and future research recommendations are also presented. The structure of this research is presented in the figure 2 below.

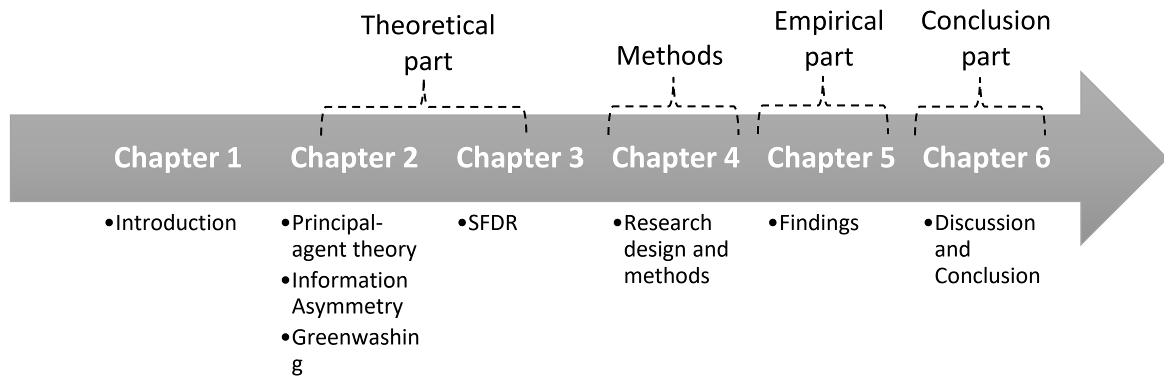

Figure 2. Structure of the thesis

2. Literature review

In this chapter the literature review about, principal-agent theory behind investor protection, the concept of information asymmetry and information asymmetry in sustainable investing are presented. The chapter follows the theoretical framework of this thesis. The principal-agent theory highlights the problems that can arise in relationship between principal and agent. In this research the end investor can be considered as a principal and investment service provider represents the agent. The problems that arise in agency relationships can be seen to underlie investor protection regulation, which is why principal-agent theory, and more specifically information asymmetry in principal-agent relationship, constructs the theoretical framework of this study.

In the first sub-chapter are discussed about the principal-agent theory behind the investor protection. The second sub-section presents the notion of information asymmetry and how information asymmetry occurs in sustainable investing. Also, different forms of information asymmetry are discussed more detailed in the second sub-section of this chapter. In the end of this chapter, the concept of greenwashing is presented briefly, as it is an issue to which information asymmetry can lead in sustainable investing, at worst.

2.1. Principal-agent theory behind investor protection

According to Sunit (2014), principal–agent problems can occur in any industry where some individuals act on behalf of others. Investment service providers have a responsibility to act in investors' best interests, regardless of their own. Despite this, the end investor cannot perfectly know how much effort the investment service providers' asset manager has put into investment decisions and detail information about all the investment targets, is not always available or it might be costly to acquire. (Sunit 2014) The problems that arise in agency relationships can be seen to underlie investor protection regulation.

Michael Jensen and William Meckling (1976) can be considered as developers of the agent theory. They define a principal-agent relationship as a contract in which one or more principals authorize the agent to carry out some service on their behalf. This involves

delegating some decision-making control to the agent. In the situations where both parties, principal and agent, try to maximize their utility, "there is good reason to believe that the agent will not always act in the best interests of the principal". (Jensen & Meckling 1976, 5)

The relationship between the principal and the agent can contain conflicts of interest. When this relationship between principal and agent involves misaligned incentives, and information asymmetry, the principal-agent problem arises. (Crockett et al. 2003, 5-7) Eisenhardt (1989) describes the relationship between a principal and an agent using a contract metaphor. According to it, the idea of agent theory is to determine the most effective functioning contract between the principal and the agent that guides the actions of these parties. The theory is based on assumptions about people, organizations and information. People are assumed to be risk averse with limited rationality, organizations are seen as conflict-sensitive and information as a purchasable commodity. (Eisenhardt 1989)

According to Hoppu (2004, 34-35) disclosure standards are a key factor in investor protection. The securities market can be said to trade in information related to the security and that is why the regulation of information is one of the basic principles of securities legislation. The aim has been to regulate information, by making compulsory to provide information to the market in certain situations. The provision of false information to the market is prohibited, and the correction of information already provided is required if it subsequently becomes inaccurate. (Hoppu 2004, 34-35)

As a rule, an investment service provider has more information about the financial products, their risks and costs, than the client has. This creates an information asymmetry between the parties. According to Crockett et al. (2004), when asymmetric information occurs in financial markets, it may lead to the two problems, moral hazard, and adverse selection. Both are often a problem in financial contracts. The seller generally has more information than the buyer, as a result of which the end investor sometimes chooses poor investment targets due to a lack of information. To be able to select good investment targets from the bad ones, the end investors should have enough sufficient information. (Crockett et al. 2004) According to Vizzotto (2012) in the situation of adverse selection, the sellers of products, in this case investment service providers, can monitor the quality or characteristics of their own services before the conclusion of a business transaction. The

buyer, in this situation the end investor, can only estimate the quality of the financial products. Due to imperfect information, the effective functioning of the market can be distorted. (Vizzotto 2012) Moral hazard can be defined as actions where agents try to maximize their own utility at the expense of others. This can occur in situations where the agent, in this situation investment service provider does not bear the full consequences or does not enjoy the full benefits of their own actions. This is usually due to uncertainty, and incomplete or restricted contracts. Incompleteness can arise for example due to the unequal information, legal barriers to contracting and different kind of costs related to the contract. (Kotowitz 1989, 207)

2.2. Information asymmetry

Information asymmetry occurs, when two parties in the business transaction does not have the same relevant information. This situation may come to exist for example, if one party access to more updated and more relevant information than the other party of the business transaction. (Wankhade & Dabade 2010, 14-18) Bergh, Ketchen, Orlandi, Heugens & Boyd (2019) recognized in their review, that in the management research the concept of information asymmetry was applied several ways. According to the review the most common ways of information asymmetry were private information, different information, hidden information, lack of perfect information and information impactedness (Bergh et al. 2019). These are presented in the figure 3 below.

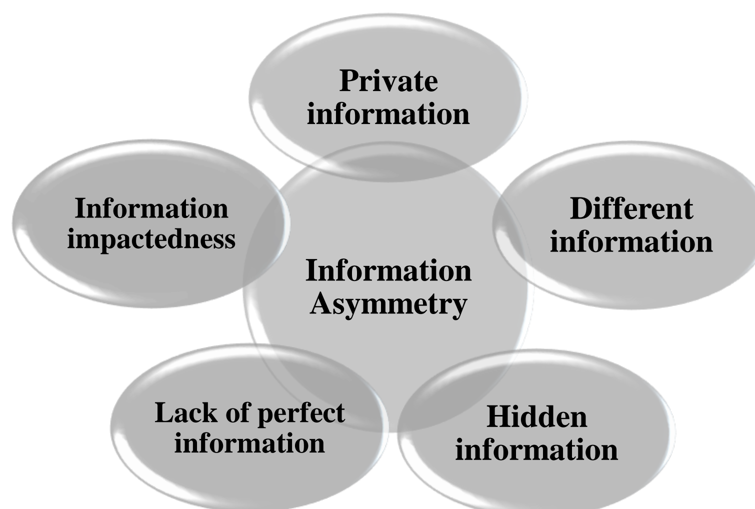

Figure 3. Common formats of information asymmetry

Information asymmetry was most commonly present in management research as *a private information* (Bergh et al. 2019). According to Connelly, Certo, Ireland and Reutzel (2011), information is not equally distributed between parties, and this is due to private information. Information asymmetry due to private information occurs between those who hold the information and who could make better decisions, if they had that information. (Connelly et al. 2011) According to Brown & Hillegeist (2007) information asymmetry causes an adverse selection problem in the market, when investors who got private information, trade based on that. Their study indicates that the quality of the disclosure information reduces private information as it reduces investors likelihood to discover and trade on private information. In that way information asymmetry decreases. (Brown & Hillegeist 2007) According to Makadok, Ketchen, Barney & Wright (2011), differences in ability to estimate the value of inputs or outputs, creates base to the information asymmetry theories. Due to private information some market participants are better informed about the value of goods, services, or resources and this increases information asymmetry. (Makadok et al. 2011) Bergh et al. (2019) mentioned that private information occurs also when managers retain information about qualities that would not be observable otherwise.

Stiglitz (2002) described information asymmetry as a situation, where *different people know different things*. According to Schmidt & Keil (2013) information is not equally distributed in the market and not everyone has access to all relevant information. At the same time, one party may interpret same information differently that the other. That is why it is important to separate the actual information from the interpretation. (Schmidt & Keil 2013) Despite the fact that information asymmetries exist in all exchange relationship, in the strategic decision process these asymmetries are highlighted (Bergh et al. 2019). In strategic decision-making process, each member brings different values, assumptions, knowledge, goals and priorities for decision-making, and in that way, the final decision may differ depending on who has done it. (Hambrick & Mason 1984). For example, analysts can promote services by using their expertise in interpreting differences in information. (Bergh et al. 2019)

Bergh et al. (2019) found in their review that *hidden information* was usually linked to the problem of “adverse selection” and “moral hazard”. According to Vanhaverbeke, Duysters & Noorderhaven (2002), assets quality and performance characteristics are not usually in shared knowledge. When information about assets quality and performance are not in

shared knowledge, provided information might be biased, and it may cause adverse selection problem (Vanhaverbeke et. al. 2002). Moral hazard can be described as a situation where one party maximizes its own utility at the expense of another. Due to incomplete or restricted contracts, that party does not bear all the consequences or enjoy full benefits of their actions, and it allows opportunistic behaviour. (Kotowitz 1989, 207-208) In decision-making processes, the mental capability of decision-maker and information available make limitations to the decisions that are reached. When rational decisions are taking into account these limitations, it is called bounded rationality. (Simon 1990) According to Gomez-Mejia, Nunez-Nickel & Gutierrez (2001) due to the bounded rationality and information asymmetries, it might be difficult for principal to specify performance criteria in advance and create contract with the services of the best possible agent.

Information asymmetry can also occur as a *lack of perfect information*. Lack of perfect information usually leads parties to reduce information asymmetries by sending and assessing “signals”. (Bergh et al. 2019) Vernimmen (2014, 482) mentioned that the basis of the financial communications are the signals that managers send to investors. Since nothing comes for free in financial world, end investors should ask themselves why the signal is being sent (Vernimmen 2014, 482). For example, the name of the mutual fund can be used as a signal. It may tell the end investor about the investment style or strategy of the mutual fund but on the other hand, asset managers who act opportunistically may turn this information asymmetry to their advantage, by sending misleading signals. (Candelon et al. (2021).

Information impactedness were depicted in review as a source of transaction costs. It can be defined as a characteristic of transactions in which the parties may act opportunistically because of the uncertainty and complexity related to the contract. According to the Bergh et al. (2019) review, information asymmetries raise the search, monitoring, and bonding costs between transaction parties. This is due to the fact that equally distributed information is expensive and difficult to achieve, and the parties tend to behave opportunistically when given the chance.

2.2.1. Information asymmetry in sustainable investing

According to Rhodes (2009), end investors are facing information asymmetry problem, when they are using investment service providers who provides sustainable investment products. To assure, that end investor's assets will be invested appropriately, target companies must first be able to inform portfolio managers of investment service providers about their performance. After that these portfolio managers must reliably inform the end investors about the portfolio's structure and characteristics. First, the portfolio manager sets the criteria for its investments and after that acquires an information, to make sure that the chosen criteria are met, and appropriate securities are selected into the portfolio. This selection is not always simple, and another asset manager might select very different securities to their portfolio than the other. Rhodes (2009) portray the decision-making process as a balancing between preferences for ethical behaviour and uncertainty of the fund's ability to full-fill its ethical promises.

With the rise of sustainable investing, the demand of non-financial data has also increased. Different independent rating agencies provides investors tools, to compare the sustainability of companies and financial products. ESG evaluation leans on independent rating providers and each of them uses unique methods for assigning company-specific ratings. (Li & Polychronopoulos 2020) Zumente and Lace (2021) noticed in their study two important challenges related to the ratings provided by independent rating agencies. Firstly, the availability of the scores, and secondly the divergence among them. They found that 72% of investigated companies did not have external ESG rating, and those who had, the ESG rating divergence was high, even among European companies with similar sustainability disclosure regulations. These findings were consistent with Li & Polychronopoulos (2020) findings, which found "a lack of correlation and consistency in ratings produced by different providers". According to them, end investors, asset managers and ESG rating providers each, have their own opinions about the issues that are most important to address, and these opinions are reflected into their choices.

Candelon, et al. (2021) studied the asymmetric information between asset managers and end investors in socially responsible investment (SRI) market in US and Europe. In their research the information asymmetry was due to investors difficulty to "evaluate the financial and extra financial performance of mutual funds" (Candelon, et al. (2021, 1).

They noticed that asset manager may maintain the information asymmetry, by using the misleading or unsubstantiated information about their mutual fund's SRI commitments. In the study, they used international dataset of 1500 mutual funds and investigated the lack of transparency of disclosure information reported by asset manages. In the research they found, that on the average, ESG scores were almost the same between conventional funds and socially responsible funds. In other words, some funds with low ESG ratings might have sustainable fund label and high ESG rating can be obtained without having a sustainability label. The study also found that European responsible funds were more likely to have a low ESG score, and more often than US funds, European funds did not respect their commitments in the SRI. These findings indicates that there is some information asymmetry between portfolio managers and end investors, and the name and certification of a given mutual fund are not always linked to the investment strategy of the asset manager. (Candelon, et al. 2021)

Investment service providers can reduce the information asymmetry by giving 'signals' to the end investors. In other words, these "signals" can be considered as actions that company takes to provide information to their stakeholders (Connelly et al. 2011). Signals can reduce information asymmetry when they provide insights to outside audience about a firm's intentions and capabilities. As mentioned earlier, according to Candelon et al. (2021) the name of a mutual fund can be considered as a signal if it helps end investor to identify the strategies and objectives of the mutual fund. On the other hand, this may lead to the opportunistic behaviour where asset manager chooses misleading name for financial product, to impact end investor perception. To reduce information asymmetry and misleading information, Candelon et al. (2021) proposed more regulation to the descriptive materials and naming manners. This suggestion is similar with Rhodes' (2009) who proposed that obtaining a consistent definition for sustainable investing and creating a metric or mechanism to confirm the comparability and conformity, could be the answer to face these challenges.

Mutual funds are managed with a certain strategy established by the asset manager or management company, and when investing, the end investor must approve the mutual fund's investment strategy. (Eurosif 2021a) To evaluate the sustainability of financial product, investor must have transparent and comparable information about its sustainability and investments. According to Ruggie & Middleton (2019) the lack of

standardization and mixed quality of information slow down the development of sustainable investing and Amel-Zadeh & Serafeim (2019) noticed that lack of comparable information across firms, is the challenge in sustainable investing. These findings are consistent with Schroders (2021) study, which noticed that the second most common concern in sustainable investing was the lack of transparency and data. According to Ruggie & Middleton (2019) this may lead on situation where investors' decisions might rely on poor information and companies may be wrongly ignored by misleading sustainable ratings. All this could have adverse impact to sustainable investing. In Schroders (2021) study were analysed investment perspectives of 750 global institutional investors and noticed, that major challenge in sustainable investing was concern about greenwashing. The concern was due to lack of clear and agreed definitions of what sustainable investment is. (Schroders 2021)

2.2.2. Greenwashing

According to Ottman (2017), to satisfy environmentally conscious consumers' demand, companies bring products and services to the market, that may intentionally or not, sound "greener" than they are. This kind of activity is also known as "greenwashing". (Ottman 2017, 131) Greenwashing is a process where company makes them products sound more environmentally friendly by giving misleading information or false impression. Its intention is to make consumers believe that the products are environmentally friendly. (Investopedia 2021) To attract these environmentally conscious consumers, companies might use claims that sounds environmentally friendly but are in general vague, and at times also false (Furlow 2011).

Silvola & Landau (2021, 159) noticed during the interviews of their book, that interviewees saw sustainable investing quite critically, and the word 'greenwashing' was mentioned more than once. According to them, although there were some differences in opinions within organisations, interviewees considered their own organisation's investments mostly sustainable. Some doubts about the reliability of some actors' sustainable investments were brought up during the conversations, when interviewees mentioned that the sustainability scores of a mutual fund can be improved quite easily. Silvola & Landau (2021, 159) mentioned in their book, that sustainability score of mutual

funds can be improved for example by excluding emerging markets, where the scores are often weaker. Exclusion improves sustainability score without paying much attention to sustainability in any other way. Because of that, interviewees felt that more than just ‘superficial checklist approach’ need to be done in sustainable investing. (Silvola & Landau 2021, 159)

When companies voluntarily disclose their engagement strategies and accomplishment, they are usually doing that without standardized and externally verified reports. According to Lashitew (2021) this creates a risk that companies misuse Sustainable Development Goals (SDGs) for “greenwashing” and “impact washing” their actions. This can be done for example by using selective reporting format or publishing only favourable information. When disclosure information is inaccurate and non-transparent, it may lead to information asymmetry that distort investors’ and stakeholders’ decision-making. (Lashitew 2021)

3. Regulatory background

In this chapter the concept of Sustainable Finance Disclosure Regulation (SFDR) is presented. The contents of the SFDR are presented in first sub-chapters. After that, the disclosure obligations have divided to entity related disclosures and products specific disclosures, and these requirements will be explained in third and fourth sub-chapters. As the product specific disclosure requirements are important in order to understand the product classifications, the Article 6, 8 and 9 of SFDR are explained in more detail in their own sub-chapters. The SFDR level 2 is also briefly explained, because although the RTSs have not come into effect yet, financial market participants need to already publish and maintain some information about these principle adverse impacts (PAI) on their website.

3.1. Contents of Sustainable Finance Disclosure Regulation (SFDR)

The first level of the European Union's (EU) Sustainable Finance Disclosure Regulation (SFDR) came into action on 10th of March 2021. The regulation is a part of the broader 2018 EU Sustainable Finance Action Plan, and its goal is to support the financial sector's contribution to a sustainable European economy. SFDR will be further extended, when level 2, the Regulatory Technical Standards (RTS), will be taken into force in 2023 (Karlsson 2021 9:10, Eurosif 2021b).

The absence of harmonized rules, different disclosure requirements and market-based practices have made comparison of financial products and financial market participants difficult, and created an unequal playing field between different financial products and financial actors. Differences between requirements, practices and definitions may have confused the end investors and distorted their investment decisions, and therefore it has been necessary to create common framework around sustainability-related disclosures. (Regulation (EU) 2019/2088)

EU Regulation 2019/2088 (i.e., SFDR) on the provision of sustainability information in the financial services sector, sets out disclosure requirements for the financial market participants, financial advisers, and financial products in EU area, and complements

existing sector-specific rules. The aim of the SFDR is to increase transparency on how environmental, social and governance (ESG) factors have been considered in investment decisions and investment recommendations. (Regulation (EU) 2019/2088)

SFDR has increased the responsibilities of the European financial sector, as it requires financial market participants to provide standardized information about sustainability impact of their investments. With standardized information, SFDR aims to reduce information asymmetry between the financial market participant and the end investor. This will be done by requiring financial market participants to provide certain information to end investor, before acting as representatives of these end investors (i.e., principals). That information includes for example the consideration of sustainability risks, adverse sustainability impacts, environmental and social characteristics, and sustainable investments. This also includes the evaluation of due diligence, before making an investment. In addition to relevant financial risks consideration, financial market participants and financial advisers should also consider all relevant sustainability risks that may have an adverse effect on the financial return of the investment or advice. They should also continuously assess such risks. (Regulation (EU) 2019/2088)

From the end investor's perspective, the most visible part of this new regulation is, that the financial products need to be classified in accordance with how sustainability risk are considered in the investment decisions. Depending on how financial market participants decide to classify their financial products, different kind of disclosure requirements will be applied. To ensure consistent and uniform application, the regulation also establish few common definitions around sustainability. According to EU Regulation 2019/2088 (17), "sustainable investment" means that companies must follow good governance practices and the principle of "do no significant harm" in a way that neither the environmental nor the social objective is significantly harmed. The regulation also defines "sustainability risk" as an event or circumstance related to the ESG factors, which could have a negative material effect to the value of the investment. (Regulation (EU) 2019/2088 Art. 2(22))

Disclosure requirements in SFDR can be divided into entity related disclosures and product specific disclosures. Financial market participants are required to publish and maintain in their website statement of principal adverse sustainability impacts in entity level. Also, requirements related to product specific pre-contractual disclosures and periodic reports are defined in SFDR. The aim of these reports is to give sufficient information for the end

investor about the sustainability impacts of financial market participants, and sustainability characteristics of financial product and its development. In the next chapters, entity related disclosure requirements and product specific disclosure requirements are explained in more detail.

3.2. Entity related disclosures

The disclosures on an entity level are regulated in the SFDR Articles 3, 4 and 5. According to Article 3 of SFDR, financial market participants must publish on their websites an information about their policies related on how sustainability risks are considered in their investment decisions. In addition to that, Article 3 of SFDR requires financial adviser to publish on their website the policies, how these sustainability risks are considered when giving investment or insurance advice. (Regulation (EU) 2019/2088, Art. 3)

The Article 4 defines the entity level obligations about transparency of adverse sustainability effects. According to the Article 4(1) of the EU Regulation 2019/2088, financial market participants must publish and maintain on their website an information, where they explain their investment decisions principal adverse impacts (PAI) on sustainability factors. The statement of PAI is mandatory for all financial market participants with more than 500 employees, and for others the "comply or explain" principle is followed. The statement must include the information on, how their due diligence policies consider the main adverse impacts of investment decisions on sustainability factors. It must inform the end investor, how the investments have negative impact on sustainability indicators and what kind of methodology they use in relation to this. According to the Article 4(1b) in the SFDR financial market participants and financial advisors must publish the information also when they do not consider adverse impacts of sustainability factors in their investment decision or investment advice. Then there should be included clear explanation about the reasons of why they do not do so. (Regulation (EU) 2019/2088, Art. 4)

In the Article 5 are defined the transparency of remuneration policies regarding the consideration of sustainability risks. According to the Article 5(1) in the EU Regulation 2019/2088, financial market participants and financial advisors must include in their

remuneration policies the information on how those are consistent with the integration of sustainability risks. (Regulation (EU) 2019/2088, Art. 5(1))

Each of these Article demand, that the information must be published in the financial market participants' website. (Regulation (EU) 2019/2088, Art. 3, 4, 5) Information provided in entity-level does not depend on how financial market participants decide to classify their financial products. So, this entity related information must be published, whether financial market participants decide to classify their products under Article 6, 8 or 9.

3.3. Product specific disclosures

Financial market participants who take into account the adverse effects of investment decision on sustainability factors, must provide concise, qualitative, or quantitative information on how such effects are considered in the pre-contractual information for each financial product. They should also provide an information that the main negative effects on sustainability factors are available on an ongoing basis. There are already a lot of sustainable products with varying target levels in a market. Therefore, according to EU Regulation 2019/2088 (21) it was necessary to distinguish requirements for financial products, that promote environmental or social characteristics, and for the financial products that have sustainable investing as investment objective. (Regulation (EU) 2019/2088)

The disclosure obligations of the financial products can be divided in to three different categories. First category applies financial products that takes sustainability risks into account in their investment decisions. The second category is for the financial products that promotes environmental and social characteristics. The final, and the most sustainable category, is the one, where the goal of the financial product is sustainable investment. (Mäkipeska, 2021, 01:30:03) These categories are presented in the figure 4.

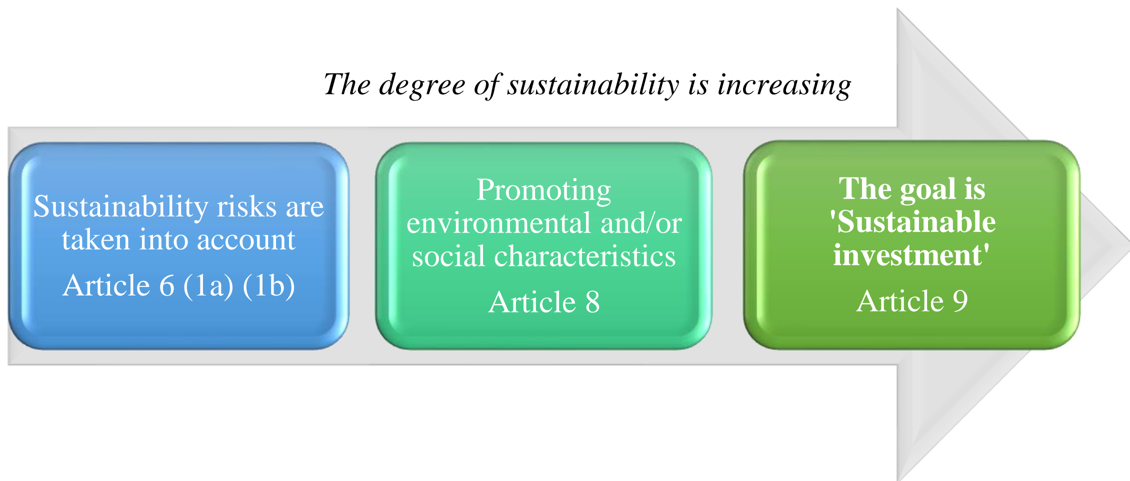

Figure 4. Disclosure obligations of the financial products divided into three categories. (Mäkipeska, 2021, 01:30:03)

According to the Finnish Financial Supervisory Authority (2021) only financial products accordance Article 8 and Article 9 can use sustainability-related terms, such as ‘sustainable’, ‘ESG ‘and ‘responsible’, in the name of the financial product. Article 13(1) of the SFDR demands that marketing communications do not conflict with the information provided under the regulation. The name of the mutual fund must give a true picture of the mutual fund's investment strategy and it may not be marketed by providing false or misleading information. The name of the financial product is considered as a part of the marketing of the product. (Finnish Financial Supervisory Authority 2021)

In addition to these three categories, there are also those financial products which are not considering the sustainability risks to be relevant in their investments. In this situation, according to the second subsection of EU regulation 2019/2088 Article 6(1), the financial market participants must include to the pre-contract information a clear explanation of the reasons.

3.3.1. Article 6 – “Integration of sustainability risks”

The first classification level that financial products could fall within is Article 6. According to Article 6(1) of Regulation (EU) 2019/2088, financial market participants must include in the pre-contractual information a description of how sustainability risks have been considered in their investment decisions. This could be done for example, by analysing,

what ESG factors are relevant for the investments of the financial product and how their effects are considered in the investment decisions and selection of investment targets (Mäkipeska, 2021, 01:30:03).

Addition to this, financial market participants need to include an assessment of the impacts, that sustainability risks are likely to have on the return on their financial products. (Regulation (EU) 2019/2088, Art. 6(1)) According to the Finnish Financial Supervisory Authority webinar (29.9.2021) the minimum disclosure obligations in Article 6 is to disclose sustainability risks in accordance with the regulation. That includes an event or circumstance related to the environment, society or governance, whose occurrence could have an actual or potential negative material effect on the value of the investment. In this case a short and qualitative description is sufficient if no other information is available. (Mäkipeska, 2021, 01:30:03) According to Article 6(1) and Article 6(2) in the EU Regulation 2019/2088, if financial market participants or financial advisors do not consider sustainability risks to be relevant for their investments, the pre-contractual information must include a clear explanation of the reasons. The information must explain, why these sustainability risks are not considered to be relevant in the investments of this financial product. (Regulation (EU) 2019/2088, Art. 6(1) and 6(2))

To summarize above mentioned, financial products which are integrating sustainability risk into their investment decisions, can be classified under Article 6. Products classified under Article 6 are required to disclose pre-contractual information in accordance with that Article. At the same time, Article 6 of SFDR could also see as a mandatory disclosure obligation for the financial products which are not considering sustainability risks to be relevant in their investments.

3.3.2. Article 8 – “Promoting environmental or social characteristics”

The Article 8 disclosure obligations are required for the financial products which promote environmental or social characteristics. Financial market participants must include in the pre-contractual information a description, whether the financial product promotes environmental or social characteristics, or both. They also need to include the information of how these characteristics are realized, or what methods are used to achieve these

objectives. Pre-contractual information needs to also include the information that good governance practices are followed in the companies that investments are made. (Regulation (EU) 2019/2088, Art. 8(1))

Article 8 of regulation does not set any requirements about the terms of design of financial product. It means that the regulation does not require certain composition of investments or minimum investment thresholds, and it does not prescribe investing styles, tools, strategies, or methodologies to be used. (ESMA 2021) However, according to Article 8(1b) of the EU Regulation 2019/2088 if there has been designated a particular index as a reference benchmark of Article 8 financial product, the pre-contractual information must include how the index is consistent with environmental and social characteristics of that financial product.

In addition to the obligations within Article 8, there are supplementary disclosure requirements to these financial products. According to Article 10(1) in the EU Regulation 2019/2088, financial products that promotes environmental or social characteristics, must publish, and maintain certain additional information also on their website. For instance, Article 10 requires financial market participants to provide a description of the environmental or social characteristics of the product. Information must also include the description of methodologies used to assess, measure, and monitor these characteristics. (Regulation (EU) 2019/2088, Art. 10(1)) Addition to these, Article 11(1) of SFDR defines still, what information Article 8 products must include into their periodic reports. These requirements will be defined and clarified in level 2 RTSs. (Regulation (EU) 2019/2088, Art. 11(1))

3.3.3. Article 9 – "Sustainable investments"

Financial products which have 'sustainable investment' as their objective needs to provide information according with Article 9 of SFDR. Sustainable investment has defined in Regulation (EU) 2019/2088, Art. 2(17) as:

> *" ... an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the*

> *circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance"*

All the investments in Article 9 financial product must meet the definition of a sustainable investment. Financial product may invest in other assets for a specific reason, for example to improve liquidity and protection of the product, but these investments must be in line with the financial product's environment and social objectives. (ESMA 2021)

Regarding to the terms of the product design, investing styles, tools, strategies, or methodologies, also Article 9 remains neutral. Although, the information of how the given mix complies with the 'sustainable investment' objective of the financial product must be informed. (ESMA 2021) Financial products, which have a specific index as a benchmark, the information of how that index reach the objectives of the financial product must be included to the pre-contract disclosure. According to Article 9(1) in the EU regulation 2019/2088, also the explanation of "why and how the designated index, differs from the broad market index", must be informed. If no index has been designated as a benchmark, the pre-contract disclosure must contain the information, how the objective of sustainable investment will be reached (Regulation (EU) 2019/2088, Art. 9(2)). This can be done by explaining the metrics and methods used to measure the achievement of sustainability objectives set for the financial product. (Mäkipeska, 2021, 01:30:03) Financial products whose goal is to reduce carbon emissions, must include a detailed explanation of how that target for low carbon emissions meets the long-term global warming targets of the Paris Agreement. (Regulation (EU) 2019/2088, Art. 9(3))

Like Article 8 financial products, also Article 9 financial products have supplementary disclosure requirements, which must be published and maintained on the website of financial market participant. According to Article 10(1) of SFDR, financial products that has 'sustainable investment' as it objective, must provide a description of its objective, and description of methodologies used to assess, measure, and monitor this goal. (Regulation (EU) 2019/2088, Art. 10(1)) Furthermore, financial market participants must include into

their periodic reports, overall sustainable impact expressed in terms of relevant sustainability indicators. (Regulation (EU) 2019/2088, Art. 11(1)) These requirements will be defined and clarified in level 2 RTSs.

3.4. Level 2 of SFDR

While the first level of SFDR provides information regarding the disclosure requirements and product classifications, further details to the regulation still awaits. According to the SFDR recital 31, the European Supervisory Authorities (ESAs), which includes European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA), were mandated to develop a significant number of regulatory technical standards (RTS). The aim of RTSs is to define how the information in relation to sustainability indicators must be presented and what that information should content. (Regulation (EU) 2019/2088 (30)) These supplementary requirements are also referred as a level 2 of SFDR.

In February 2021, the draft of RTS was published by ESAs. It provides details and specifications for some terms used in SFDR level 1, but also mandatory templates for entity- and product level statements. The RTS was initially planned to be applicable from the same date as the first level of regulation, but it has been delayed several times and will be applicable in later stage. The RTS is most likely to come into force in 2023, but the reference period for these entity-level adverse sustainability impacts has already started in January 2022, which means that financial market participants should have started to collect this data. (The European Supervisory Authorities 2021, European Commission 2021b, Eurosif 2021b)

The RTS draft includes mandatory template for principal adverse impacts (PAI) - statement, but also harmonized product level, pre-contractual and periodic reporting requirements, which are stated in SFDR Article 7(1). According to The European Supervisory Authorities (2021, 7-9) harmonised templates for "pre-contractual and periodic product disclosures set out the details of the content and presentation of information to be disclosed". The template of PAI-statement focuses on numerical sustainability indicators in relation to climate and environment, as well as issues related to

society, employees, human rights, and corruption. In the PAI-statement, the indicators are divided into 18 mandatory general indicators and 46 additional indicators. (The European Supervisory Authorities 2021).

On the entity-level, the final statement of PAI must include at least 20 indicators and it is mandatory for all financial market participants. According to the European Supervisory Authorities (2021, 9) for financial products which objective is to make sustainable investments is required to disclose, "how the product complies with the do not significant harm principle" in relation to the PAI-indicators. For these financial products, the financial market participant must review all indicators to identify which indicators are relevant. Also, in this situation 18 mandatory and two voluntary indicators from overall 46 voluntary indicators must include to the report. Until the final RTS with mandatory templates will come into force in 2023, financial market participants can use the templates of RTS as a reference in reporting, but it is not mandatory. (The European Supervisory Authorities 2021).

4. Research design and methods

This chapter explains how this research was designed and what methods were used. The first sub-chapter begins with the discussion about the research design and chosen research strategy. After that, the data collection methods and data analysis methods are described. Interviewees selection and descriptive information about the interviews are also presented in this chapter. In the end of this chapter, the reliability and validity of this research are discussed.

4.1. Research design

This research has been done by using qualitative research method. According to Hennink, Hutter and Bailey (2020), qualitative research is approach to examine experiences in detail, by using different methods, such as interviews and content analysis. By using qualitative research method, researcher can identify issues from the perspective of the objects of the research. When quantitative data measures phenomena, qualitative data characterise them (Johannesson & Perjons 2021, 66). With qualitative research it is possible to recognize and understand the contextual influences on the research topic. (Hennik et al. 2020) As the aim of this study is to understand how SFDR meet its goal to reduce information asymmetry, the qualitative research method fits well for this research.

The set-up of qualitative research is flexible. It does not seek to find reliable information on how often a phenomenon occurs, but seeks to bring out different perspectives from which the subject can be viewed (Juuti & Puusa 2020). Therefore, in the qualitative research the findings are not dependent on single variable, but the data is usually analysed as a whole (Alasuutari 2011). According to Alasuutari (2011) when doing qualitative research analysis, the information that is relevant to the research topic is extracted from the collected data and the observations are combined by searching for a feature or factor that connects them. Based on that data, qualitative research aims to find answers to the research questions. (Alasuutari 2011) As the topic of this research is new and there is no previous research about the topic, qualitative research is best suited for this study. The qualitative research can be done by using different kind of strategies, for example case study -method

and Grounded Theory (Johannesson & Perjons 2021, 46-49). The case study method has been used in this research.

4.1.1. Case study method

This study uses a multiple case study as its research strategy. The study compares answers from multiple investment service providers, i.e., uses multiple sources to empirically investigate the new regulation and its goals to reduce information asymmetry. A case study is suitable method, when the study focuses on instance of the phenomenon and when the aim of the study is to get rich, in-depth description about that instance (Johannesson & Perjons 2021, 46). Because the research topic is new and there are no previous studies, the multiple case study strategy fits well, as it can offer deep and versatile understanding about the topic. According to Thomas (2021) case study could provide the most vivid and inspirational analysis that research can offer. It provides a form of research that raises a view of world in its complexity (Thomas 2021). A case study can be defined as intensive research about a person, a group of people or a unit, which generalizes over several units (Gustafsson 2017).

When research tries to answer questions of “how”, “who” and “why”, the case study method is suitable choice. According to Farquhar (2012) it is useful when researcher is investigating event that occurred in contemporary context and when researcher has little control over events. A contemporary event in this study is the new regulation and how it improves comparability and transparency of financial products. According to Johannesson and Perjons (2021, 47), case studies can be used for different purposes, for example case studies can be categorized into exploratory, descriptive, and explanatory studies. This study is exploratory one, as it tries to understand the new regulation generally and how the regulation reaches its goals to reduce information asymmetry and greenwashing. According to Johannesson & Perjons (2021, 47), the key decision made in case study is to decide the instance to be studied.

Thomas (2021) describes the ‘case’ as a particular instance, event or happening which is surrounded by set of circumstances. According to Johannesson & Perjons (2021, 47) that instance can be for example a person, a company, a department in an organisation, or a regulation. Case study can be done by using single case study method or multiple case study method. The difference between these two methods is the number of researched

cases. The multiple case study gives researcher understanding about the differences and similarities between the cases. (Gustafsson 2017) For data collection method, case study can use for example interviews and survey (Farquhar 2012). In this study, as the interviewees are selected from different investment service provider companies, each interviewee represents its own case. The practices within the organizations are usually similar, but the practices in different organizations can differ notably which is why is possible to get wide picture about the phenomena under study when interviewees are selected from different companies.

4.2. Data collection and analysis

In qualitative research, there are a lot of different kind of data collection methods such as queries, observations, and interviews (Alasuutari 2011), According to Juuti & Puusa (2020) the most common data collection methods are different kind of interviews. Interview can be considered as a conversation, which have a pre-defined goal. At its best, the interviewer indirectly captures the thoughts, preferences, expectations, and experiences of the subjects. The interviews can be implemented in many kinds of methods, as structured, thematic and semi-structured interviews, and different methods have different kind of goals. (Juuti & Puusa 2020) The data for this study is collected with semi-structured interviews. Since the topic of this research is new, and the goal is in-depth understanding about the regulation in the investment service providers' point of view, the semi-structured interview supports well the goal of this study.

The semi-structured interview is more flexible than structured interview, where answers are pre-defined. In semi-structured interview the interviewer has done the interview questions in advance but there are no pre-defined answers to the questions. In semi-structured interviews additional questions can be also presented during the interviews. The benefit of the semi-structured interview is that it gives interviewees opportunity to give answers to the questions in their own words. That brings a possibility to get point of views that researcher did not have considered before the interview. (Juuti & Puusa 2020) According to Johannesson & Perjons (2021, 60) semi-structured and unstructured interviews are better, when the topic under investigation is complex. When the answers are not pre-defined, interviewees can express their ideas and feelings in more free way. The semi-structured interview is suitable to this study, as it provides an opportunity for new

perspectives to emerge but keeps the discussion within the research topic. To get a deep and detailed conversation about the researched topic, the interviews for this study were conducted in one-to-one conversations between researcher and interviewee. The interviews were conducted by Microsoft Teams platform and the data was captured by using audio-recording.

Interview questions were formulated to get a broad view about the topic under research. Questions tried to clarify the situation before SFDR, advantages and challenges of SFDR, and what the regulation has brought to the sustainability-related reporting and to the end investor. Although the interview questions were defined in advance, interviews were conducted flexibly and specifying questions were used when interviewees pointed out topics, that were not considered in interview questions. The structure of the interview questions is presented in Appendix 1.

Data analysis was started with transcribing the audio-recordings and it was done soon after the interviews. For analysing the qualitative data, thematic analysis was chosen. Thematic analysis is descriptive method which aims to identify, analyse, and report the themes within data, and it is commonly used as it can point out wide variety of questions and topics from the data (Castleberry & Nolen 2018). Gioia, Corley and Hamilton (2013) divided thematic data analysing steps in three. First order analysis includes big number of different categories, and it aims to identify important concepts from the data. Second order analysis try to identify similarities and differences between these categories and build a second order themes based on them. Finally, these second order themes are separated further into “aggregate dimensions”. (Gioia et al. 2013) This same approach was used also in this study. When analysing the interviews, the material of the interviews was divided to the different first order categories. By that way it was possible to get a good picture about the collected data, but as Gioia et al. (2013) mentioned in their paper, at this point the number of different categories is usually big. After that, the similarities and differences between these first order categories were compared and these were divided into second-order categories. Fifteen second-order categories were found in total. Finally, these second-order categories were analysed, and main themes were found. The main themes are presented in the Chapter 5, where the findings of this research are introduced.

4.2.1. Interviewee selection

According to Farquhar (2012), it is important that the interviewees are selected in a way that they can provide the information required to the research. The selection will depend on the information the researcher will seek, but the participants should be selected because the researcher thinks that they will provide important perspectives that will clarify the topic under research (Farquhar 2012) The interviewees were selected based on the goals of this study from different banks and fund management companies. All participants were expected to have good knowledge related to the topic under research. Each interviewee has worked on sustainable investment in their day-to-day work and therefore are experts in the subject under study.

This study was completed in the perspective of investment service providers in Finnish market exclusively. All interviewees spoke Finnish, and therefore the interviews were conducted in Finnish. In total, 10 sustainable investing experts from different investment service provider companies, were invited to participate to the interview, and five of them agreed for the interview. The invitations were sent via email during January and February 2022.

Each of the interviewees were informed about the main themes of the interview. The aim of the study was explained for each interviewee and the core questions of the interview were given to the interviewee beforehand upon their request. Information about the interviews and interviewees are presented in the table 1 below.

Table 1: The descriptive information about the interviews and interviewees.

Interviewee	**Job description**	**Working experience in sustainable investment**	**Duration of the interview**
Interviewee 1	Portfolio Manager, ESG specialist	5 years	33 minutes
Interviewee 2	Head of investments	15 years	28 minutes
Interviewee 3	Senior ESG manager, Lawyer	3 years	49 minutes
Interviewee 4	Head of ESG	4 years	34 minutes
Interviewee 5	Head of responsible investments	16 years	39 minutes

4.3. Reliability and validity

The research process and methods of this study have been presented as accurately as possible, which makes the reliability of this study better. The study also describes how the data has been collected and analysed, which allows to repeat the study and increases its reliability. However, it must consider that in qualitative research the results are always contextual, and the analysis of the data is based on the researcher's own perceptions. Therefore, the results might differ, if repeating the study. Although the research materials were approached objectively as possible, in a certain extent, the perspective and views of researcher are always involved in the interpretation of the results. The reliability of the study has been increased by adding straight citations from the interviews.

To improve the validity of the study, interviewees were selected from different investment service provider companies from Finland. This gives wider insight into the topic under research. The selection of the interviewees was done according to the delimitations of this research. All the interviewees have personal experience working with sustainable investing and SFDR, which increases the internal validity of the research. The research focuses only on SFDR, and the interviewees have been selected from the Finnish market only, which is why the result of this research cannot be fully generalized on a larger scale. Even though the results might have differed if the interviewees would have been selected from different EU countries, the study gives good insight on what kind of effects this kind of disclosure regulation may have to the information asymmetry between investment service providers and end investors.

5. Findings

This chapter presents the empirical findings of this research. The chapter is divided into two main sections which are "advantages and potential shortcomings of SFDR" and the "effect to the disclosure information and end investors". The sections are divided on the basis of sub-research questions of this study. To increase the trustworthiness of this research, straight quotes from the interviews are used in the findings. Only findings from the interviews are presented in this chapter and later in chapter 6 these findings are turned into conclusions.

In the table 2 is presented the coding frame, which was built to identify the main themes and second-order categories of the analysis. As mentioned earlier, the second-order categories are based on first-order categories, and these are presented with bullet points below second-order categories. Due to the layout of the interview questions the main themes, that were found in data-analysing process, comply the structure of interview questions. The coding frame includes five main themes, and these are: sustainability reporting before SFDR, advantages of SFDR, challenges of SFDR, effects to the disclosure information and effects to the end investor. All the main themes are divided to the second-order categories and short quotations of these are presented in the coding frame.

Table 2: Coding frame

Main theme	**Second-order categories** • **first-order categories**	**Quotation**
Sustainability reporting before SFDR	Reporting as a part of the strategy • voluntary based • customers' demand • strategic relevance	*"At first, it was based entirely on the need for customer communication. There was no obligation to tell or do anything at all" (Interviewee 3)*
	Divergence of reports • product specific reports • commitments to principles • ESG-rating providers	*"Many actors have published various responsibility reports, also numerical, about their mutual funds…." (Interviewee 2)*
	Biased approach • reporting reflects each actor's own perspective • no common formula • no common language or definitions	*"Missing definition on what constitutes a sustainable investment has been a challenge - everyone has had their own interpretation of it." (Interviewee 4)*

Advantages of SFDR	Obligation to disclose information • from voluntary to mandatory • re-evaluation of investing strategies	*“First of all, at least that something needs to be published. In the past, it was not necessary.” (Interviewee 3)*
	Standardization of reporting • controlled by bigger authority • unified framework • PAI-indicators and disclosure templates	*“Definitely positive is that a much larger authority defines this whole theme - what it holds and what it does not hold.” (Interviewee 4)*
	Transparency • classification of financial products and requirements for each of them • more detailed explanations also in entity level • the role of level 2 PAI-indicators	*“After all, it is more transparent - for example, the classification of financial products and when it is explained how sustainability risks are taken into account in investment activities” (Interviewee 2)*
	Comparability • format of information • classification of financial products	*“The fact that the EU already defines the format in which reporting is to be made, makes it comparable.” (Interviewee 1)*
Challenges of SFDR	Lack of data • availability of data • role of third-party data providers • estimated data	*“We depend on how companies provide data. Especially in smaller companies, being able to provide a certain type of data takes its own time.” (Interviewee 5)*
	Interpretability • ambiguous definitions • absence of limit values • discretion in reporting due to the delay in level 2	*“It is said that there must be ‘good governance’, but what that ‘good’ means – it is left to everyone to interpret. (Interviewee 1)*
	Two-stage entry into force • unfinished regulation • absence of PAI indicators • absence of pre-defined templates	*“There is not only room for interpretation, but also unfinished regulation, and financial products should be classified based on that – which is quite interesting set-up.” (Interviewee 4)*
Effects to the disclosure information	Common language • sustainability-related definitions • formulas of numerical indicators	*“Sustainability risks, adverse sustainability impact, sustainability factor, etc. they are all defined in the SFDR, and they should be used…” (Interviewee 3)*

	New reporting practises • unified templates only at level 2 • annual reports from level 2 enable monitoring in the future	*"At this point, it is essential to understand that there are no specific reporting templates in the first level – these will come from the second level…" (Interviewee 3)*
	Classification of financial products • investment screening • disunity in classifications due to interpretation • re-evaluation when level 2 comes into effect	*"Not all financial products can be classified as Article 8 products, much less Article 9 products - In other words, it means that there has been done some screening." (Interviewee 1)*
Effects to the end investor	Information availability • increased information • the amount and diversity of different sustainability-related publications	*"If some actor has not previously had any sustainability policy available on its website, now because of SFDR, that information is mandatory to share" (Interviewee 5)*
	Incompleteness of comparability and transparency • impacts of delay in level 2 • comparison based on only product classifications may be misleading	*"The comparison may be easier, but it can be biased. Easier to know if you are investing in an Article 6, 8 or 9 products, but due to the ambiguity of interpretation, you may get whatever" (interviewee 2)*

5.1. Advantages and potential shortcomings of SFDR

This chapter covers the main findings about the advantages and potential shortcomings of SFDR. The chapter aims to find an answer to the first sub-question of this study. Themes related to the first sub-question are: sustainability reporting before SFDR, advantages of SFDR and challenges of SFDR. Findings from all these themes are discussed separately in their own sub-chapters. In the figure 5 are illustrated the main themes and second-order categories of this section.

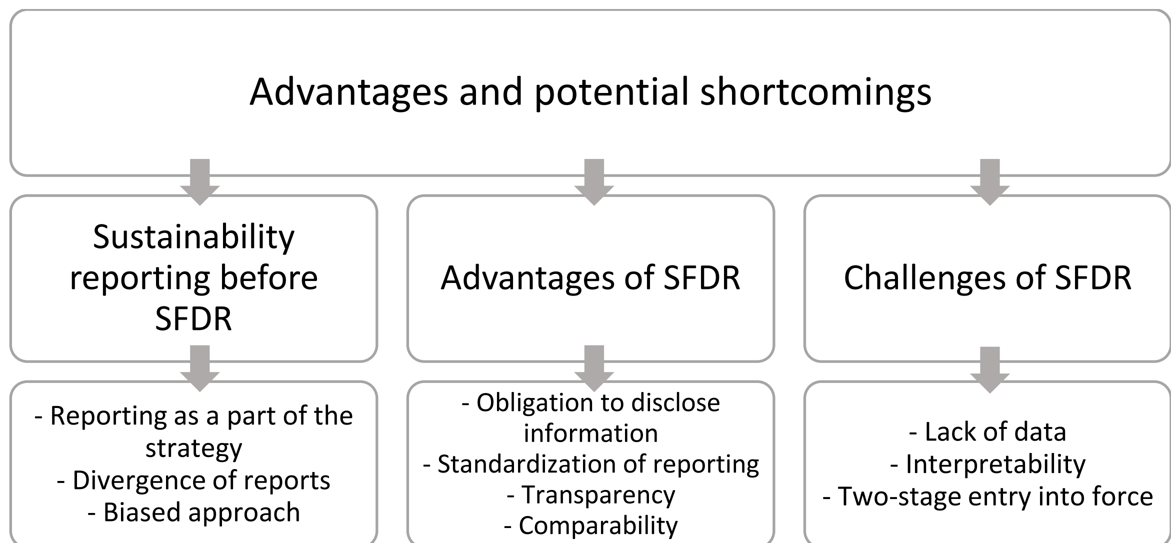

Figure 5: Main themes and second-order categories related to the advantages and potential shortcomings of SFDR.

5.1.1. Sustainability reporting before SFDR

In this sub-chapter the findings about sustainability reporting before SFDR is presented. To get a full understanding about the changes in the sustainability reporting, it was necessary to have a conversation with interviewees about the sustainability reporting before regulatory obligations. From the data, three main topics were possible to notice. These topics were: reporting as a part of the strategy, divergence of reports and biased approach. Findings about these topics are presented next.

Reporting as a part of the strategy

Based on the interviews, even when the sustainability reporting has been voluntary for investment service providers, most of the actors have done it already a decade. However, the reasons for sustainability reporting have differ and changed over time. One interviewee mentioned that the sustainability reporting had partly done because of customers' demand. End investors are increasingly interested about the sustainability of financial products, and investment service providers had to answer for that demand. According to interviewee 3, at the beginning, sustainable investing, and reporting about that, was based on the fact, that the actors saw it sensible for business. Back then, sustainability policy was mostly marketing materials.

> *"At first, it was based entirely on the need for customer communication. There was no obligation to tell or do anything at all" (Interviewee 3)*

When discussing about the sustainability reporting before SFDR, conversations revealed, that many investment service providers have had principles of sustainable investing as a part of their strategies a long time. Also, portfolio managers have considered those principles in their investment activities for years. Some interviewees pointed out that Nordic countries have been pioneers in sustainability, which is why the implementation of regulation has not influenced much in the investment strategies of them – merely for the reporting format.

Divergence of reports

According to the interviews, before SFDR came into effect, end investors were able to compare and evaluate sustainability of financial products by using several reports provided by investment service providers. For example, product specific ESG reports, Principles of Responsible Investment (PRI) -report and principles of corporate governance -report, have been a part of the reporting for many investment service providers a long time. Based on interviews, some investment service providers have also reported some numerical data about the sustainability factors of the financial products.

> *"Many actors have published various responsibility reports, also numerical, about their mutual funds, in addition to these semi-annual or annual responsible investments reports. Perhaps the first to come were tables about carbon footprints of different financial products." (Interviewee 2)*

A few interviewees also pointed out the importance of outsider data- and ESG-rating providers, as a part of the evaluation of sustainability of financial products. These third-party data providers have offered a tool for end investors to evaluate a sustainability of specific financial products, but also a tool for portfolio managers to evaluate and develop their investment strategies. However, interviewee 4 pointed out that these have been each data provider's own view on sustainability.

> *"Various investment service providers have sought to bring different ways to reflect the sustainability of a mutual fund or even an individual stock - we are talking about these third-party service providers. ... but these are each service provider's own view of that sustainability" (Interviewee 4)*

Biased approach

Since before SFDR, there have not been requirements for the financial products about the published sustainability information, the comparability and transparency of financial products have not been that unambiguous. According to the interviews, investment service providers have been publishing sustainability reports almost a decade, as it has been seen important, but in fact it has not been mandatory at all. The information provided about financial products have reflected each investment service provider's own perspective and as there has not been a common formula for the reports, everyone has been able to provide whatever information they have seen important.

> *"...Basically, in the end investors perspective it has been reading and evaluating the different publications of each actor. The problem with that is when everyone talks about their practices in their own way, measures in their own way and typically measures things and publishes information in which they are already good. When you focus on something - you tell a lot about it. But you don't talk about the things in which you are not so good or where you are not so focused on. The investor must have been terribly enlightened to know what is really being done there." (Interviewee 3)*

Some interviewees mentioned that the lack of a common language and definitions has posed challenges to the implementation and reporting of the sustainable investing strategy, as all investment service provides have been able to define the sustainability on their own way.

> *"Missing definition on what constitutes a sustainable investment has been a challenge - everyone has had their own interpretation of it. Prior to this regulation, no one had really defined what that 'sustainable investment' is." (Interviewee 4)*

To summarize the findings about the sustainability reporting before SFDR, it can be said that investment service providers have been publishing different kind of sustainability reports a long time before new regulation came into effect in March 2021. Sustainability has been a part of the strategy more than a decade, but the reasons for sustainable strategies and sustainability reporting have differ and changed over time. As there has not been any obligations to the sustainability reporting or formality of financial products' sustainability reports, investment service providers have been able to disclose the sustainability information in their own way. Before SFDR there has also been a possibility to not disclose any sustainability information.

5.1.2. Advantages of SFDR

In this sub-chapter the findings about advantages of SFDR are presented. Based on the data, four main advantages raised from the conversations. These were: obligation to disclose information, standardization of reporting, transparency and comparability.

Obligation to disclose information

After the first level of SFDR came into effect, the investment service provider have been required to disclose how they consider the sustainability risk in their investment decisions. If investment service provider does not consider sustainability risk in their investment decisions, the information about it, must be also published. According to the interviews, these requirements have increased the attention to sustainability in investing, and those investment service providers who did not consider sustainability risks important in their investments, are now forced to give a thought for it.

> *"First of all, at least that something needs to be published. In the past, it was not necessary. ...when you are required to give an information about something, you must pay attention to it differently. "(Interviewee 3)*

Interviewees mentioned that because of SFDR, the investment service providers are required to give certain information about their sustainability in entity level, but also in a product level, and these requirements are same for every investment service provider. The obligation imposed by the SFDR, that something must be published, has required all investment service providers to pay attention to their investment strategies and reporting practices. According to interviews, from the perspective of investment service providers, this has required deeper knowledge about sustainability practices and more careful consideration when doing investments.

> *"With the entry into force of the SFDR, each actor has had to look more closely at their own ESG processes" (Interviewee 5)*

Standardization of reporting

Based on the interviews, prior to the SFDR, most of the investment service providers have reported about the sustainability of their financial products but each of them has done it in their own ways. According to the interviews, after SFDR came into effect, these practises

have been standardized, as the regulation sets obligations to provide certain sustainability information but also gives definitions to the sustainability vocabulary. According to the interviewee 4, the fact that the whole sustainability theme is controlled by bigger authority, has been seen as a positive thing.

> *"Definitely positive is that a much larger authority defines this whole theme - what it holds and what it does not hold." (Interviewee 4)*

> *"Not only the SFDR but the whole EU sustainable finance strategy will unify the definitions - for example the definition of sustainability" (Interviewee 1)*

Interviewee 3 mentioned that one of the biggest values of the SFDR is that it gives a unified framework to the sustainability measurement. According to interviewee, same way as in accounting, to evaluate any kind of business, it is necessary to have a common language. It does not only include definitions around the sustainability, but also the level 2 principal adverse impact (PAI) -indicators and pre-defined disclosure templates, that will change the reporting more formal permanently.

> *"The biggest benefit comes from the fact that we can genuinely discuss the sustainability implications of companies – in commensurately way*" (Interviewee 3)

Based on the interviews, the first level of regulation has standardized the definitions and frameworks around sustainable investing, but the formality of reporting will not be fully achieved until level 2 regulatory technical standards will come to effect. In the future, when level 2 will come into force, each investment service provider must disclose same information in accordance with RTS-templates, and according to the interviews, this change will formalize the reporting standards more than the level 1.

Transparency

Based on the interviews, transparency has been already improved with SFDR level 1 obligations as every investment service provider have been obligated to consider their attitude related to sustainability. Interviewees pointed out that each investment service provider needs to tell, how they consider sustainability in their investment and if some investment service provider does not consider sustainability risk important on their investment, this information should be also disclosed.

"After all, it is more transparent - for example, the classification of financial products and when it is explained how sustainability risks are taken into account in investment activities" (Interviewee 2)

Interviewees also noted that transparency has increased since financial products must be classified accordance of Article 6, 8 and 9. Based on conversation, the transparency has increased as when financial product will be classified, for example under Article 9, the article sets certain obligations not only to the product, but also information provided about the product. According to the interviewee 3, in addition to classification, investment service provider is required to explain on how their product meet the requirements of certain article.

"This is a disclosure regulation, and its purpose is that the investment service providers tell what is done there, so that the end investor can assess whether the financial product is suitable for him/her" (Interviewee 3)

According to the interviewee 1 the most concrete thing that SFDR will bring to the sustainability reporting, are the PAI-indicators. Interviewee mentioned that these PAI-indicators are something that did not exist before and which are seen as a positive change, as those will improve the transparency of reporting when they give numerical information about the sustainability factors. Most of the interviewees saw these pre-defined templates as a positive thing because they will formalize the reporting. Although these templates have been a little rigid in some cases and will not be mandatory to use until level 2 of SFDR will come into force.

Comparability

During the conversations, interviewees saw that the comparability of financial products has also improved after SFDR level 1. Mostly because every investment service providers should provide same information about their financial products. After the level 2 will come into the effect, same disclosure information for financial products marketed throughout the EU must be published in the same form, which increases the comparability even more.

"The fact that the EU already defines the format in which reporting is to be made, makes it comparable." (Interviewee 1)

Some interviewees also saw that the comparability was improved because of the classification of financial products. As there are criteria for each article, the products under articles do not differ from each other so much – or at least there is assumption about it. Also, according to the interviewee 5, the information provided about the financial products is more comparable, as the processes need to be defined more detail level in the financial product prospectuses.

> *"Now when the financial products have to be classified according to SFDR, also the processes must be described very precisely in the prospectuses – end investor has more information" (Interviewee 5)*

To summarize the findings about the advantages of SFDR, it can be said that the regulation has many benefits for the sustainability reporting. Based on the interviews, the obligation to disclose information has been seen as a positive thing, because it requires every investment service provider to give attention to the topic. Level 1 has brought some formality to the reporting, but real benefits will be seen only when level 2 comes to effect. Transparency and comparability have improved after level 1 of SFDR because of the classification of financial products and obligation to disclose information in accordance with regulation. Based on the findings, transparency and comparability will still improve, after the pre-defined templates will be take into practice in level 2 of regulation.

5.1.3. Challenges of SFDR

In this sub-chapter the challenges of SFDR are presented. To understand, what are the real benefits of this regulation, it was important pay attention also to the challenges that investment service providers have noticed during the implementation of the regulation. Based on the data, three main challenges were noticed. These were: lack of data, interpretability, and two-stage entry into force.

Lack of data

Based on the interviews, one of the main challenges in SFDR is that it requires investment service provider to provide a certain information about their investments, that even the target companies do not provide. This problem is highlighted in the situations when the target company is not public company, but an unlisted company.

> *“We depend on how companies provide data. Especially in smaller companies, being able to provide a certain type of data takes its own time.” (Interviewee 5)*

When talking about the lack of data, interviewees pointed out that basically the information is now based on third-party data providers. According to the interviewee 1, the regulation requires investment service providers to report information that companies do not report themselves yet. This means that the investment service providers need to buy the data from third-party data providers, which is based on estimates. According to interviewees, the problem with the estimated data is highlighted when investment service providers buy the estimated data from different third-party data providers. Every data provider has their own calculation methods and evaluation models, which only transfers the responsibility about the transparent and comparable sustainability data to one level lower. When data is bought from different third-party data provides it has an effect to the information in final sustainability reports.

> *“As long as companies do not produce that data themselves, on some basis someone will make an assessment of them – Data providers have different models, industry-based, etc., but they are not commensurate.” (Interviewee 3)*

Interpretability

During the interviews, the interpretability of the regulation was pointed out in many ways. According to interviewee 2, sustainability as a subject is very complex, and when the regulation tries to define complex thing in simple way, it may still leave some room for interpretation. Interviewees agreed the fact that it is impossible to define everything so precisely that there is no room left for interpretation, but at the same time it may influence how the regulation reaches its goals.

> *“It is said that there must be ‘good governance’, but what that ‘good’ means - it is left to everyone to interpret. (Interviewee 1)*

According to the interviewee 3, interpretability is also due to the fact that the first level of regulation requires investment service providers to disclosure some sustainability information but without any pre-defined templates. It means that, even when there is some formality about the required information, the investment service providers can still provide

the required information in their own words and using their own templates and formulas. Therefore, the regulation leaves quite a lot of discretion to the actors themselves.

> *"At the moment, regulation is very open to interpretation, because you only have the level 1 obligations - it says that you have to describe how sustainability risks are taken into account in investment activities - in principle it can be a two-sentence description or a very detailed 50-page procedural description" (Interviewee 3)*

When the interpretability was talked about, a few interviewees also mentioned that the absence of limit values increases the scope for interpretation. For example, interviewee 3 explained how the regulation says that in sustainable investment, the principle of 'do no significant harm' must be ensured in the way that neither the environmental nor the social objective is significantly harmed. What the regulation does not tell, is the limit between harm and significant harm. These things need to be thought when the sustainability of target companies is evaluated, and without any limit values, it is under own consideration of each actor. Some interviewees also mentioned that there are some problems about measuring sustainability. According to interviewee 1, there are companies that can be considered sustainable in some level, but the problem is that the actual share of sustainability in the final revenue may remain quite small, depending on how sustainability is interpreted or measured. According to interviewee, leaving some definitions and percentages open is ambiguous, and there is certainly a risk of green washing.

Two-stage entry into force

Based on the interviews, from the perspective of investment service providers, the absence of level 2 regulatory technical standards (RTS), leaves a lot of discretion to the actor. When the first level of regulation defines the requirements quite broadly, there is a risk that some investment service providers have interpreted the regulation differently than others. Based on conversations, this may have an effect for example to the classification of financial products, as some may have classified similar kind of financial products according to Article 9 and another according to Article 8.

> *"There is not only room for interpretation, but also unfinished regulation, and financial products should be classified based on that - which is quite interesting set-up." (Interviewee 4)*

Based on the interviews, with level 2 pre-defined templates and PAI-indicators, reassessment of financial product classification would be done more easily, as each investment service provider disclose same information by using same templates. Interviewees believed that when level 2 reports will be published first time, financial markets will slowly start finding their best practises in financial product's classification and reporting. If level two of regulation would have come into effect at the same time as level 1, transparency and comparability would have been better at the very beginning and the search of common good practises would have already begun.

> *"When the first reports of level 2 will be published, I believe that then the search for common good practice will begin." (Interviewee 5)*

To summarize the findings about the challenges of the SFDR the biggest concern is lack of data. Regulation requires investment service providers to disclose information, which even target companies do not provide. Due to that, investment service providers rely mostly on third-party data providers' estimated data. Based on the findings, regulation leaves room for the interpretation because of imprecise definitions and absence of limit values. Conversations revealed that these challenges are partly due to delay in level 2 of SFDR. Because of failed regulatory timetable, end investors and investment service providers are now in intermediate stage where the current state might be even more confusing than the time before SFDR.

5.2. Effects to the disclosure information and end investor

This chapter covers the main findings about effects of SFDR advantages and challenges to the disclosure information and end investor. The chapter aims to find an answer to the second sub-question of this study. Themes related to the second sub-question are: effects to the disclosure information and effects to the end investor. Findings from these themes are discussed separately in their own sub-chapters. In the figure 6 are illustrated the main themes and second-order categories of this section.

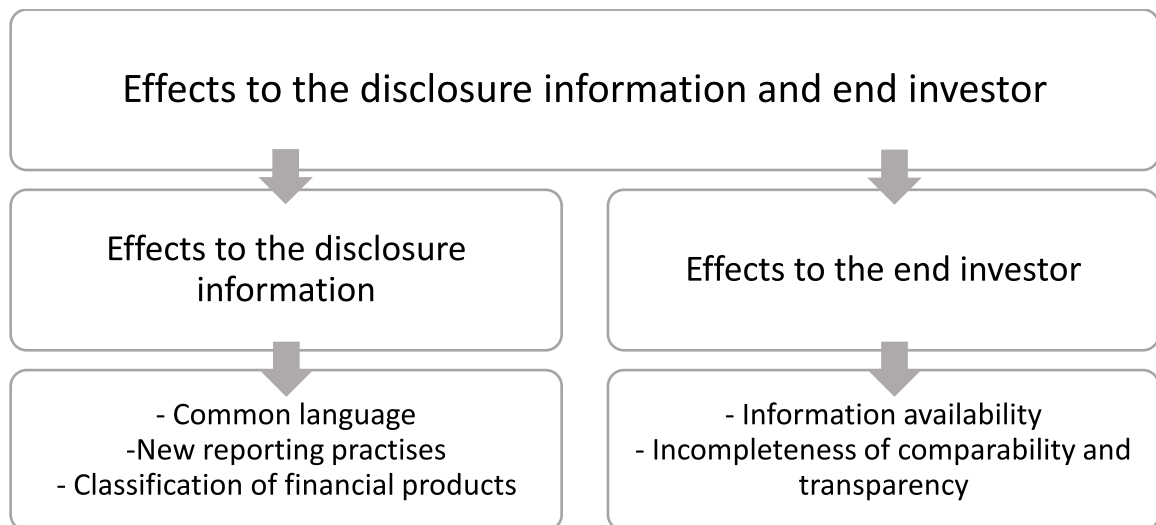

Figure 6: Main themes and second-order categories related to the effects to the disclosure information and end investor.

5.2.1. Effects to the disclosure information

During the conversations, interviewees pointed out some advantages and challenges which have an impact on how well the goal of regulation is achieved. In this sub-chapter the findings about effects to the disclosure information are presented. From these discussions, three main topics were possible to notice. These topics were: common language, new reporting practises and classification of financial products.

Common language

Based on the interviews, SFDR has improved common language in sustainability reporting. The regulation gives a lot of definitions to the words that were previously based on each investment service provider's own interpretation. Due to SFDR, investment service providers are required to give certain information and use unified language in their sustainability reports, which have had unifying impact to the reports. According to the interviews, this has improved the comparability and transparency of sustainability reporting, as now every investment service provider should define sustainability related topics same way.

> *"Sustainability risks, adverse sustainability impact, sustainability factor, etc. they are all defined in the SFDR, and they should be used - I think industry's slang has become more standardized with this." (Interviewee 3)*

Some interviewees pointed out that when the level 2 of regulation will come into effect, the common language will improve even more, as then the reporting will also include some numerical indicators. Calculation methods behind these indicators will be defined in level two RTS, and these must be used. Interviewee 4 saw that these indicators will increase the transparency of financial reports even more.

> *"I think a good opening from this regulation is to start collecting these different impact indicators - which will then be used in reporting to make financial products more transparent." (Interviewee 4)*

New reporting practises

Based on the interviews, it can be said that SFDR has already changed the sustainability reporting practises, as it requires certain information to be given. Although, interviewees pointed out that delay in level 2 of regulation has influenced on how the required information is provided. Due to the delay in level 2, there is no requirements that investment service providers should use RTS's pre-defined templates when reporting about their sustainability. This means that even when the certain information is required to give, the format and wording of given information can vary between investment service providers. According to interviews, when you do not have any benchmark values or comparable reporting templates, it is quite hard to evaluate the sustainability of investment service provider or compare different actor's financial products.

> *"At this point, it is essential to understand that there are no specific reporting templates in the first level – these will come from the second level. When the regulation is complete, you will receive a key information document where certain information has been told, and then you can put each actor's templates in row and evaluate what is being done there" (Interviewee 3)*

According to interviewee 5, the second level requirements will change reporting practises also because these indicators must be published annually in the future. Interviewee 5 mentioned that in the future these indicators make possible to monitor how for example environmental and social impacts of investments will develop over time. This will improve transparency and comparability of sustainability reports but may also direct more money to sustainable investments. According to interviewee, this could also encourage each actor to review more deeply their sustainability and investing strategies.

Classification of financial products

As mentioned before, interviewees pointed out that one of the advantages of SFDR is that the financial products must be classified accordance of Article 6, 8 and 9. For the most part, interviewees saw this classification as a good thing, because this mandates investment service providers to consider sustainability of each investment more carefully. Interviewees also mentioned that classification have a positive impact to the transparency of information, as in each of these articles have certain requirements for the investments and provided information.

> *"Not all financial products can be classified as Article 8 products, much less Article 9 products - In other words, it means that there has been done some screening." (Interviewee 1)*

Although the classification was seen mostly a positive thing, interviewees also saw some concerns related to it. They pointed out that the lack of data, interpretability of regulation and delay in level 2, have an effect to the classification of financial products. According to interviewee 2, the existence of such an EU classification may give some credibility to financial product, for example if the product is classified to Article 9 product, but that credibility may be delusion because regulation is interpreted differently, and different data is used for evaluation. Based on the interviews this is due to the fact that data is based on estimates and different third-party data providers have used different calculation methods behind these estimates. Interpretation in what business is considered sustainable and what limit values are used, can differ in each investment service providers, which is why the classification practises may also vary.

> *"It is a good thing that such criteria and delimitations are being made, but there is perhaps a little too much room for interpretation in the regulation - it has led some actors to classify their products a little more cautiously, and others more boldly." (Interviewee 4)*

Based on the interviews, as sustainability is something that customers demand, investment service providers want to classify their financial products in accordance with article 8 and 9. According to interviewees 3 and 4, when regulation level 2 will come into effect and investment service providers start to report these PAI-indicators, there is a chance that some of those 'boldly classified' financial products need to be re-evaluated. Interviewee 3

pointed out that in the first level of regulation, when there are not those indicators, investment service providers can quite easily classify financial product under Article 9, but in a year's time, these products may no longer be Article 9 products.

> *"There is a big risk that you will have to downgrade the classification. Then you are in a situation where you have promised to your customer that the product is an article 9 product - Personally, I would classify conservatively. That has been my message in every direction. But not everyone agrees." (Interviewee 3)*

The delay in level 2 of regulation has caused an environment where every investment service provider tries to classify their financial products, but no one actually knows if the interpretation is in line with other investment service providers. However, based on the conversations, interviewees agreed that the 'best practices' for classification will be found eventually.

To summarize the findings about effects of disclosure information, SFDR has brought to the sustainability reporting common language and new reporting practises. The classification of financial products has made sustainability information little more straightforward, but until level 2 of regulation will come into effect, investment service providers may provide the information in their own format. Because of interpretation in regulation and delay in level 2, approaches in classification of financial products may vary on different investment service provider. This may lead to the situation where investment service providers need to re-evaluate their financial product's classification, when level 2 of regulation will come into effect. However, based on the conversations, the direction is correct and 'best practices' for classification and reporting will be found eventually.

5.2.2. Effects to the end investor

When considering the challenges and advantages of SFDR from the perspective of end investor, two main topics were found in the conversations. In this sub-chapter, these findings are discussed. These topics were: information availability and incompleteness of comparability and transparency

Information availability

When discussing about the advantages and challenges of the SFDR, interviewees agreed that from the perspective of end investor, the sustainability information of financial products has increased with SFDR. With this they meant that since SFDR came into effect, every investment service provider should have some sustainability information on their website and end investor should been able to find it. Before SFDR sustainability information was not mandatory, and in some cases end investor did not have any sustainability information available about the financial product.

> *"Now end investor can go to any investment service provider's website and there should be a policy on how they consider sustainability risks in their investments" (Interviewee 3)*

> *"If some actor has not previously had any sustainability policy available on its website, now because of SFDR, that information is mandatory to share" (Interviewee 5)*

On the other hand, some interviewees had some doubts about how interested end investors are about this kind of sustainability information. According to interviewee 1, SFDR may even make the diversity of sustainability publications too big, as the customers do not usually want to read many different reports but want to get all the information easily from one report. Interviewee 2 had some doubts on how interested end investors are about this kind of data, as a lot of different kind of reports are already published about the financial products but not all end investors read those.

> *"A lot of different information has already published about the financial products, but the percentage that reads them is quite small" (Interviewee 2)*

On the other hand, interviewee 2 noted the fact, that end investors are more and more interested about the sustainability of products, and aware that there might be a certain type of greenwashing. Based on the interviews, requirements that some information must be provided is mostly considered as a good thing from the end investor's point of view, as it eases the evaluation of sustainability.

Incompleteness of comparability and transparency

Interviewees saw that from the perspective of end investor, comparability and transparency have improved a little with first level of regulation, although interpretability and delay in level 2 of regulation might have some impact on those. According to interviewee 1 the classification of financial products helps at least end investor to delimit the investment universe.

> *"Comparability has improved with classification, as one can compare within classes, without having to consider the entire investment universe." (Interviewee 1)*

Although classification helps end investor in some way, interviewees had also some concerns about the impact of interpretability of regulation. Based on the interviews there is a chance that for example financial products under Article 8 or Article 9 are considered now similar in each group, even when investment service providers might have interpreted regulation differently. Based on the interviews, especially in Article 8 products, different approaches and strategies have been used. According to interviews, some asset managers may have used only negative screening when another asset manager has picked each investment carefully and used positive screening as an investment strategy. This may lead to the situation where products under certain article are considered automatically to be equally sustainable, even when the level of sustainability may vary in different financial products within same article a lot.

> *"The comparison may be easier, but it can be biased. Easier to know if you are investing in an Article 6, 8 or 9 products, but due to the ambiguity of interpretation, you may get whatever" (interviewee 2)*

As level 2 of regulation has not came into effect, there is no requirements for formality of the information, or obligation to disclose PAI-indicators. According to interviews, from the end investor perspective, this has impact to the comparability and transparency of financial products, as words can be misleading in some cases and based on investment service providers' own interpretation. Interviewee 3 pointed out that information is available, but in an ambiguous way, as each actor freely describes them. Based on the interviews, as long as we are waiting the second level of the regulation, from the end investor's perspective the information provided is not fully transparent or comparable. As providing information in accordance with pre-defined templates is not required yet, the end investor needs to make

lot more effort to compare and evaluate sustainability of financial products. On the other hand, according to interviewee 1 and 2, from the perspective of end investor the delay in level 2 does not have a huge effect, as end investors probably do not expect any new reports about sustainability of financial products.

To summarize the findings, information availability has had a positive effect for the end investors, as now investment service providers should provide at least the information that they do not consider sustainability risks in their investments. More information can be said to improve the transparency. From the end investor's perspective, comparing sustainability of financial products and investment service providers may be little easier, but because of interpretability and delay in level 2 of the regulation, the information may be misleading in some cases. Anyway, SFDR has brought a good framework for sustainability reporting, which eases end investor's evaluation.

6. Discussion and conclusions

In this chapter, the findings of research are presented by answering to the research questions of this study. Conclusions are also presented in this chapter. The chapter reflects the main findings of this study to the theoretical part of this study, and the aim is to establish a dialogue between the findings and theory. Finally, reliability and limitations of this research are evaluated. Also, future research topics are presented in the end of this chapter.

6.1. Summary of the findings

This sub-chapter outlines the summary of the findings in this study by answering the main research question: “How does the Sustainable Finance Disclosure Regulation (SFDR) reach its goal to reduce information asymmetry in sustainable investing between investment service provider and end investor?”. The answer for this main research question is presented through the sub research questions: “What are the advantages and challenges in SFDR?”, and “How does these advantages and challenges affect the information provided about financial products? And what are the effects to the end investor?”. The answers are combined from theoretical and empirical part of this study.

What are the advantages and challenges in SFDR?

As empirical findings showed, before SFDR came into effect, sustainability-related reporting was consisted mainly of different kind of reports, where each investment service provider was able to provide whatever information, they considered important. Sustainability-related reporting was seen sensible for business and was mostly done because of customers’ demand. As Crockett et al. (2004) mentioned, investment service provider has usually more information about their financial products than the client has, and this creates information asymmetry between the parties. Before SFDR, investment service providers have been able to disclose whatever sustainability information they want or even decide not to disclose sustainability-related information at all. In situations, where this information was not provided at all, evaluating sustainability was hard and depended on third party data-providers ratings. Before SFDR, information provided might have also been biased, as investment service providers were able to disclose only things that they are

already doing well and fail to disclose things that may adversely affect to the end investor's opinions. Because of that, end investors must have been very enlightened, to be able to evaluate and compare sustainability of different investment service providers and financial products.

When considering the advantages of the regulation, based on the empirical findings, the most important is the obligation to disclose information and the fact that sustainability-related disclosures in the financial services sector has finally been brought under regulation. According to Jensen & Meckling (1976, 5), if both parties, principal and agent, tries to maximize their utility, "there is good reason to believe that the agent will not always act in the best interests of the principal", and according to Hoppu (2004, 34-35) disclosure standards are a key factor in investor protection. As empirical findings of this study showed, advantages of SFDR are that it not only set obligation to provide information, but it also sets the requirements to the provided information and unifies language around sustainable investing. As providing information is mandatory, and requirements and definitions are defined in regulation, empirical findings show that the transparency and comparability have been improved some. According to empirical findings, comparability and transparency are improved because every investment service provider has same definitions and requirements, which are defined and controlled by bigger authority. Taking these into account, it can be said that the regulation has already given some responses to the Rhodes' (2009) suggestion, that obtaining a consistent definition for sustainable investing and creating a metric or mechanism to confirm the comparability and conformity, could be the answer to face information asymmetry in sustainable investing. Based on the empirical findings, this mechanism to compare will improved when level 2 of regulation will come into effect, as it enables comparing between PAI-indicators and pre-defined templates.

However empirical findings proved that SFDR has not resolved all the problems around information asymmetries in sustainability reporting. The lack of sustainability-related data about the target companies, forces investment service providers to rely on third-party data providers. According to Rhodes (2009) when selecting securities into portfolio, asset managers, must first set the criteria for its investments and after that obtain an information, to make sure that the chosen criteria are met. It means that when investment service providers' asset managers are considering the investments of their financial products, they

need to set criteria and make sure that these criteria are met. To evaluate how these criteria are met, investment service providers need enough sufficient data. When target companies do not provide sufficient sustainability information, it complicates the investment service providers' asset managers' evaluation of possible investment targets and forces them to buy estimated data. As Zumente & Lace (2021) and Li & Polychronopoulos (2020) noticed in their studies, the divergence among different third-party rating provides scores is noticeable. Taking this into account, as long as target companies do not provide sustainability data by themselves in a ready-to-use format, investment service providers must buy estimated data from third-party data providers. According to the empirical findings of this study, this may have an impact to the final disclosure information of financial products, and so on to the information asymmetry, as each data provider has their own interpretation about the sustainability of industries or target companies. At least, end investor needs to take this into account, when evaluating the sustainability of different financial products and investment service providers.

As Rhodes (2009) mentioned, selection of investments to the portfolio is not simple, and another asset manager might select very different securities to their portfolio than the other. According to ESMA (2021), SFDR does not require certain composition of investments or minimum investment thresholds, and it does not prescribe investing styles, tools, strategies, or methodologies to be used. Based on empirical findings, this has caused confusion among investment service providers, even when the regulation gives certain frameworks on what is considered sustainable and what is not. Based on the findings, regulation leaves too much interpretability for some definitions and the lack of limit values makes evaluation of different criteria hard. This may lead to the situation, where one asset manager classifies financial product according to Article 8, when another asset manager might think that the product is sustainable enough to classified in accordance with Article 9.

Regulation two-stage entry into force was also seen as a challenge, as investment service providers are not required to give any numerical indicators about their sustainability factors. This means that now, when investment service providers describe, how sustainability risks are taken into account in investments activities, some may already define it very precisely, when another gives only little information. Based on the empirical findings this have an effect to the products classification but also to the comparability and transparency of sustainability related reports. Empirical findings pointed out that "best

practices” in reporting and product classification is hard to found without standardized reporting templates of level 2.

How does these advantages and shortcomings affect to the information provided about financial products? And what are the effects to the end investor?

When considering, what kind of effect those advantages and challenges had to the information provided of financial products and what are the effects to the end investor, empirical findings of this study found few. According to Crockettin et al. (2004), to evaluate the sustainability of financial products, investor must have enough transparent and comparable information. To be able to select good investment targets from the bad ones, investors should have enough sufficient information. Based on the empirical findings, the amount of sustainability-related information has increased with SFDR, and even when the level 2 pre-defined templates and PAI-indicators are not in use yet, investment service providers thought that information is already more standardized between different actors.

According to empirical findings, before SFDR, each investment service provider may have had their own definition about sustainability risks, sustainable investment etc., and this has affected to the transparency and comparability of reports. Provided information has varied between different actors and each actor has interpreted and reported sustainability-related themes in their own way. This finding is similar with Ruggie & Middleton (2019) and Serafeim (2019), which noticed that the lack of standardization and comparable information across actors, has been challenge in sustainable investing. As empirical findings showed, the common language around sustainability reporting has standardized with SFDR. This means that industry slang has become more consistent, and with it, information reported is more transparent and comparable.

Based on the empirical findings, one of the biggest effects to the information provided and to the end investor, has been the classification of financial products. As financial products must be classified according to Articles 6, 8 and 9, investment service providers have been forced to consider their practises related to sustainability more carefully. As investment service providers are required to explain on how their products meet the requirements of certain article, ‘impact washing’ or ‘greenwashing’ those products is more difficult. For example, according to empirical findings of this study, not all financial products can be classified under Article 9. This is not only decreasing the investment universe of end investor’s but also the investment universe of asset managers’, who are doing the

investment to the target companies in mutual funds. Each investment decision needs to be more carefully decided as the investment needs to reach certain requirements of each Article, and all investment decisions, especially in Article 9 products, must be justified. However, at this point the concern about that end investors rely too much on product classifications is present. Because of the demand in sustainable financial products, investment service providers want to classify their financial products under Article 8 and 9, but as long as any numerical indicators are not required, comparing the sustainability of different products is hard. Instead of relying too much to the classifications of financial products, end investor should pay attention to the information provided in prospectuses, which may reveal more about the strategies and objectives of the financial products.

As Bergh et al. (2019) mentioned, one format of information asymmetry is lack of perfect information, and it can be reduced with sending and assessing “signals”. According to Candelon, et al. (2021) the name of a mutual fund can be considered as a signal if it makes easier for investor to identify the characteristic of the mutual fund. On the other hand, this may lead to the opportunistic behaviour where asset manager chooses the name of the financial product, which is not representative of its characteristics, to impact end investor perception. According to the Finnish Financial Supervisory Authority (2021), only Article 8 and Article 9 financial products can use sustainability-related terms, such as ‘sustainable’, ‘ESG ‘and ‘responsible’, in the name of the financial product. This at least reduces opportunities to give misleading sustainability-related names for financial products that do not consider sustainability in their investments at all. However, based on the empirical findings of this study, the sustainability degree, especially in Article 8 products, may vary a lot and products can be quite easily classified under Article 8.

According to Gomez-Mejia et. al. (2001), when the assumption of bounded rationality and information asymmetries are considered, it may be impossible for principal to specify performance criteria ex ante and create contract with the services of the best possible agent. Because of the SFDR, end investor has more information about the sustainability of financial product, but based on the empirical findings, until level 2 of regulation will come into effect, SFDR’s impacts to the end investor will remain relatively small. Empirical findings showed that even, when the regulation makes requirements for product classification and information provided, at this point, it has had bigger effect to the investment service providers than to the end investors. Investment service providers have

been required to re-evaluate their sustainability practises, and give more information about those. Still, as no pre-defined templates or numerical PAI-indicators are required, from the end investor's perspective, comparing sustainability of different products and investment service providers may be difficult.

How does the Sustainable Finance Disclosure Regulation (SFDR) reach its goal to reduce information asymmetry in sustainable investing between investment service provider and end investor?

Based on the empirical findings, before SFDR there was a situation where some investment service providers did not disclose any sustainability information. And those who disclosed the sustainability information, has done it for different reasons and in different ways. Connelly et al. (2011) defined that information asymmetries occur between those who hold the information and those who could make better decisions if they had the information. According to them, this information asymmetry is due to private information. Based on the empirical findings, when the providing sustainability-related information is mandatory and supervised by bigger authority, the end investors can be sure that the information is available in every investment service provider's website. When sustainability-related information is available, transparency increases and comparing financial products is easier. Due to that, the amount of private information between end investor and investment service provider can be said decreased.

According to Makadok et al. (2011), private information also occurs, when some market participants are better informed about the value of traded goods, services, or resources. Based on the empirical findings of this study, sustainability-related information has been published before SFDR because of customers' demand and because investment service providers have seen it sensible for business. As bigger authority has not given requirements for the information, the information provided was biased and based on each actors' own interpretation of sustainability. Now, when SFDR requires investment service providers to give certain sustainability information, actors are not able to decide fully by themselves, what information they are providing, which indicates that information asymmetry, i.e., private information, between investment service providers and end investors is decreasing.

According to Stiglitz (2002), information asymmetry occurs in as a situation, where different people know different things. Schmidt & Keil (2013) mentioned that access to relevant information is not possible to everyone and at the same time different actors may

interpret same information differently. Based on the empirical findings, interpretation of regulation is one of the main challenges, which have an impact for example to the classification of financial products. Before SFDR, there was no common language around sustainability and each actor defined those topics by themselves. This has had a huge impact to the information asymmetry as someone's definition of sustainable investment might have vary significantly from another's. When SFDR brought unified definitions around the sustainability, the language used in reports has become more comparable and transparent. According to Hambrick & Mason (1984) in strategic decision processes, where each actor reflects its own knowledge, values, goals etc. to the decision, result vary among different actors, and information asymmetry is accentuated. This was pointed out also in the empirical findings when interviewees mentioned that the regulation leaves still room for interpretation as someone's interpretation about 'significant' adverse impact or 'good' governance practices may vary from another's. Although the first level of regulation unifies the language around sustainability, regulation interpretability still causes some information asymmetry between end investor and investment service providers.

Due to the lack of sufficient data, rely on third-party data providers and not everyone has access to all information. This leads to the situation were investment service providers makes investment decisions based on these third-party data providers estimates, and provides sustainability information to the end investors based on these same estimates. Depending on what third-party data provider has been used and who receives the information, investment decisions and information provided may vary, as according to Hambrick & Mason (1984) each decision-making member brings different values, assumptions, knowledge, goals, and priorities to bear on the decision. Due to this, some information asymmetry will always be present, but if the data would become from the same source, the amount of different information between parties would decrease.

Brown & Hillegeist (2007) study noticed that the quality of the disclosure information primarily affects information asymmetry. Based on the empirical findings, quality of sustainability-related disclosure has improved because now investment service providers are required to disclose same information. The information should be also disclosed regardless of how positively or negatively information provided affects to the investors' opinions. Before SFDR, there were no requirements for the sustainability-related disclosure information of financial products, which why information might have been

biased. On the other hand, because of the delay in level 2 of regulation, investment service providers are not required to use harmonised templates or PAI-indicators when providing the information, which is why it is quite easy to formulate the provided information to their own advantage. According to Vanhaverbeke et. al. (2002), information about the assets quality and performance characteristics are not usually in common knowledge, which leads to the situation where information provided might be biased and it may cause adverse selection problem. As hidden information was usually linked to the problem of "adverse selection", based on the findings it is possible to say that SFDR tackles some challenges regarding to the hidden information, but true benefits will be seen when the second level of regulation will come into effect.

As mentioned earlier, lack of perfect information can be considered as a format of information asymmetry, and it can be reduced by sending and assessing different kind of "signals". (Bergh et al. 2019) Same way as the name of the mutual fund, the classification of financial product can be considered certain kind of signal, as it gives to the end investor some information about how sustainability has been considered in investment decisions. Before SFDR, there were no requirements for financial product classification and investment service providers were able to define sustainability of their products in their own way. Since SFDR came into effect, investment service providers have been classified their financial products in accordance with Articles 6,8 and 9, and tried to make sure that investments of these financial products meet requirements of given article. Empirical findings showed that this has improved the transparency of financial products and because not all financial products can be considered in the most sustainable category, the information asymmetry has decreased with these product classifications. On the other hand, considering earlier mentioned delay in level 2 of regulation and interpretation in some definitions, these "signals" may in some situations give false impression about sustainability of financial product. The end investor must be careful if evaluation of financial product is only based on its classification, as lack of perfect information still causes information asymmetry.

In the table 3 are summarized main results of this study. Based on the results, SFDR decreases private information between the investment service provider and the end investor. Research did not notice any factors that increases private information. Based on the findings, also hidden information and lack of perfect information has decreased with

SFDR, but delay in the level 2 of regulation still have an effect, how well the regulation decreases information asymmetry between the investment service provider and the end investor. After level 2 of regulation will come into effect, these identified problems in information asymmetry should be decrease. Although, information asymmetry related to the different information, cannot be completely resolved with level 2. With the level 2 PAI-indicators and templates, "best practises" in the product classification and reporting will eventually to be found, but the lack of sufficient data is still problem that must be resolved. Based on the findings of this study, investment service providers have a lot to think about where to get the necessary data.

Table 3: The effects of regulation on different forms of information asymmetries

Format of information asymmetry	**Time before SFDR**	**Time after SFDR**	
		↓ decreases information asymmetry	**↑ increases information asymmetry**
Private information	No obligation to disclose any information Motivation behind sustainability-related reporting: • sensible for business • customers' demand	Obligation to disclose information: Amount of sustainability-related information has increased Motivation behind sustainability-related reporting: • regulation → unity of reporting	
Different information	No common language: Each actor had their own definition about sustainability risks, sustainable investment etc.	Unified language: Definitions come from regulation and are same for each actor	Interpretability of definitions and lack of limit values: actors may interpret differently Lack of data: usage of third-party data providers estimates
Hidden information	No requirements for reporting format: Information provided might have been biased	SFDR sets the requirements to the provided information: Information provided should be more unified	The formality of reporting is deficient as level 2 templates are missing: reporting discretion
Lack of perfect information	No classification of financial products: "sustainability level" was defined by each investment service provider by themself	Classification of financial products: also, obligation to explain how products meet the requirements of certain article	Due to delay in level 2 and interpretability, classifications of financial products may vary between different actors

As presented in the beginning of this study, the theoretical framework has been constructed to the basis of information asymmetry in principal-agent relationship. In the theoretical framework, two main gaps where information asymmetry in this relationship can form, were noticed. The first gap was between the regulation and the investment service provider, and the second gap was between the investment service provider and the end investor. The first gap was related on how investment service providers interpreted the regulation and what kind of investments decisions they do within the regulatory framework. The second gap was related on how the investment service provider manage to inform the end investor about the characteristic of their investments and financial products. Factors that affect the first gap, will eventually affect the second gap and in that way to the information asymmetry. In the figure 7 is visualized the factors that still causes information asymmetries between investment service providers and end investor and in that way causes problems in principal-agent relationship.

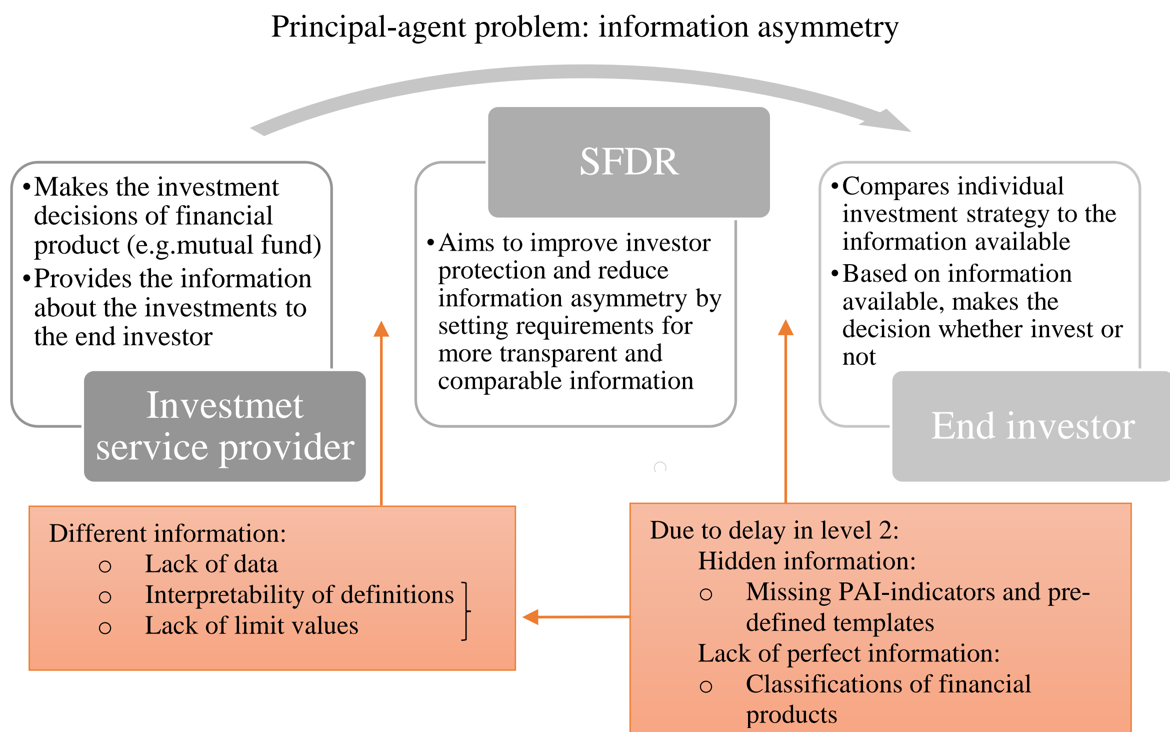

Figure 7: Factors that still causes information asymmetries

As presented in the figure 7, the lack of data has an impact to the information asymmetry, as investment service providers need to rely on different third-party data provider's

estimates about the sustainability of certain company or industry. It does not only impact to the investment decisions, but also to the information provided about sustainability of investments and financial products. Interpretability of definitions and lack of limit values leaves room for discretion when investment service providers are doing investments and product classifications, and eventually it will critically affect how well regulation reduces information asymmetry. The lack of limit values and interpretability are challenges in principal-agents relationship as they increases information asymmetry in the first gap. At this point, when only level 1 of regulation is in effect, missing PAI-indicators and pre-defined templates and divergence in product classifications, have an impact to the second gap between the investment service providers and the end investors. When regulation level 2 will come into effect, it does not only decrease information asymmetry in the second gap, but also in the first gap, when "best practices" in limit values and definitions will eventually to be found. This is illustrated by an arrow between two boxes in figure 7. As it is possible to see in the figure 7, the information asymmetry due to lack of data cannot be fixed with level 2 of regulation.

6.2. Conclusions

The aim of this research was to examine how EU's Sustainable Finance Disclosure Regulation reaches it goal to reduce information asymmetry between investment service providers and end investors. Based on the findings, it can be said that this kind of disclosure regulation has been very welcoming and resolves already some information asymmetry problems between investment service providers and end investors. Given that there were no obligations to provide any kind of sustainability-related information before SFDR, the changes introduced by the new regulation will significantly reduce information asymmetries between the parties. When level 2 of regulation will come into effect, the transparency and comparability of sustainability information will be further improved.

In order to resolve the problems regarding to principal-agent relationship and information asymmetry, it is essential that all the actors comply with regulatory obligations. Two-phase entry into force of the SFDR has posed challenges for the parties, and led to a situation where different investment service providers may interpret the regulation in slightly different ways. From the perspective of end investor, different practices and interpretations

may threaten investor protection if those differences are significant between investment service providers. It should be also noticed, that due to the unfinished regulation, the “best practises” are not found yet, and problems with data availability need to be resolved before investment service providers are obligated to start reporting the PAI-indicators.

In general, due to SFDR, the end investor has significantly more sustainability-related information on both investment products and investment service providers. Increased information can be seen reducing information asymmetry between the principal and the agent and allowing the end investor to make investment decisions based on more transparent and better information. Regulation makes sustainability of investment products and investment service providers more transparent, which is why it is interesting to see how this will affect to the competitive environment in the investment services market. The growing number of requirements for disclosure information may reveal shortcomings in the sustainability of investment products or investment service providers, but also reduce doubts about greenwashing or impact washing.

Prior to the entry into force of the SFDR, the perspective for sustainability information has varied between investment service providers and has been driven by operators' own preferences and motives. As sustainability-related information becomes more transparent and comparable, the principal-agency problem between end investor and investment service provider will decrease, and the end investors will be able to make decisions based on their own values. As stated in the beginning of this study, in addition to the return of investments, the end investors increasingly appreciate the impact of investments on the world around them. When operations of investment service providers are transparent and comparable, winners are those who can meet these end investors’ expectations. In other words, those whose investments stands closer analysis and comparison.

6.3. Limitations and Future Research

The first level of Sustainable finance disclosure regulation (SFDR) has come into effect in March 2021, which is why earlier research related to this topic has not done much. While this research expands the understanding and knowledge about the sustainable investing and how the SFDR aims to reduce information asymmetry between investment service

provider and end investor, there are also some limitations which are important to take into consideration.

The research is geographically limited to Finnish market. All the interviewees were chosen from different investment service provider companies operating in Finland and interviews were conducted in Finnish. As this regulation has come into effect on EU area, the results of the study might have been different if the interviewees would have been chosen from different countries of EU. Therefore, the results of this research can be fully generalized to Finnish financial market only.

This research has limited sample size of interviews. Although the research tried to consider all the comments of the interviewees as precisely as possible, some important perceptions might have left out unintentionally. The conclusions of this study are based on the researcher’s own understanding of the interviews and the materials. To confirm the assumptions, more research in the field of this topic is needed.

During the writing process the regulation and reporting practises have developed, as level 2 of regulatory technical standards (RTS) were still under process when the writing process was started. Also, some unclear definitions and requirements have been clarified by EU Commission and other authorities. All these changes and corrections have been taken under consideration with the author’s best knowledge, but some recent clarifications and changes might be missing.

In the future, when the level 2 of regulation will come into effect, more research how the regulation reaches its goal to reduce information asymmetry between end investor and investment service providers is much needed. It would be interesting to investigate, how this regulation has changed the investments of financial products e.g., investments of mutual funds, as now most of the investment service providers wants to classify their products at least under Article 8. Effects of the regulation would be also good to research from the perspective of end investor, for example how this regulation has affected their investment decisions. Finally, after first PAI-indicators and harmonized templates will be published, it would be necessary to research, how these Article 8 and 9 products differ between different investment service providers. It would be also interesting to research, will there be any changes to the classifications of financial products after numerical

indicators are visible to everyone and harmonised templates are comparable between different actors, i.e., are those “best practises” eventually to be found.

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Appendices

Appendix 1. Interview questions in English

GENERAL

1. What is your current job description / title?
2. How long you have been in that position / worked in sustainable investment?

SFDR

3. Prior to the entry into force of the regulation, how end investor was able to assess and compare the sustainability of the financial products?
4. What do you think the SFDR brought to the sustainability reporting of financial products?

SFDR - information provided to the investor

5. What do you think the SFDR has brought to the end investor?
6. How did the transparency and comparability of sustainability of financial products improved with SFDR?
7. Do you think that the sustainability reporting has become more transparent? What about more comparable? In what ways?
8. Do you think that the sustainability reporting has become more harmonized between different investment service providers? In what ways?
9. Do you think that SFDR makes assessing and comparing the sustainability of financial products easier for end investor? In what ways?

SFDR – interpretability and shortcomings

10. What kind of shortcomings/interpretability do you see in SFDR?
11. What do you think these are due to?
12. What kind of effects do you think these shortcomings/interpretabilities may have to the information provided? What about to the end investor?
13. Do you think that these shortcomings/interpretabilities have an impact to the goals of regulation to improve comparability and transparency in sustainability-related disclosures? What kind of impact?

SFDR - two-phase entry into force

14. What kind of challenges do you see in that level 1 of regulation has already came into effect but there has been delay in level 2 regulatory technical standards?

Appendix 2. Interview questions in Finnish

YLEISTÄ

1. Mikä on tämänhetkinen työnkuvanne?
2. Kuinka kauan olet toiminut kyseisessä työssä / kestävän sijoittamisen parissa?

SFDR

3. Ennen asetuksen (SFDR) voimaantuloa, mitkä olivat mielestäsi ne keinot, joilla sijoittaja pystyi arvioimaan ja vertailemaan sijoitustuotteiden kestävyyttä?
4. Mitä asetuksen (SFDR) voimaantulo mielestäsi toi rahoitustuotteiden kestävyysraportointiin?

SFDR – sijoittajalle raportoitavat tiedot

5. Mitä asetus (SFDR) on mielestäsi tuonut sijoittajalle?
6. Millä tavoin sijoitustuotteiden kestävyystekijöiden läpinäkyvyys ja vertailukelpoisuus mielestäsi parani asetuksen (SFDR) voimaantulon myötä?
7. Muuttuiko sijoitustuotteiden kestävyystekijöiden raportointi asetuksen (SFDR) myötä mielestäsi läpinäkyvämmäksi? Entä vertailukelpoisemmaksi? Millä tavoin?
8. Näetkö, että sijoitustuotteiden kestävyystekijöiden raportointi on asetuksen (SFDR) myötä yhtenäisempää myös eri sijoituspalveluiden tarjoajien välillä?
9. Näetkö, että asetuksen (SFDR) voimaantulon myötä sijoitustuotteiden kestävyyden arviointi ja vertaileminen on loppusijoittajalle helpompaa?

SFDR – tulkinnanvaraisuus / puutteet

10. Millaista tulkinnanvaraisuutta /puutteita näet asetuksessa?
11. Mistä luulet asetuksen (SFDR) niiden johtuvan?

12. Mitä seurauksia asetuksen (SFDR) puutteilla/tulkinnanvaraisuudella voi mielestäsi olla rahoitustuotteista raportoitaviin tietoihin? Entä sijoittajaan?
13. Onko asetukseen (SFDR) liittyvällä puutteilla/tulkinnanvaraisuudella vaikutusta siihen, miten asetus onnistuu sen tavoitteessa parantaa raportoinnin läpinäkyvyyttä ja vertailukelposuutta? Millainen vaikutus?

SFDR – kaksivaiheinen voimaantulo

14. Millaisia haasteita näet siinä, että asetuksen ensimmäinen vaihe on tullut voimaan, mutta vaiheen 2 tekniset sääntelystandardit tulevat voimaan vasta myöhemmin?