Haute Ecole

« ICHEC – ECAM – ISFSC »

Enseignement supérieur de type long de niveau universitaire

How can the SFDR contribute to embedding the financial industry?

Mémoire présenté par :

Lisa-Marie Heck

Pour l'obtention du diplôme de :

Master en gestion de l'entreprise

Année académique 2022-2023

Promoteur :

Christel DUMAS

Boulevard Brand Whitlock 6 - 1150 Bruxelles

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Table of Contents

Acknowledgements 4

Introduction 8

Part 1: Literature Review 10

1. Karl Polanyi's concept of embeddedness 10

1.1 Historical context 10

1.2 The concept of Embeddedness 11

1.3 The concept of disembeddedness 11

1.4 The concept of re-embedding 12

1.5 Characteristics of Embeddedness 13

1.6 How the concept of Embeddedness applies to finance 14

1.7 Critics of Polanyi's concept of Embeddedness 15

2. SFDR Directive Explained 15

2.1 The concept of ESG criteria 16

3. Understanding the SFDR Directive: An Overview 17

3.1 Greenwashing and impact washing 17

3.2 The concept of double materiality 18

4. Defining the SFDR Directive 19

4.1 Definition 19

4.2 Timeline 21

4.3 Objectives 21

4.4 Scope of the SFDR 22

5. Detailed Examination of the SFDR Directive 23

5.1 Functionalities 23

5.2 SFDR Classification 26

5.3 Annex II - Annex IV 28

6. The SFDR and Taxonomy: Establishing the Connection 28

6.1 What is Taxonomy? 28

6.2 Connection between SFDR and Taxonomy 29

7. Conclusion Part I: SFDR and Embeddedness 31

Part 2: Qualitative Case Study 32

8. Qualitative methodology 32

9. Data collection: semi-structured interviews 32

10. Participant selection 33

11. Interview Guide 33

12. Analysis of the Interviews: Gioia Coding method 33
Case Study 35
13. Positive Factors of SFDR 35
13.1 Shift to more Sustainability Integration 35
13.2 Increased Accountability 36
13.3 Increased Awareness 36
13.4 Changing Strategies and Processes 37
13.5 Rethinking Governance 37
14. Negative Factors of SFDR 38
14.1 Changing processes 38
14.2 Data and Methodology Issues 38
14.3 Not enough Accountability 39
14.4 Market Mechanisms 39
15. Discussion 40
15.1 Why is the financial sector disembedded? 40
15.2 Discussing the positive factors of SFDR 41
16. Discussing the negative factors of SFDR 42
17. Conclusion 42
18. Recommendations for Further Research 45
19. Limits and criticism of my research 46
20. Personal Conclusion 47
Bibliography 48
Appendix 1: Gioia Coding 52

Introduction

Climate change is a pressing global issue that demands immediate attention. Its impacts are already devastating and will continue to pose significant challenges for the economy in the coming years. The economy, being one of the primary drivers behind climate change, faces considerable risks and negative consequences as a result.

The implications of climate change are far-reaching and multifaceted. Changes in temperature patterns, rising sea levels, extreme weather events, and shifts in precipitation have severe socio-economic repercussions on all industries.

Furthermore, constantly increasing greenhouse gas emissions from economic activities exacerbate these effects. As such, the economy itself becomes both a major culprit causing climate change and bears substantial harm due to its own actions. Breaking this vicious cycle requires concerted efforts from governments, businesses, and individuals alike to reduce carbon emissions, migrate towards sustainable practices and invest in technologies that mitigate the adverse impacts of our current course.

Climate change has significant implications for the financial industry in the coming decades. The potential risks are substantial and cannot be overlooked. Moreover, it is important to acknowledge that the financial industry itself plays a crucial role in driving climate change through its support and funding of industries and businesses that contribute to environmental degradation.

In order to address these intertwined challenges, there needs to be a paradigm shift within the financial sector. It is essential for banks, investment firms, and other financial market participants operating within this industry to recognize their responsibility in mitigating climate change risks. This entails divesting from activities supporting high-emission sectors such as fossil fuel exploration or deforestation-driven agriculture. Furthermore, incorporating Environmental, Social, and Governance criteria into investment strategies can enhance sustainability efforts while still maintaining profitability objectives.

To tackle this issue, the United Nations took a significant step in 2004 by releasing a report titled "Who cares wins" (United Nations, 2004). Within this influential publication, the UN introduced the notion of Environmental, Social, and Governance criteria as an essential framework for decision-making. The report passionately urged all economic participants to embrace these criteria and integrate them into their operations.

The report serves as a crucial blueprint for promoting sustainable business practices worldwide. It emphasizes that economic stakeholders have a responsibility not only to maximize financial returns but also to consider the potential environmental and social impacts of their actions. By adopting ESG criteria laid out in the UN's groundbreaking publication, businesses can contribute to mitigating climate change risks while fostering more responsible growth.

However, until the last years, there was no framework obliging financial market participants to disclose their ESG practices or to align their investments with sustainable goals. This changed in 2019 with the introduction of the European Union's Sustainable Finance Disclosure Regulation. The SFDR aims to embed sustainability and ESG factors within the financial industry by establishing a common language and framework for disclosure. The SFDR requires financial market participants to disclose how they consider ESG factors in their investment and advisory processes, as well as to disclose the sustainability impacts of their investments.

The main objective of my thesis is to examine and comprehend the various elements of the Sustainable Finance Disclosure Regulation that contribute to integrating sustainable practices within the financial industry. To provide a conceptual framework for this exploration, I have drawn upon Polanyi's notion of embeddedness, which asserts that an economy should not be viewed in isolation from its institutional, social, and cultural context. Given the growing significance of climate change as a critical topic in our society and with regulatory frameworks aiming to standardize and incorporate sustainable finance practices, it becomes imperative to evaluate how SFDR facilitates the integration of sustainability within the financial sector.

By delving into the literature review, I will first define the concept of "embeddedness" and explore its connection to the financial industry. I will then elaborate the concept of ESG criteria, with the last section of my literature review being a comprehensive study of the SFDR itself, analyzing its objectives, requirements, and implications for the financial market.

The literature review has provided a solid foundation for conducting an empirical study that involved interviews with auditors from EY who specialized in the review of SFDR disclosures. To gain a deeper understanding of the factors that contribute to embedding the financial industry through the SFDR, I utilized the 3-Level-Gioia method and analyzed these interviews. Through careful coding, I identified five key aggregate positive factors that play a significant role in facilitating this embedding process.

In the subsequent section of discussion, I will examine how these five aggregate positive factors are associated with different characteristics of embeddedness within the financial sector. Furthermore, during my analysis of interview data, I also discovered five negative factors related to the SFDR's implementation. In subsequent sections, I will explore these negative factors in greater detail and consider their potential implications for future developments.

However, I will also elaborate on the limitations and challenges encountered during the interview process, highlighting the need for further research and exploration in this area. In the final chapter of my thesis, I will conclude by presenting a comprehensive summary of the main discoveries made throughout my research. Additionally, I will include further research opportunities, limits of my study and a personal conclusion to reflect on the knowledge gained during this investigative processes.

Part 1: Literature Review

1. Karl Polanyi's concept of embeddedness

1.1 Historical context

Karl Polanyi, an influential Hungarian economic historian, economist, and social philosopher, played a significant role in popularizing the concept of "embeddedness." This notion asserts that economies are deeply intertwined with societies and are profoundly influenced by their political, cultural, and social contexts. According to Polanyi's perspective on embeddedness, economic activities cannot be examined or understood in isolation from broader societal interactions. Instead of regarding the economy as a separate entity disconnected from society at large (as traditionally assumed), Polanyi emphasizes how it is intricately connected to various aspects of human life. By highlighting the indispensability of understanding the impact of sociopolitical factors on economies' inner workings, we can better comprehend real-world economic processes (Beckert, 2007).

Karl Polanyi was a prominent scholar who conducted his work during the mid-20th century, which was characterized by major global changes and transformations. This era witnessed the rise of neoliberal economic policies along with the aftermath of devastating world wars. One of Polanyi's most significant contributions to social thought is his groundbreaking book, "The Great Transformation," published in 1944. In this influential work, he critically examines the market ideology espoused by the classical liberal school and its detrimental effects on society as a whole (Machado, 2011).

Polanyi's insights were largely shaped by his own firsthand experiences during turbulent times such as the Great Depression, fascism's emergence, and even World War I. These historical events deeply impacted him and served as motivators for his research into understanding how unrestricted markets can lead to serious societal consequences (Hodgson, 2016).

Polanyi's assertion is that the dominant view of a market-centric economy is actually an aberration in history. Before the industrial revolution, societies did not perceive their economies as separate and self-regulating entities. Instead, economic activities were deeply intertwined or "embedded" within other aspects of social life. For example, economic transactions were governed by social norms, customs, and religious beliefs (Machado, 2011).

The concept of embeddedness holds that disembedding from these social relationships has had negative consequences for contemporary economic systems and society at large. Polanyi argues that this shift towards a detached notion of economy has resulted in detrimental societal impacts. In summary, Polanyi contextualizes his idea of embeddedness by highlighting its historical significance and contrasting it with the current understanding dominated by market-centrism (Gemici, 2008).

1.2 The concept of embeddedness

Embeddedness was first mentioned by Karl Polanyi in his book "The Great Transformation" (1944), where he describes the economy as being embedded in social relations in premarket societies. According to him, the economy is associated with motives of material gain, whereas the social refers to norms of reciprocity and redistribution.

The term embeddedness is used to highlight the interplay between economic activities and societal norms and relations. Karl Polanyi's concept of embeddedness refers to the idea that economic behavior and institutions are deeply embedded within social, political, and cultural structures. This contrasts with the traditional economic view that markets operate independently of these structures. According to Polanyi, the idea of a self-regulating, autonomous market was a historical anomaly. Historically, economies were always embedded and regulated within society's other, non-economic institutions, like kinship, politics, and religion. Economies have always needed social, institutional, and political contexts to function properly (Stanfield, 1980).

Polanyi argues that the concept of embeddedness challenges the neoclassical economic assumption of homo economicus, which depicts individuals as rational and self-interested actors who make decisions solely based on economic considerations. Instead, Polanyi argues that economic behavior is influenced by social and cultural factors, such as norms, values, traditions, and institutions (Gemici, 2008).

In the context of the financial industry, Polanyi's concept of embeddedness sheds light on how economic activities and institutions within this sector are deeply intertwined with social, political, and cultural structures. For example, the financial industry is subject to various regulations and laws set by government authorities, like for example the SFDR or Taxonomy regulation, which shape the operations and activities of financial institutions. Additionally, the financial industry is influenced by societal norms and values regarding financial transactions, investments, and risk management. Moreover, the financial industry is embedded within broader social and cultural systems that influence its practices and outcomes (Bengo et al, 2022).

1.3 The concept of disembeddedness

Disembeddedness, a concept derived from Karl Polanyi's economic sociology, refers to the separation or detachment of the economy from society. According to Polanyi, this concept highlights the unique nature of the capitalist market economy. In traditional societies, economic activities were integrated into and influenced by social relationships and norms. However, with the emergence of capitalism, Polanyi argues that the economy has become disembedded – breaking away from its connection to social structures and instead, following its own independent laws (Machado, 2011).

Polanyi's critique of a disembedded economy is multifaceted and encompasses several

consequences. One such consequence is market fundamentalism, which arises from the belief that markets are self-regulating entities that function optimally without external influence. This perspective oversimplifies human behavior by reducing it to economic calculations, an approach Polanyi vehemently criticizes. Another consequence of a disembedded economy is social and environmental disjunction. As the focus shifts solely towards market mechanisms like supply and demand, there can be a disconnection between economic activities and their social or environmental repercussions. This detachment has the potential to result in negative impacts on society, culture, and ecology as important considerations beyond mere profit maximization may be disregarded (Machado, 2011).

Another consequence of a disembedded market economy is the potential weakening of social policy. As economic transactions and institutions become separate from social structures, there is a risk that social policy becomes subordinated to economic interests. This can result in reduced investments in public welfare programs and a focus on prioritizing economic policies over social protections. Lastly, the detachment of economic life from societal values and norms in a disembedded market paves the way for dehumanization. In such an environment, human labor becomes commodified, reducing individuals to mere factors of production or objects within an exchange process. The consequences are far-reaching as this dehumanization undermines dignity and well-being by equating one's worth solely with their ability to participate within market activities (Machado, 2011).

Polanyi (1944) referred to this retaliatory response of society as a "double movement". The first movement is towards the self-regulating market (disembeddedness), and the second movement constitutes society's attempts to protect itself from the destructive impacts of an unfettered market system. This could include efforts to re-embed the economy within the social fabric through regulation and legislation, or introducing policy measures like welfare systems, minimum wage laws, or labor rights in an attempt to mitigate the potentially harmful effects of a disembedded economy (Machado, 2011).

1.4 The concept of re-embedding

Re-embedding a disembedded economy involves bringing it back under the influence of social norms, regulations, and practices, thereby curbing the economy's "self-regulating"' behavior by (Machado, 2011):

- Government Policy and Regulation: One of the most significant instruments for re-embedding the economy is government intervention through policy formulation and regulation. This can be done through labor laws, market regulations, the establishment of minimum wages, welfare systems, and other similar legislative measures.
- Social Movements: Social movements can also play a pivotal role in advocating for the reinterpretation of market forces. They can challenge prevailing economic norms, propose alternative economic practices, and push for more responsible corporate behavior.

- Changes in Corporate Practices: The corporate sector can contribute to re-embedding through the adoption of socially responsible practices, prioritizing more than just profitability and incorporating elements like environmental sustainability and social fairness into their business models.
- Educational Initiatives: Promoting awareness and understanding of the social and environmental impacts of market forces is crucial in fostering a culture of re-embedding. Educational initiatives can help individuals recognize the consequences of a disembedded economy and encourage them to make informed choices as consumers, investors, or employees.
- Collaboration between Stakeholders: Addressing the challenges posed by a disembedded economy requires collaboration between various stakeholders.
- Strengthening Social Institutions: Re-embedding an economic system can also involve strengthening social institutions that indirectly influence economic actions, such as educational institutions, family structures, and religious organizations.
- International Cooperation: Global challenges such as environmental degradation, income inequality and social justice, cannot be managed by individual nations alone. International cooperation is a crucial mechanism for re-embedding economies, it includes agreements, conventions and treaties, international labor and environmental standards, and advocacy by international organizations.

1.5 Characteristics of Embeddedness

The characteristics of embeddedness can be grouped into various aspects based on the different types of embeddedness (Hodgson, 2017):

1. Social Embeddedness: The concept of social embeddedness refers to the significant role that personal relationships and social networks play in shaping economic behavior. It recognizes that individuals' actions are not solely determined by rational calculations or market forces, but also influenced by interpersonal connections and social norms within their networks. For example, trust, shared values, obligations, and expectations arising from being part of a social network can all influence economic decision-making.

2. Institutional Embeddedness: In addition to personal relationships, economic actions are also shaped by formal and informal rules, regulations, and institutions present in society. Institutions provide the framework within which economic interactions take place and govern how these interactions occur. These institutional structures include legal systems, government policies/regulations related to commerce/industry/trade/workforce etc., as well as cultural practices that guide business conduct.

3. Territorial or Geographical Embeddedness: This form of embeddedness recognizes the impact of geographical location or regional context on economic activities. Local cultures,

norms specific to certain regions or communities, intangible knowledge systems possessed by local populations, and availability/accessibility of resources unique to certain locations contribute significantly to economic behavior. These factors go beyond individual choices/preferences and shape a range of economic transactions, such as production methods, modes of exchange, distribution channels, target markets, and consumption patterns.

4. Cognitive or cultural embeddedness: This refers to how shared cognitive frameworks and cultural norms, such as values, beliefs, and knowledge, shape the perceptions and decision-making processes of economic actors. In this sense, individuals' behaviors in an economic system are influenced by their shared understanding of what is socially acceptable or desirable within their culture.

5. Network embeddedness: This form focuses on the role played by connections between different actors in an economic system. This includes interconnections among firms, resources, and individuals who form networks within which they interact with one another. The relationships established through these networks create interdependencies that significantly influence economic outcomes.

1.6 How the concept of Embeddedness applies to finance

The concept of embeddedness is crucial in understanding the functioning of financial markets within specific social contexts. Financial markets cannot be viewed in isolation; rather, they interact with broader institutional structures that include legal frameworks and cultural norms. The behavior of financial actors is heavily influenced by these institutional factors.

Within the realm of finance, the notion of '"embeddedness"' implies that financial activities, including operations within financial markets, are intricately intertwined with societal and political processes. This perspective challenges the traditional liberal economic view which posits money as a neutral entity and banks as mere allocators or distributors of risk without actively creating it. Instead, this perspective suggests that financial activities such as profit creation through investing inject inherent uncertainty into the economy (Scheiring, 2016).

Furthermore, the concept of embeddedness extends beyond just social and cultural processes, but also encompasses the regulatory frameworks and legal structures that shape financial transactions. These regulations serve to embed the financial sector within broader societal norms and values, ensuring that economic activities are conducted in a manner that is fair and ethical. An example of this can be seen through Environmental, Social, and Governance regulations which aim to promote sustainable practices within the financial industry. Polanyi's notion of embeddedness further contributes to our understanding of money as more than just a neutral medium. Rather, it is viewed as a construct shaped by society with inherent uncertainty. Trust plays an important role in shaping monetary systems alongside regulatory policies implemented by governments or central banks. Additionally, actions taken by various financial institutions have a profound impact on how money operates

within the economy. Considering both sociocultural factors along with regulatory frameworks when analyzing economic activity at large scale or even examining specific sectors like finance helps us understand how these elements interact to shape behavior patterns (Scheiring, 2016).

While there may be limited sources specifically discussing embeddedness in relation to the financial industry, scholars have acknowledged its significance in comprehending how this sector functions within broader social, political, and cultural contexts. (Beckert, 2016)

To better understand the embeddedness of the financial industry, it is essential to analyze the political and regulatory landscape in which it operates. Therefore, the goal of my thesis is to analyze how the Sustainable Finance Disclosure Regulation (SFDR) can contribute to embedding the financial industry. This regulation aims to incorporate environmental, social, and governance considerations into financial practices. By examining the SFDR and its impact on the financial industry, we can gain insights into how social and environmental concerns are becoming more embedded in financial practices. (Machado, 2011)

1.7 Critics of Polanyi’s concept of Embeddedness

Polanyi’s work was interpreted on many occasions and received both praise and criticism from scholars. For example, some critics argue that Polanyi's concept of embeddedness is too broad and does not provide clear criteria for distinguishing between embedded and non-embedded markets. These critics argue that viewing embeddedness as a variable undermines its analytical usefulness and may lead to arbitrary distinctions between different markets because in an attempt to measure embeddedness in a standardized way it might not accurately capture the unique and context-specific aspects of each market. However, despite these criticisms, Polanyi's concept of embeddedness remains a valuable framework for understanding the interconnectedness of the financial industry with broader social and political contexts (Gemici, 2008).

2. SFDR Directive explained

Sustainable investing has gained significant traction in recent years as investors increasingly prioritize environmental, social, and governance factors when making investment decisions. In response to this growing demand for sustainable investments, the European Union has introduced the Sustainable Finance Disclosure Regulation. This regulatory framework aims to enhance transparency in the financial sector by requiring financial market participants and advisers to disclose information about their ESG practices. The SFDR is part of a broader EU sustainability policy framework that includes other key regulations such as the Taxonomy Regulation (Chiu, 2022).

In the next Section of my thesis, I will provide a comprehensive and detailed overview and analysis of the SFDR, including its objectives, requirements, and implications for financial

market participants and elaborate further the implication of ESG factors and the connection to the Taxonomy Regulation.

2.1 The concept of ESG criteria

Since the SFDR directive is about disclosing on ESG factors, it is important to understand what ESG factors encompass. In recent years, there has been a growing recognition among both investors and companies of the significance of incorporating sustainability factors into their decision-making processes. This awareness has resulted in increased attention towards ESG criteria, which stands for Environmental, Social, and Governance criteria. The development and widespread adoption of these criteria can be attributed to organizations like the Global Reporting Initiative seeking to establish standardized sustainability metrics. By employing ESG criteria as part of their assessment process, stakeholders gain insight into a company's performance with regards to environmental impact, social responsibility practices, and corporate governance standards (Kwak et al., 2022).

2.1.1 Environmental pillar

The E in ESG, which stands for Environmental, focuses on various aspects of a company's impact on the environment. This includes evaluating factors such as carbon footprint, resource consumption, waste management strategies, and support for renewable energy sources. Adopting proactive measures to minimize negative environmental effects and promote sustainable practices is of utmost importance for companies that aim to align their operations with ESG principles (Bengo et al., 2022).

This emphasis on the environment reflects growing recognition within corporate circles about the urgent need to address pressing environmental issues like climate change. By integrating environmentally responsible practices into their operations, companies can demonstrate their commitment towards mitigating potentially harmful impacts and contribute towards achieving larger sustainability goals (Billio et al., 2021)

2.1.2 Social Pillar

The social component, represented by the S in ESG, comprises a range of factors that assess a company's impact on society and its stakeholders. This includes areas like employee welfare, labor practices, community engagement, diversity and inclusion efforts, as well as human rights considerations. Prioritizing social responsibility involves investing in the well-being of employees, promoting fair labor practices across the organization, engaging with local communities and actively fostering diversity and inclusivity within corporate culture. Companies that adopt these measures are more likely to establish positive reputations while also maintaining strong relationships with their stakeholders such as employees, customers, and residential environments they operate within (Billio et al., 2021).

2.1.3 Governance Pillar

In addition to the environmental and social aspects, the governance component of ESG is a crucial factor in assessing a company's overall performance. Governance refers to the systems and structures that guide a company's operations, including various factors such as board composition, executive compensation, risk management practices, transparency in financial reporting, and decision-making processes. By adopting strong governance principles, companies can ensure ethical conduct and transparent operations that prioritize the interests of their stakeholders. Effective governance practices enable companies to establish robust oversight mechanisms while minimizing potential conflicts of interest. It also enhances accountability within organizations by fostering an environment where responsible decision-making is encouraged. Embracing good governance standards not only benefits individual firms but also contributes towards building trust among investors and other stakeholders (Billio et al., 2021).

3. Understanding the SFDR Directive: An Overview

The Sustainable Finance Disclosure Regulation is a policy initiative introduced by the European Union to foster sustainability within the financial sector. It aims to enhance transparency and disclosure obligations related to environmental, social, and governance factors in financial products and services. The SFDR mandates that asset managers and investment funds define their strategic approach towards sustainability while also disclosing information about how they integrate ESG risks into their investment decision-making processes. Additionally, it requires these entities to provide clear information regarding the extent to which ESG factors are considered when designing their financial products (Malecki, 2022).

Moreover, one of the key objectives of the SFDR is to offer investors reliable and comparable data on the sustainable attributes of different financial offerings. By implementing this regulation, EU intends not only promote responsible investing but also combat misleading practices such as greenwashing or impact washing (Bengo et al., 2022).

3.1 Greenwashing and impact washing

Greenwashing and impact washing are two misleading practices prevalent in the financial market that the SFDR aims to address. Greenwashing refers to the deceptive practice of presenting an investment or financial product as environmentally friendly or sustainable without having substantial evidence to support such claims. This misleading practice can lead investors to make decisions based on false or incomplete information, ultimately undermining the goal of promoting sustainable finance (Cremasco & Boni, 2022).

Impact washing, on the other hand, refers to the misleading practice of highlighting positive social or environmental impacts without concrete evidence or proper measurement. These

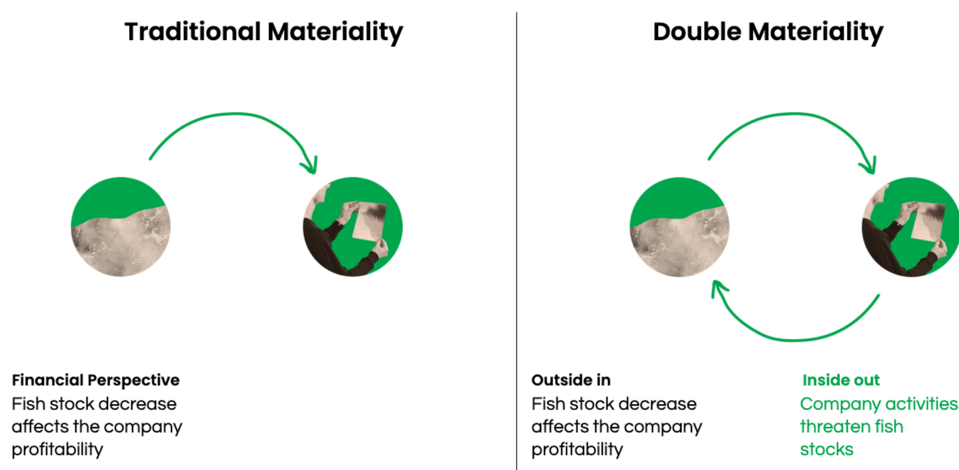
practices are detrimental as they create a false perception of sustainability and mislead investors into believing that their investments align with their values and contribute to positive societal change, when in reality, they may not have any significant impact (Putri et al., 2021).

The SFDR aims to tackle these deceptive practices by requiring financial actors to provide accurate and transparent information about the sustainability characteristics of their products, allowing investors to make informed decisions based on reliable data (Busch, 2023).

3.2 The concept of double materiality

The concept of double materiality is central to the SFDR, in simple terms it involves expanding the scope of information that is "material" or important beyond just financial performance. The SFDR incorporates the double materiality principle by requiring firms to disclose how they manage sustainability risks that have an impact on their financial performance, as well as how their investment decisions impact on sustainability factors and therefore the global community (Cremasco & Boni, 2022).

Figure 1: Traditional Materiality vs. Double Materiality



Source : What Is Double Materiality & How Does It Fit In With CSRD Requirements? (nexioprojects.com)

This means that financial market participants must take into account the potential negative impacts that their investment decisions may have on sustainability factors such as climate change, biodiversity loss, human rights violations, social inequality, etc. Furthermore, financial market participants must also consider the potential positive impacts that their investment decisions may have on these sustainability factors (Cremasco & Boni, 2022).

3.2.1 Benefits of Double Materiality

Adopting the concept of double materiality in sustainability reporting offers several benefits to financial market participants. Firstly, it provides a comprehensive and holistic approach to assessing and managing sustainability risks and impacts. By considering both the negative and

positive impacts of investment decisions, financial market participants can effectively address potential risks and seize opportunities for creating positive change (Chiu, 2022).

Secondly, the incorporation of double materiality strengthens the alignment between financial and sustainability considerations. Traditionally, financial performance has been the primary focus for investors and market participants. However, by expanding the materiality assessment to encompass sustainability factors, the significance of non-financial aspects is recognized and integrated into decision-making processes (Chiu, 2022).

3.2.2 Challenges of double materiality

Despite the benefits that the concept of double materiality brings, it also presents several challenges that need to be addressed. One of the challenges is the poor disclosure of the process of determining material sustainability issues. Organizations may not fully disclose how they determine what sustainability issues are material, which reduces transparency and hinders stakeholders' ability to assess the accuracy and relevance of the disclosed information (Adams et al., 2021).

Another challenge is the variation in the approach used by organizations to apply the concept of materiality. Different organizations may have different interpretations of what constitutes material sustainability issues, leading to inconsistencies in reporting and decision-making processes. Furthermore, stakeholder engagement might be used to manage risks by reducing the materiality attached to reporting information rather than genuinely enhancing transparency and accountability (Adams et al., 2021).

Additionally, organizations often lack the necessary skills to effectively apply materiality to the sustainability reporting process. They may not have the expertise or resources to conduct thorough assessments and determine the significance of different sustainability issues. This can result in a lack of rigor and accuracy in identifying material issues and may prioritize financially material issues over non-financial ones that are equally important for sustainable development. Finally, the lack of disclosure of the process of determining material issues reduces the perceived credibility of sustainability reports (Adams et al., 2021).

4. Defining the SFDR Directive

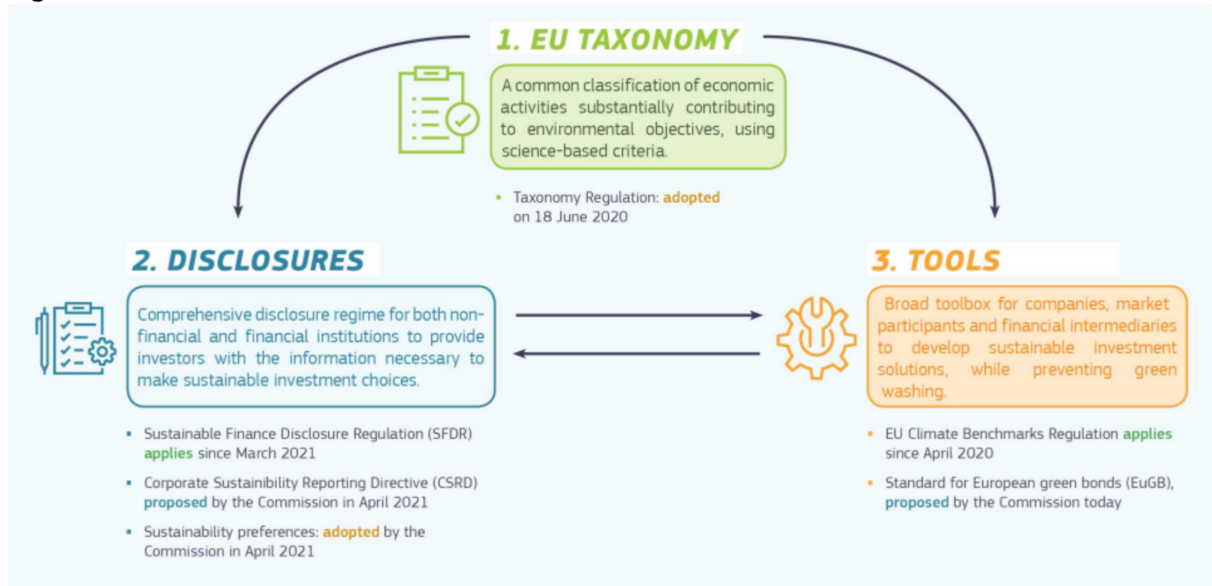
4.1 Definition

The SFDR is an EU regulation that aims to harmonize sustainability-related disclosures across financial markets. The main goal is to provide transparent sustainability-related information to investors and consumers. It seeks to create uniform rules and regulations across Member States, financial products, and distribution channels to make it easier to compare different financial products, create an even playing field, and remove barriers in the internal market

(Busch, 2023).

The SFDR is part of the EU's broader Sustainable Finance Action Plan, which aims to shift capital towards more sustainable investments and promote the integration of environmental, social, and governance factors into investment decisions and the SFDR works in conjunction with the EU Taxonomy for sustainable activities (Busch, 2023).

Figure 2: The foundations of the EU Sustainable Finance Framework



Source: Andreas-Rajchl-EU-Commission.pdf (worldbank.org))

Key components of the broader Sustainable Finance Action Plan include (Malecki, 2022):

1. EU Taxonomy Regulation (2020/852): This defines a framework that categorizes and labels certain economic activities as environmentally sustainable, to aid investors in directing investments towards more sustainable technologies and businesses.

2. Integration of sustainability risks and factors into MiFID II: This requires financial advisors to explicitly consider sustainability preferences when providing advice to their clients.

3. Integration of sustainability into the UCITS Directive and AIFMD: This forms the basis of a regulatory framework for fund managers to integrate ESG factors into their operations and disclosures.

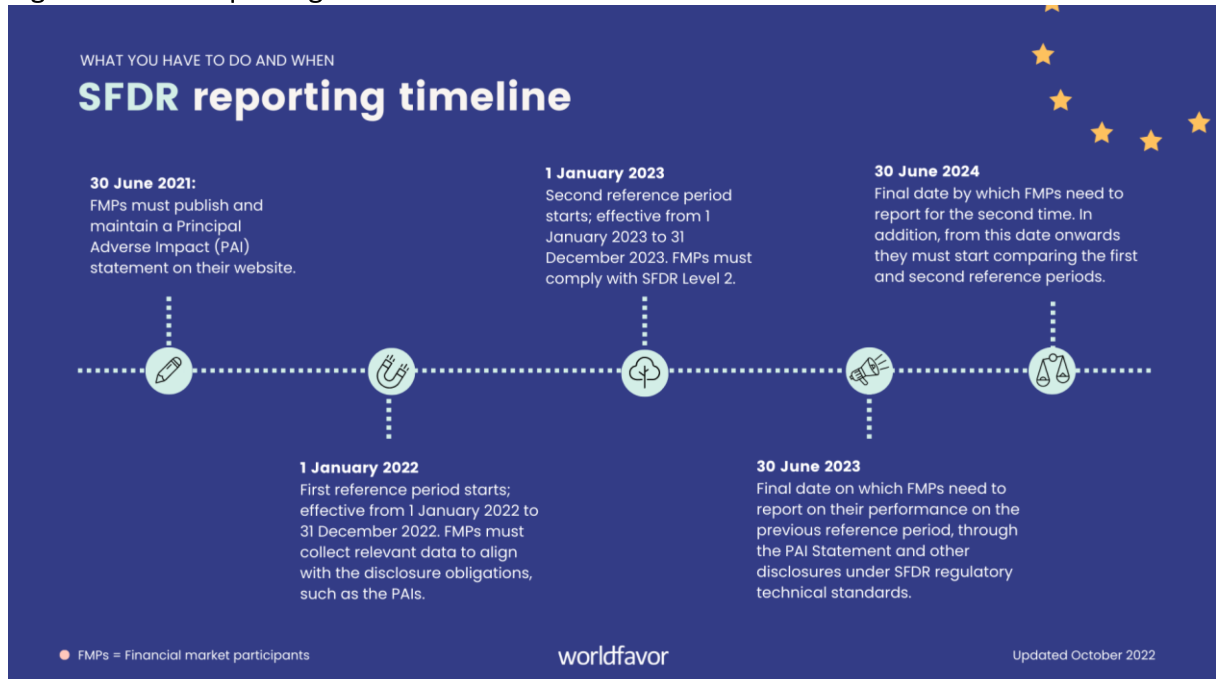
4. Amendments to non-binding guidelines on non-financial reporting: The amendments update the guidelines to specifically integrate the disclosure of climatic impact and related risks.

These measures collectively aim to transform Europe's financial system, encouraging sustainable investments and reducing the flow of capital into unsustainable sectors.

4.2 Timeline

The implementation of the SFDR started in 2021:

Figure 3: SFDR reporting timeline:



Source: [SFDR reporting timeline: what you have to disclose and when (worldfavor.com)]

4.3 Objectives

4.3.1 Objective 1: Increase Transparency

The Sustainable Finance Disclosure Regulation is designed to promote transparency in financial markets. It requires financial market participants and advisors to disclose information about their sustainability policies, the integration of sustainability risks into investment decision-making processes, and the consideration of adverse sustainability impacts on investments. This includes providing clear and understandable information on how sustainability is incorporated into investment strategies, as well as highlighting any potential negative effects that investment decisions may have on sustainability factors. Moreover, financial products are required to specify any specific environmental or social characteristics they aim to promote (Malecki, 2022).

4.3.2 Objective 2: Facilitate comparability

The Sustainable Finance Disclosure Regulation plays a vital role in enhancing transparency and comparability among various financial products. By implementing standardized disclosure requirements and methodologies, the SFDR aims to simplify the process of evaluating different investment options for investors and consumers. Financial market participants are now obligated to disclose specific details concerning their sustainability objectives, policies, and strategies. This means that they must provide comprehensive information on how they

measure and evaluate sustainability risks inherent in their investments. Additionally, these entities need to demonstrate the extent to which sustainable factors influence their decision-making processes when it comes to investing. Overall, this regulation allows stakeholders- including both investors and consumers- greater visibility into how financial products align with sustainable objectives by providing clear guidelines regarding what information should be made available (Busch, 2023).

4.3.3 Objective 3: Ensure consistency, adherence and compliance

The Sustainable Finance Disclosure Regulation was introduced by the EU with the aim of establishing a consistent and harmonized framework for sustainability disclosures across the European Union. One way in which this is accomplished is through providing clear definitions of key terms, ensuring that there is a common understanding among financial market participants. In addition to this, SFDR also outlines criteria for determining whether an investment can be considered environmentally sustainable. By doing so, it offers guidelines on how to assess sustainability risks when making investment decisions (Malecki, 2022).

Moreover, one of the objectives of SFDR is to foster sustainable investments and contribute to broader sustainability goals set by the EU. This means that financial companies and agents are required to integrate sustainability risks and principal adverse impacts into their decision-making processes when offering advice or making investments themselves. Furthermore, under SFDR's regulations, financial market participants must regularly update published information regarding their activities in order to remain transparent and accountable. Any changes made should be clearly explained and not contradict previously published information under SFDR's requirements (Busch, 2023).

4.3.4 Objective 4: Sustainable Financial Investments

Another important aim of the SFDR is to encourage sustainable financial investments. In order to achieve this, the regulation mandates that information regarding how the sustainable investment objective aligns with a selected benchmark index must be disclosed for financial products. If a benchmark index has not been chosen, then an explanation detailing how this objective will be achieved becomes necessary. This requirement ensures transparency and clarity surrounding sustainability goals and enables investors to assess whether their investment decisions are in line with their desired environmental or social outcomes (Malecki, 2022).

4.4 Scope of the SFDR

The SFDR is applicable to financial institutions that act as financial market participants, including banks and investment companies that manage portfolios, insurers, insurance intermediaries, asset managers, institutions for occupational retirement provision (IORP), manufacturers of pension products, providers of pan-European personal pension products

(PEPP), managers of qualifying venture capital funds that are registered in accordance with Article 14 of Regulation (EU) No 345/2013, and managers of qualifying venture capital funds that are not registered under Regulation (EU) No 345/2013. The rule also applies to financial institutions working in the capacity of financial advisors, such as banks, asset management companies, and investment firms that offer investment advice as well as insurers and insurance intermediaries who offer insurance advice (ING, 2023).

The following financial products are subject to the rules (ING, 2023):

- Portfolio management at the discretion of financial institutions or investment firms
- Investment funds such as alternative investment funds (AIFs) and UCITs
- Investment products based on insurance (IBIPs)
- Pension products including pension schemes and pan-European personal pension products (PEPP)

5. Detailed Examination of the SFDR Directive

5.1 Functionalities

The SFDR directive introduces several key functionalities to promote sustainable finance and enhance transparency in the market. Firstly, it establishes a framework for the disclosure of sustainability-related information by financial market participants. This includes information regarding how environmental, social, and governance factors are integrated into their investment decision-making processes. Financial market participants are required to disclose their strategies and policies for integrating sustainability risks into their investment decisions, as well as the measures they take to ensure adverse sustainability impacts are identified, managed, and prevented. In addition, the SFDR mandates that financial market participants disclose specific information about the sustainability of their products (Busch, 2023).

This includes information on the sustainability objectives of their products, the extent to which these objectives are met, and any adverse impacts associated with their investments. Financial market participants are also required to disclose how they take into account sustainability factors and if they consider the principal adverse impacts on sustainability factors within their investment or insurance advice (Busch, 2023).

5.1.1 Annex I: Template principal adverse sustainability impacts statement: Principle Adverse Impacts

Principle adverse impacts refer to the negative effects that an investment may have on sustainability factors such as climate change, pollution, human rights violations, and labor standards. Under the SFDR directive, financial market participants are required to assess and disclose the principal adverse impacts on sustainability factors that their investments may

have (Busch, 2023).

They must consider factors such as carbon emissions, resource depletion, biodiversity loss, and social inequalities. This assessment should cover both the investments held in their portfolios and the investee companies or projects they support. Financial market participants should evaluate the potential adverse impacts of their investments throughout the investment lifecycle, from selection and acquisition to management and divestment. Financial market participants must also disclose the methodologies and data sources used to assess these impacts (Cremasco & Boni, 2022).

5.1.2 Annex I

Annex I of the SFDR Directive provides a template for financial market participants to use when disclosing information about the principal adverse sustainability impacts of their investment products. The template includes several key elements that financial market participants must address in their disclosure statements. The Annex became mandatory to disclose on as of 30th June 2023. In total there are four key sections in the Annex I template (Busch, 2023):

1. Adverse sustainability indicators: Financial market participants are required to identify and disclose specific adverse sustainability indicators that are relevant to their investments. These indicators may include metrics related to greenhouse gas emissions, energy consumption, water usage, waste generation, social inequality, labor practices, human rights violations, and corruption.

2. Measurement and disclosure of principal adverse impacts: Financial market participants must provide information on the measurement and disclosure of principal adverse impacts on sustainability factors.

This includes the methodology used to calculate these impacts, the data sources relied on, and any limitations or challenges encountered in obtaining this information.

3. Explanation and rationale: Financial market participants must provide a detailed explanation and rationale for the identified principal adverse impacts on sustainability factors.

This includes an analysis of the underlying drivers and causes of these impacts, as well as any efforts or initiatives undertaken to mitigate or address them.

4. Actions taken and planned: Financial market participants are required to disclose the actions they have taken or plan to take in response to the identified principal adverse impacts on sustainability factors. These actions may include changes to investment strategies, engagement with investee companies to address sustainability issues, or collaborations with stakeholders and industry groups to drive positive change and improve sustainability performance.

There are 18 mandatory PAI's which include:

- GHG emissions (Scope 1,2, and 3, and total GHG emissions)
- Carbon
- GHG intensity of investee companies
- Share of investment in companies active in the fossil fuel sector
- Share on non-renewable energy consumption and production
- Energy consumption intensity per high-impact climate sector
- Activities negatively affecting biodiversity - sensitive areas
- Emissions to water
- Hazardous waste ratio
- Violations of UN Global Compact principles and Organizations for Economic Cooperation and Development (OECD) guidelines for multinational enterprises
- Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact Principles and OECD Guidelines for Multinational Enterprises
- Unadjusted general pay gap
- Board gender diversity
- Exposure to controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons)

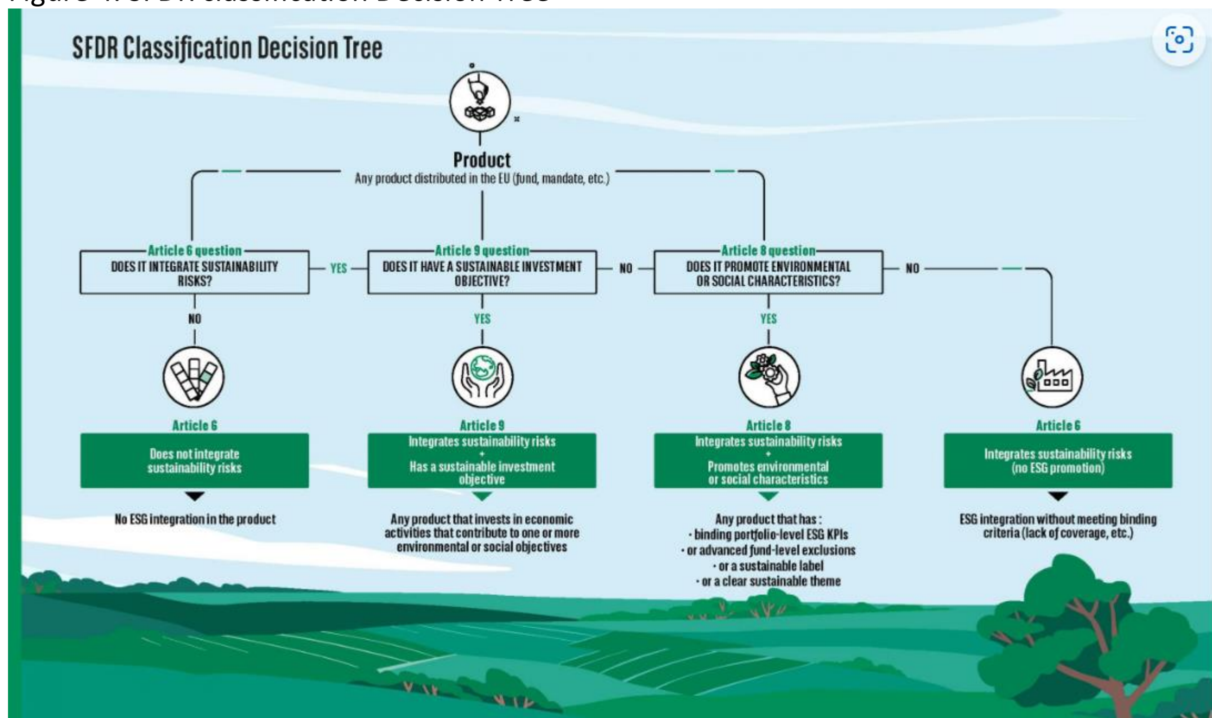
In addition to those mandatory PAIs, financial market participants are also obliged to report on at least 1 of additional non-mandatory PAI's.

5.2 SFDR Classification

The SFDR directive introduces a classification system that categorizes financial products into three main categories: Article 6, Article 8, and Article 9 products.

This classification system is based on the level of sustainability ambition and the extent to which the financial products promote environmental or social characteristics captured in the comprehensive illustration:

Figure 4: SFDR classification Decision Tree



Source: [Sustainable Finance Disclosure Regulation - BNPP AM Greece private investor (bnpparibas-am.com)]

5.2.1 Article 6 products

For financial products categorized as Article 6 products, the pre-contractual disclosure must include a clear statement indicating that the investments underlying the product do not take into account the EU criteria for environmentally sustainable economic activities. This means that these products do not prioritize or consider sustainability factors in their investment decisions (Chiu, 2022).

This lack of consideration for sustainability criteria makes these products less aligned with the goals of promoting sustainable development and mitigating environmental and social risks. In order for these financial products to be deemed relevant and credible, the pre-contractual disclosures must provide a clear and concise explanation of why sustainability risks are not taken into account and the reasons for this approach (Busch, 2023).

5.2.2 Article 8 products (light green)

On the other hand, financial products categorized as Article 8 products are those that promote environmental or social characteristics. These characteristics could include investments in renewable energy projects, companies with strong corporate governance practices, or those that demonstrate a commitment to social responsibility. Financial market participants offering Article 8 products are required to provide pre-contractual disclosures that not only state the environmental or social characteristics being promoted but also explain how the investments underlying the product contribute to these characteristics (Busch, 2023).

Furthermore, market participants must disclose the percentage of the financial product's assets that are allocated to sustainability-related investments. This disclosure provides investors with transparency regarding the extent to which their investment aligns with sustainability objectives and the EU Taxonomy (Chiu, 2022).

In addition to the pre-contractual disclosures, financial market participants offering Article 8 products are also required to publish and maintain on their websites a description of the environmental or social characteristics and the sustainable investment objective of the product. This description should include information on the methodologies used to measure and assess the environmental or social characteristics, as well as any third-party verification or certification obtained (Busch, 2023).

5.2.3 Article 9 products (dark green)

Financial products classified as Article 9 products have an even higher level of sustainability ambition and are intended to have a substantial positive impact on the environment or society. These products must not only promote environmental or social characteristics but also contribute to the achievement of a specific sustainable objective that stands out from traditional market objectives. For Article 9 products, financial market participants are required to provide even more detailed information to investors. This includes a comprehensive description of the specific environmental objectives to which the investments underlying the financial product contribute. Financial market participants offering Article 9 products must also provide a description of how and to what extent the investments underlying the product are in economic activities that qualify as environmentally sustainable (Busch, 2023).

This description should specify the proportion of investments in environmentally sustainable economic activities, including details on the proportions of enabling and transitional activities, as a percentage of all investments selected for the financial product. Moreover, financial market participants are also required to provide information on the methodologies used to assess, measure, and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the Article 9 product. This information should, like the information for Article 8, include details on any third-party verification or certification

obtained for these investments (Busch, 2023).

5.3 Annex II - Annex IV

Annex II - Annex VI are templates for the pre-contractual disclosure for the financial products referred to in Article 6, 8 and 9. The pre-contractual disclosure requirements outlined in Annex II - Annex VI of the SFDR directive aim to provide clear and standardized information to investors regarding the sustainability characteristics and potential impacts of financial products. This includes information on how environmental, social, and governance factors are integrated into investment decisions, the sustainability objectives of the financial product, and any adverse impacts of the investment decisions on sustainability factors (Busch, 2023).

The templates answer to questions about (EU, 2022):

- The objective of a product
- If environmental/social characteristics promoted were met
- How the product considers PAIs
- What the top investments of the financial product are (Amount, sector, %Assets, Country),
- What the asset allocation of sustainability-related investments is
- To what extent the sustainable investments are aligned with the EU Taxonomy and what the share of sustainable investments not aligned with EU Taxonomy is
- What the share of socially sustainable investments is
- Actions taken to meet environmental/social objectives
- The performance of the product compared to the reference benchmark

6. The SFDR and Taxonomy: establishing the connection

6.1 What is Taxonomy?

To understand the connection between the SFDR and Taxonomy, it is essential to have a comprehensive understanding of what Taxonomy is and how it relates to sustainable finance.

In this context, the concept of taxonomy refers to a system or structure for classifying economic activities based on their level of environmental sustainability. The European Union Taxonomy Regulation, which was implemented in 2020, provides a framework for assessing the environmental sustainability of various economic activities. This regulation identifies six key environmental objectives that serve as criteria for determining whether an activity is considered environmentally sustainable (Chiu, 2022).

These objectives include mitigating climate change by reducing greenhouse gas emissions and adapting to its impacts, promoting sustainable use and protection of water resources and

marine ecosystems, transitioning towards a circular economy model that promotes resource efficiency and waste reduction, preventing pollution through effective measures, as well as protecting biodiversity and restoring ecosystems (Bengo et al., 2022).

The Taxonomy Regulation classifies an economic activity as "environmentally sustainable" if (Breyer et al., 2020):

1. It makes a significant contribution to one or more of the environmental objectives mentioned above.
2. It does not significantly harm any of the other environmental objectives and avoids adverse environmental impacts.
3. It complies with minimum social safeguards and avoids social adverse impacts. Those minimum safeguards set out in the Regulation.
4. It meets the technical screening requirements established by the Technical Expert Group in the form of delegated actions, effective as of January 1, 2022 for climate-related objectives, and as of January 1, 2023 for other environmental objectives.

6.2 Connection between SFDR and Taxonomy

The SFDR directive and the Taxonomy regulation are closely interconnected as they both aim to promote sustainability and transparency in the financial sector.

The taxonomy regulation lays out a framework to determine whether an economic activity is environmentally sustainable, while the SFDR directive establishes disclosure requirements for financial market participants regarding the environmental and social characteristics of their financial products. This connection between the SFDR and Taxonomy is crucial in ensuring transparency and consistency in sustainable finance (Bengo et al., 2022).

In the context of the SFDR, Taxonomy plays a crucial role in providing a classification system for defining and identifying environmentally sustainable economic activities. Thus, it forms a precise basis against which a firm's activities can be evaluated and reported within Annex I of the SFDR, which pertains to the Principle Adverse Impact indicators (Busch, 2023).

As follows, Taxonomy is a fundamental instrument used in the SFDR annexes to ensure consistency, clarity, and transparency in sustainability disclosures. Entities subjecting to SFDR need to explain how, and to what extent, Taxonomy has been used for determining the sustainability of the investments, especially when making claims in accordance with Annex I and II of the SFDR (Claringboul, 2019).

6.2.1 Example of Application of Taxonomy in the SFDR Disclosure

In this scenario, a financial product's total investments are visualized using a graph and divided into four categories (EU, 2022):

1. "Sustainable" - Investments here align strictly with EU Taxonomy, focusing on activities with clear environmental or social objectives.

2. "Taxonomy-aligned Other Environmental/Social" (E/S) - Investments that may not be fully sustainable, but still adhere to E or S characteristics promoted by the financial product. They do not contradict the criteria of the EU Taxonomy.

3. "Taxonomy-aligned: Fossil gas" and "Taxonomy-aligned: Nuclear" - These represent investments in fossil gas and nuclear energy. These investments are classified as Taxonomy-aligned only if they satisfy specific criteria that prevent them from significantly harming any of the EU Taxonomy's objectives.

4. "Non-Taxonomy aligned"– These are investments which do not qualify as sustainable, in that they do not align with the EU Taxonomy's objectives.

Through these categorizations and visual representations, stakeholders can assess the environmental and social alignments of a financial product's investments in line with the EU Taxonomy's sustainability objectives.

7. Conclusion Part I: SFDR and Embeddedness

In conclusion, the concept of embeddedness is crucial for understanding the functioning of financial markets and their relationship with society.

Embeddedness emphasizes the social and cultural aspects that shape economic actions and the value attributed to goods and services. This understanding challenges the traditional economic model of action that is purely based on self-interest and rationality. By recognizing that economic activities are influenced by social factors, embeddedness provides a more realistic and comprehensive framework for analyzing financial markets. Moreover, the introduction of the Sustainable Finance Disclosure Regulation enhances the embedding of financial markets by incorporating environmental, social, and governance factors into investment decisions.

The SFDR promotes the integration of sustainability considerations into the financial sector and encourages market participants to offer transparent and reliable information to investors. This regulation helps to align financial markets with societal values and promotes responsible investment practices. By requiring financial market participants to disclose their sustainability strategies and risk management processes, the SFDR enhances transparency and accountability. It also enables investors to make informed decisions based on their values and preferences, ensuring that their investments contribute to sustainable development goals.

Overall, the SFDR could play a crucial role in embedding the financial market by promoting sustainability and transparency.

Moving forward, the next section of this thesis will delve into a qualitative study to explore the aspects of the SFDR that help embedding the financial markets but also aspects that could help if they are improved in the future.

Part 2: Qualitative Case Study

The first part of my thesis was dedicated to providing a comprehensive theoretical foundation for the study. This involved exploring relevant concepts and theories related to the concept of embeddedness, ESG and the SFDR. As mentioned in the literature review, there are few sources tying the concept of embeddedness and the financial industry. As a result, to effectively address my research question and make a meaningful contribution to the field of research and existing literature, the second part of my thesis is dedicated to help answer my research question of "How can the SFDR contribute to embedding the financial industry?".

8. Qualitative methodology

After consideration, I have determined that utilizing a qualitative research methodology would be the most appropriate course of action.

Qualitative methodology is a research approach that emphasizes understanding and interpreting social phenomena from the perspective of individuals or groups involved (Kahlke, 2014). It is a technique that allows researchers to gather in-depth and rich data that captures the complexity and nuances of human experiences, perspectives, and behaviors (Jamshed, 2014).

This approach is especially valuable when exploring subjective topics or phenomena where the focus is on understanding the "why" and "how" rather than establishing quantitative measures or generalizability (Kahlke, 2014). In the context of my study, qualitative methodology provided me with the flexibility to examine the perspectives, experiences, and practices of SFDR auditors.

9. Data collection: semi-structured interviews

Semi-structured interviews are widely recognized as a flexible and versatile method of data collection, making them an ideal choice for researchers in both individual and group settings. They provide an opportunity for an improvised and dynamic dialogue between the interviewer and participant, facilitating a reciprocal relationship where the interview can respond to unique responses with tailored follow-up questions. Moreover, this approach allows participants to express themselves using their own words, encouraging detailed and authentic responses. The structured nature of these interviews ensures that similar types of information are gathered from each participant which enables better comparative analysis (Kallio et al., 2016).

My interviews aimed to gather relevant insights and perspectives from colleagues at EY who have prior experience reviewing SFDR disclosures. A total of six interviews were conducted, which proved sufficient for reaching data saturation. Data saturation refers to the point where additional interviews no longer bring forth any new information or themes that contribute to further understanding of the research topic. Hence, it was determined that additional

interviews beyond this point would not yield significant additional insights.

10. Participant selection

In order to obtain comprehensive insights on how the SFDR contributes to embed the financial industry, I conducted interviews with a total of six participants who possess significant expertise and experience related to SFDR reviews and ESG consulting. To gather valuable perspectives, four individuals from the Climate Change and Sustainability Services (CCaSS) department were interviewed. Additionally, two colleagues from my own team of Banking and Capital Markets Consulting participated in these interviews, as they are highly specialized in ESG consulting services that encompass SFDR disclosure assessments.

Table 1: Participant Selection

Interview	Role	Date	Duration	# of pages transcribed
Sixtine Duroyon	Intern in CCaSS	02/06/23	18:03 min	8
Maëlys Dubé	Senior in Consulting	26/06/23	27:34 min	11
Chiara Foti	Junior in Consulting	16/06/23	24:20 min	9
Blanca Hidalgo	Senior in CCaSS	21/06/23	18:24 min	8
Anastasia Bego	Junior in CCaSS	02/06/23	31:41 min	13
Michelangelo Schenone	Senior in CCaSS	20/06/23	27:02 min	12

11. Interview Guide

In order to maintain a sense of coherence and organization during the interview process, I developed an interview guide. However, it is worth mentioning that this guide was deliberately kept brief, consisting only of three predetermined questions. This approach allowed for ample room to pose probing follow-up inquiries and ensured that the conversation unfolded naturally rather than being overly structured or rigid. The open-ended nature of these questions fostered a free-flowing exchange between me as the interviewer and the participants, permitting them to provide insightful and comprehensive responses.

12. Analysis of the Interviews: Gioia Coding method

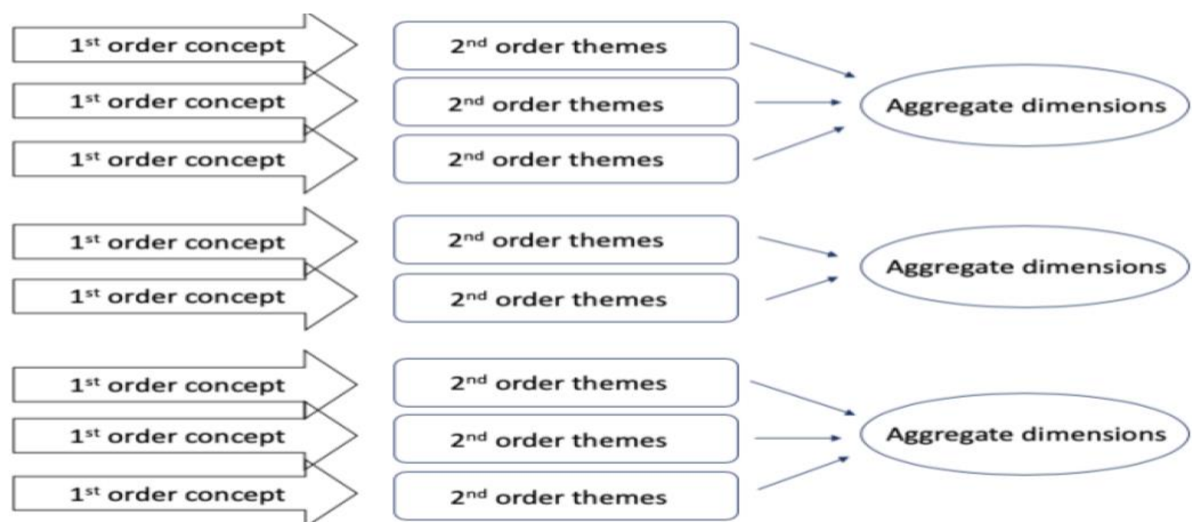
To effectively analyze the data collected during the interviews, I employed Gioia's 3-Level Coding method. This approach allowed for a comprehensive examination of the gathered information and facilitated identifying meaningful patterns and themes within the dataset. The application of this coding technique ensured that each piece of data was meticulously analyzed and categorized at multiple levels, enabling a deeper understanding of the research findings (Gioia et al., 2012).

In the first phase of analysis, emphasis is placed on identifying the primary concepts. This involves breaking down the raw data into smaller, more manageable fragments using interview transcripts and categorizing them based on their descriptive characteristics. These categories are known as first-order concepts and are articulated using the words and language used by participants themselves to maintain the integrity of data interpretation (Gioia et al., 2012).

The next phase of the analysis is the comparison and axial coding to identify similarities and dissimilarities among the first-order concepts. This methodical process serves the purpose of reducing the number of categories to a more concise collection while also enabling researchers to take a broader perspective and observe emergent patterns across all data points. This step facilitates the development of second-order themes, which are characterized by their higher level of abstraction and interpretive nature compared to the initial first-order concepts (Gioia et al., 2012).

In the next step, researchers focus on generating aggregate dimensions. These aggregate dimensions are overarching categories or themes that encompass and group together the second-order themes identified earlier. By identifying these broader umbrella categories, researchers gain a deeper understanding of the relationships among different concepts and themes within their data. This process of generating aggregate dimensions is crucial as it allows researchers to organize and structure their findings in a meaningful way. It helps to provide a comprehensive framework for analyzing and interpreting data by highlighting the main focal points or major aspects of the studied phenomenon. These aggregate dimensions serve as guiding principles for further analysis, allowing researchers to explore connections between various second-order codes and develop theoretical insights into the research topic (Gioia et al., 2012).

Figure 5 : Gioia Coding



Case Study

After conducting interviews and utilizing the 3-Level Gioia Coding method, I have identified five overarching positive factors and four negative factors related to the SFDR. Each of these aggregate factors consists of multiple components, which can be found in Annex 1 for more detailed coding information.

In the next section, I will provide a comprehensive analysis of each of these aggregate factors along with their corresponding subcomponents (2nd Level Coding). Following this analysis in the subsequent discussion section, I will assess whether these identified factors contribute to or detract from the overall embeddedness of the financial industry.

13. Positive Factors of SFDR

In total, I have identified 5 positive factors of the SFDR: Shift to more sustainability integration, shift to more accountability, increased awareness, changing strategies and processes, and rethinking governance.

13.1 Shift to more Sustainability Integration

The SFDR makes the financial market shift to more sustainability integration thanks to further availability and ESG integration.

13.1.1 More availability of sustainability

The increasing consumer demand for sustainable products has led to a surge in funds that are focused on investing in environmental and social (E/S) products, thereby creating a growing market for such offerings. In response to this demand, numerous Article 8 and Article 9 funds have emerged as financial instruments geared towards meeting customers' sustainability preferences (Duroyon, 2023).

Consequently, by aligning with these evolving customer expectations, funds are launching specialized investment options centered around ESG considerations. In fact, the SFDR plays a critical role in facilitating sustainable investments and the emergence of Article 8 and 9 funds, because the regulation provides clear guidelines about the structure of those funds (Bego, 2023).

The SFDR also serves as a catalyst for impact funds to further prioritize their objectives. Impact funds are already driven by the purpose of creating positive societal and environmental outcomes. However, the SFDR amplifies this motivation by emphasizing the importance and significance of their actions (Schenone, 2023).

13.1.2 ESG Integration

For a long time ESG reporting was not mandatory. With the advent of the SFDR, this is changing. FMPs now have to integrate ESG into their core systems (Bego, 2023) promoting the

integration of ESG indicators within these systems (Dubé, 2023).

13.2 Increased Accountability

Due to peer pressure reputation risks and thanks to more transparency, the SFDR promotes accountability of financial market participants.

13.2.1 Reputation and Peer Pressure

The implementation of the SFDR has resulted in a significant shift towards accountability and transparency among financial market participants. This is primarily due to the requirement for all market participants to disclose information on sustainability practices, creating comparability within the industry. As outlined by Foti (2023), this uniformity fosters a sense of responsibility as companies understand that their disclosures will be evaluated and compared with those of their peers. Consequently, there is increased pressure for businesses to enhance their sustainability efforts in order to maintain a positive reputation and uphold stakeholder trust.

In relation to Luxembourgish market specifically, leading players have shown a particular inclination towards embracing sustainable practices driven by reputational motivations (Bego, 2023).

13.2.2 Increased Transparency and avoiding greenwashing

One of the biggest goals of the SFDR is to address information asymmetry and promote transparency in the financial industry. According to my colleagues at EY, the SFDR has effectively been instrumental in enhancing transparency across the financial market (Dubé and Hidalgo, 2023).

One example is that initially, numerous Article 8 and Article 9 financial products were prevalent in the market. However, after the implementation of the regulation, a significant proportion of these products underwent a downgrade due to the requirement for funds to provide comprehensive disclosures regarding the specific attributes that qualified them as either Article 8 or Article 9 investments (Foti, 2023). This is an effective way to prevent greenwashing from happening and to protect customers from it (Duroyon, 2023).

13.3 Increased Awareness

The SFDR forces to think about the sustainability practices and their impact on the environment and society which increases awareness for ESG issues.

13.3.1 Change in Mentality

In order to foster a shift in mindset, it is essential to integrate the concept of sustainability into the daily routines of financial market participants. By doing so, they are compelled to consistently consider their impact on social and environmental aspects, adopt ESG strategies, and effectively manage risks. Ultimately, this continuous reflection can contribute to a transformative change in mentality within the industry. During the initial stages of such

transformation, voluntary actions alone may prove insufficient. Hence, regulations play a crucial role in expediting progress by acting as catalysts for change (Bego, 2023).

13.3.2Forced to think about ESG Strategy

As previously stated, the SFDR compels financial market participants to outline and implement ESG strategies and incorporate them into their fundamental operations. This directive presents a range of complex questions that require thorough examination and the creation of extensive datasets and calculations related to ESG factors, PAI's, and the EU Taxonomy (Bego, 2023).

13.4 Changing Strategies and Processes

To be compliant with SFDR, MFPs subsequently have to change strategies and processes.

13.4.1 Guidance

Another advantageous feature of the SFDR is that it offers financial market participants clear direction and assistance in developing an ESG strategy. It enhances transparency by providing additional details about the strategies employed by other players in the financial market, allowing for easy comparison between different participants. This not only facilitates comparability but also presents an opportunity for FMPs to gain valuable insights and guidance when formulating their own strategies. (Hidalgo, 2023)

13.4.2 Constantly updated templates

In the past year and a half, the European Union has made multiple revisions to the annex templates of the SFDR in order to adapt to new developments and maintain its relevance and effectiveness. Consequently, financial market participants are required to continually enhance their processes (Dubé, 2023). To assist with understanding these updated templates, the EU provides question-and-answer resources that address any queries raised by financial market participants (Schenone, 2023).

13.4.3 Giving Clarity

To promote understanding and facilitate the seamless adoption of the revised templates, the ESMA provides regular updates on how to interpret and implement the SFDR through a bi-monthly question-and-answer process. This initiative aims to assist financial market participants in effectively aligning their strategies and processes while ensuring transparency and clarity (Foti and Schenone, 2023).

13.5 Rethinking Governance

Another change brought about by the SFDR is the need to re-evaluate governance within financial market participants.

13.5.1 New organization

To implement and align to the SFDR, there is a need for financial market participants to establish new organizational structures to address the requirements and obligations set forth

by the regulation. This includes the establishment of dedicated sustainability teams or committees within the organization to oversee and manage the ESG-related aspects of the business (Dubé, 2023).

13.5.2 Shift in strategic decisions

The SFDR also urges financial market participants to reassess their strategic decision-making. They are required to integrate sustainability factors into their investment strategies and risk management frameworks, as well as assess the possible environmental and social consequences of their investments. In doing so, they should make informed choices that align with sustainable objectives and responsible investing principles (Dubé, 2023).

14. Negative Factors of SFDR

14.1 Changing processes

Even though changing processes is a positive factor of the SFDR, the lack of clear guidance on how to implement and comply with the regulation can pose challenges for financial market participants. Furthermore, sometimes being compliant and implementing the SFDR can lead to increased burdens for MFPs.

14.1.1 Lack of Guidance

As Foti (2023) stated in her interview, regulations can bring chaos and confusion in the beginning because it's new and nobody really knows how to implement it in the beginning.

Furthermore, it is important to note that there is a strong connection between SFDR and Taxonomy. Nevertheless, the development of Taxonomy is still ongoing and lacks precise and definitive instructions (Hidalgo, 2023).

14.1.2 Burden of reporting

According to Schenone (2023), when speaking with some of the Luxembourgish clients, it is apparent that they perceive the SFDR primarily as a compliance task they must fulfill, and therefore only put in minimal effort.

14.2 Data and Methodology Issues

The challenge around data and methodology is one of the biggest negative aspects of the SFDR.

14.2.1 Lack of Data

One of the most prominent difficulties encountered by financial market participants currently revolves around acquiring precise and dependable information regarding sustainability factors (Dubé, 2023).

This challenge exists on multiple levels, as they are required to collect such data internally within their own organizations. A significant issue arises when attempting to obtain accurate data from underlying funds, as they may not be able to provide it (Hidalgo, 2023).

Furthermore, obtaining pertinent information about companies in which they invest necessitates reliance on benchmarking entities like Sustainalytics or Refinitiv. However, there are instances where these external sources do not possess the required data yet for analysis and comparison purposes. Hence, procuring appropriate and reliable data poses a formidable task (Dubé et al. 2023).

14.2.2 Different calculation methods

Another challenge related to data and methodology is the inconsistent use of calculation methods for measuring sustainability factors. For example the methodology used by one FMP to calculate the carbon footprint of a portfolio may differ from another FMPs methodology, leading to inconsistencies and difficulties in comparing (Dubé, 2023)

14.3 Not enough Accountability

While the SFDR significantly enhances the level of accountability for financial market participants, there remains room for further improvement.

14.3.1 Not audited

A major limitation of the SFDR is its lack of being audited. This implies that while disclosures are reviewed and recommendations may be provided to clients, it ultimately falls upon them to decide how they will act on these suggestions from entities like EY. Consequently, there exists a scarcity of assurance and verification when it comes to ensuring the accuracy and reliability of the disclosed information. Although checks are conducted to determine compliance with regulatory requirements, there is no comprehensive audit process for scrutinizing the details underlying these disclosures (Duroyon et al, 2023).

14.3.2 Being scrutinized

Moreover, Hidalgo (2023) highlights that financial market participants in Luxembourg are cautious about revealing excessive information due to concerns of the potential consequences of making unrealistic commitments. As a result, they tend to opt for minimal levels of disclosure.

14.4 Market Mechanisms

Another limit to the SFDR are current market mechanisms that may hinder its effectiveness in achieving its goals.

14.4.1 No financial Materiality

In today's financial market, the primary focus of financial market participants remains on generating financial returns. However, the highest level of returns is not necessarily achieved through investments in environmental, social, and governance products (Dubé, 2023).

15. Discussion

As discussed in the preceding section of my thesis, I have outlined five favorable aspects of the SFDR. In this section, I will first establish why the financial sector is disembedded and then make connections between these positive factors and various features related to integration within the financial sector as explained in Part I. Primarily, one can argue that the SFDR enhances institutional integration within the financial market by implementing standardized guidelines and regulations across Member States and financial products. Nonetheless, it should be emphasized that its impact goes beyond mere institutional embeddedness.

15.1 Why is the financial sector disembedded?

The financial sector is disembedded for several reasons. Firstly, one reason for the disembedding of the financial sector is its separation from society. This separation is evident in the ways in which financial institutions operate independently from societal norms and values. This can be seen in the pursuit of profit maximization and the prioritization of shareholder interests over the well-being of society (Cremasco & Boni, 2022).

Moreover, the financial sector is also disembedded from the "real economy," which includes the production and distribution of goods and services. This disembedding is reflected in the fact that the financial sector often operates in a virtual world of transactions, disconnected from the concrete activities and tangible outcomes of economic production (Chiu, 2022).

The disembedding of the financial sector can also be attributed to the influence of globalization and neoliberalism. Globalization has allowed for the expansion of financial markets and the integration of economies on a global scale. This has led to the disembedding of financial relations from national programs of governance, as market forces and financial institutions exert more control over economic decision-making than the state (Beckert, 2007).

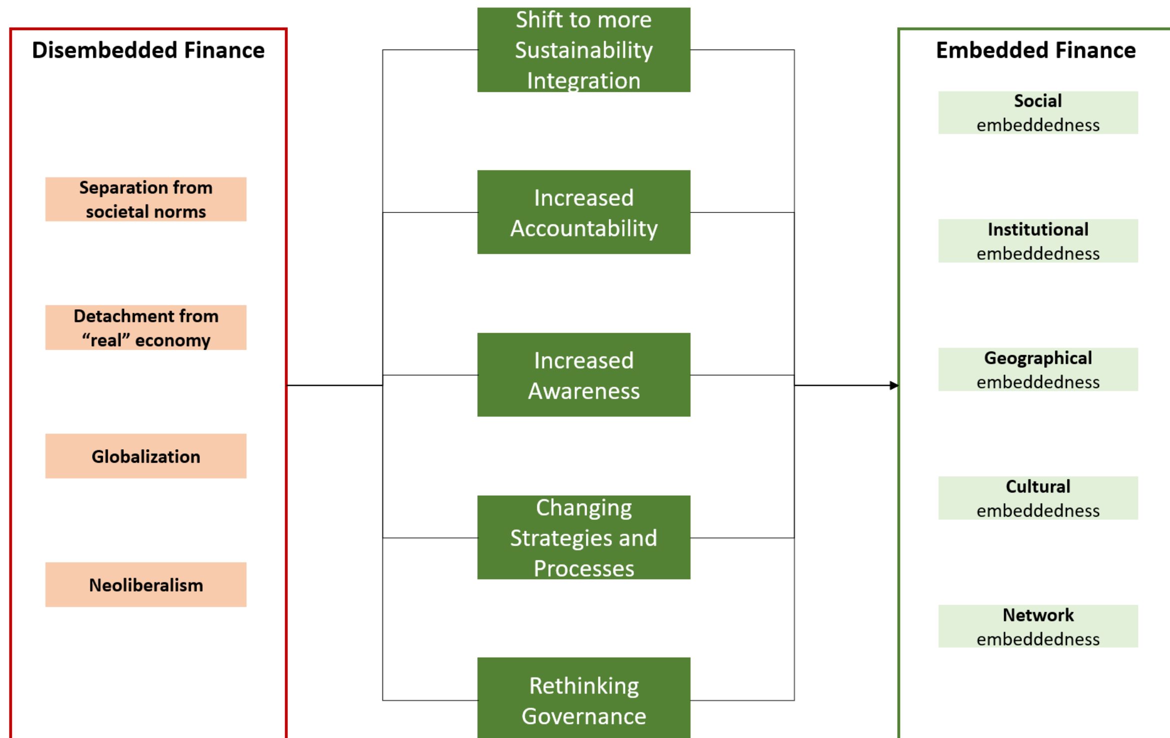
Furthermore, the rise of neoliberalism has contributed to the disembedding of the financial sector. Neoliberal policies, which emphasize deregulation and the shrinking role of the state in the economy, have allowed for the financial sector to operate with increased autonomy and reduced oversight from the state (Machado, 2011).

In summary, the financial sector is disembedded due to its separation from societal norms and values, its detachment from the "real economy," and the influence of globalization and neoliberalism in promoting financial autonomy and reducing state oversight. How does the SFDR positively impact embeddedness in the Financial Industry?

15.2 Discussing the positive factors of SFDR

The following figure shows a self-elaborated model of my analysis, where a disembedded finance becomes re-embedded through the positive factors of the SFDR.

Figure 5: Analysis Model



15.2.1 Shift to more Sustainability Integration

This factor can be linked to the characteristic of social embeddedness. Because of the higher demand from clients in sustainable products, numerous products centered around ESG considerations have emerged. The SFDR plays a critical role in facilitating sustainable investments for costumers by establishing clear definitions of sustainability factors and sustainable investment. This helps build trust and confidence among investors, promoting social embeddedness by aligning the interests of financial market participants with the expectations of their clients.

This factor can also be associated with cognitive embeddedness, as it requires the integration of ESG indicators into the core systems of financial market participants.

15.2.2 Increased Accountability

This element can be linked to network embeddedness. It should be noted that the implementation of standardized disclosure requirements not only significantly enhances transparency and prevents greenwashing, but it also facilitates easy comparison among various financial market participants by clients and competitors alike. Consequently, this intensifies the competition between market players, exerting pressure on them to achieve superior performance compared to their competitors.

15.2.3 Increased Awareness

This factor can be linked to cultural embeddedness. The SFDR enables a shift in mentality within the financial industry by obliging FMPs to adopt ESG strategies and address and mitigate their associated risks. Thanks to that, the SFDR creates new values and knowledge in the financial industry.

15.2.4 Changing Strategies and Processes

This element can be associated with institutional embeddedness. The SFDR has an impact on the structural elements within organizations by altering their strategies and processes, providing guidance and clear instructions for the development of an ESG strategy.

15.2.5 Rethinking Governance

This factor can also be linked to institutional embeddedness since the SFDR enforces new organizational structures and the reassessment of decision-making by integrating ESG factors and risk management practices.

16. Discussing the negative factors of SFDR

Even though the negative factors identified during my interviews are not the core of my research question, I find it important to discuss them for the following reasons:

- When looking at the negative factors that have emerged during my interviews, I notice that most are temporary. For instance, the implementation of the SFDR has resulted in some initial confusion and challenges for financial market participants in terms of understanding and complying with the new disclosure requirements. However, as market participants become more familiar with the regulations and adapt their processes, these challenges are expected to diminish over time.
- Another negative factor is the lack of data available and the different methodologies used. However, this is only due to the transitionary nature of the SFDR, wherein market participants are still in the process of aligning their reporting practices and methodologies with the new requirements. The EU will continue to provide more standardized methodologies like they already did in the last 18 months. Going forward, the data problem is expected to improve as market participants gain more experience in collecting and reporting ESG-related data and thanks to the emergence of the CSRD directive applicable to a large number of companies by 2024, the availability and quality of ESG data on firms they are investing in will be further enhanced.
- Another major limitation of the SFDR is that it is not audited to this date. However if this would change in the future, it would contribute tremendously to the embeddedness of the financial market since the information disclosed would be even more scrutinized.

17. Conclusion

This thesis has extensively examined the question of how SFDR can contribute to embedding

the financial industry. During my extensive literature review, it has become evident that the topic of the SFDR and its impact on the embeddedness of the financial industry has not received sufficient attention in previous studies. Hence, one of my primary objectives is to shed light on both potential positive and negative factors associated with the SFDR's influence.

By conducting interviews and utilizing a rigorous analytical method known as the 3-Level Gioia Coding, various positive and negative factors associated with the SFDR have been identified. These factors have elucidated how this regulatory framework influences embedding the financial industry.

One significant positive factor is observed in the shift towards more sustainability integration, which contributes to social embeddedness. This shift is driven by an increasing demand for sustainable products from clients, prompting numerous ESG-focused investment products to emerge in response. The SFDR plays a pivotal role in facilitating such investments by providing clear definitions of sustainability criteria and outlining principles for sustainable investing. Furthermore, it acts as a safeguard against greenwashing.

Moreover, an important aspect emphasized by those interviewed was that through heightened accountability enforced by SFDR guidelines and network embeddedness, market participants are compelled to adopt explicit ESG strategies while recognizing their associated risks. Not only does this foster increased awareness about environmental and social concerns among financial institutions but it also encourages them to develop appropriate risk management mechanisms accordingly.

Additionally, the implementation of SFDR has also significantly contributed to increased awareness within the financial industry. This can be attributed to various factors such as enhanced transparency and improved reporting requirements mandated by the regulation. By providing clear guidelines on sustainability factors, ESG integration, and sustainable investments, SFDR has successfully raised awareness among investors about their impact on environmental and social issues, strengthening the cultural embeddedness. As a result, more stakeholders are now proactively seeking out information regarding sustainable investment opportunities.

Furthermore, the SFDR serves as a catalyst for changing strategies and processes within the financial industry. For instance, companies are compelled to integrate sustainability factors into their decision-making processes and investment strategies. Everchanging processes and strategies are linked to institutional embeddedness. This integration not only enhances the overall sustainability performance of financial institutions but also promotes responsible investment practices.

Additionally, the SFDR prompts a rethinking of governance structures within the financial industry. Financial institutions are required to establish effective governance frameworks to ensure appropriate oversight and integration of sustainability factors. This brings more structure into organizations and is seen as contributing to institutional embeddedness.

Alongside these positive factors, I have also identified several negative factors related to the SFDR. These negative factors include: Changing processes, data and methodology issues, not enough accountability and market mechanisms. However, most of these negative factors can be easily addressed and mitigated by the EU in the near future.

From my analysis, it is evident that the SFDR has made significant strides in embedding the financial industry. While certain challenges still persist, this regulation marks a significant step forward in advancing sustainability integration and accountability within the financial sector. I am optimistic that in the coming years, further improvements will be made to address any existing issues and strengthen its impact on the industry. However, it is important to note that the findings of my research were based solely on the perspectives and opinions provided by the interviewees. While their knowledge offers valuable insight into the topic at hand, it is crucial to acknowledge that these views may not be representative of all stakeholders in the industry. Thus, more interviews with other stakeholder in the industry would enable a more comprehensive understanding of this subject matter.

In the subsequent sections, further research suggestions and limitations of this study will be discussed before ending with a personal conclusion.

18. Recommendations for Further Research

Further research could focus on the long-term effects of the SFDR on the financial industry and its embeddedness. This research could explore the impact of the SFDR on investor behavior and decision-making, as well as the extent to which the regulation has improved transparency and accountability in the financial industry.

Moreover, an examination could be conducted to explore the possibility of the SFDR playing a pivotal role in catalyzing widespread transformation within the industry by fostering the uptake of environmentally and socially responsible practices as well as integrating ESG considerations throughout financial institutions.

Additionally, further research endeavors can be pursued to assess how successful the SFDR has been in attaining its desired outcomes. This includes evaluating its efficiency in reducing information imbalances among investors and advancing sustainable investment goals.

Additionally, it would be valuable to examine the challenges faced by market participants in implementing the SFDR and identify areas where further guidance and support may be needed to ensure successful implementation and compliance.

Another research matter could be to examine the potential impact of audited SFDR disclosures on investor confidence and trust in the financial industry.

Furthermore, it could be investigated how the negative aspects of the SFDR evolve in time and how they are addressed.

Another interesting point would be to do the research with a more diverse pool of interviewees to capture a broader range of perspectives and experiences related to the SFDR in the financial market since my pool of interviewees was limited to my EY colleagues.

Another field of research would involve examining the potential impact that the implementation of the CRSD may have on the Sustainable Finance Disclosure Regulation. Such an analysis could delve into several aspects, including exploring whether there is any interplay between these two regulatory frameworks and how they align or differ in terms of sustainability disclosure obligations. Moreover, investigating whether companies' compliance with CSRD has any implications for their adherence to SFDR requirements could shed light on the effectiveness and consistency of these regulations in promoting transparency and ESG integration within the financial sector. Undertaking this investigation would provide valuable insights into how different environmental reporting initiatives interact and contribute towards sustainable finance objectives.

19. Limits and criticism of my research

This section is dedicated to taking a critical step back from any research work, and outlining its limitations.

One limitation of the current literature on embeddedness in the financial market is its scarcity. There are not enough academic studies and documentation that specifically explore the concept of embeddedness within this context. This lack of research makes it challenging to fully understand and analyze the implications and effects of embeddedness on the financial market.

One potential limitation of this study is the restricted number of respondents included in the interviews, all from a single organization. This aspect may constrain the applicability and generalizability of the results to a wider population or industry. It would be beneficial to include participants from various companies and sectors to ensure that more diverse perspectives are captured, thus enhancing external validity. Expanding the sample size will allow for a broader range of experiences and insights, which would contribute to drawing more robust conclusions.

Furthermore, it is important to consider the potential limitations of using the 3-Level-Gioia Coding method for data analysis. One such limitation is that this approach can introduce subjectivity and bias into the findings. This occurs because the interpretation of the data heavily relies on subjective understanding and categorization of interview responses by researchers. As a result, there may be variations in how different researchers code and interpret the same set of data, potentially compromising its reliability and validity.

Another limitation of this research is the language barrier. As the interviews were conducted not in their mother languages, there may be limitations in accurately capturing and interpreting nuances and subtleties of meaning in the interview responses.

Furthermore, it is crucial to acknowledge the limitations in terms of feasibility. These encompass the constraints of time and resources that were available for conducting this research. It should be highlighted that the study was carried out alone and with minimal prior experience in the field of research. Additionally, due to substantial restrictions on time, only a limited timeframe was allocated for data collection and analysis. As such, these factors may have influenced the comprehensiveness and depth of findings obtained from this study.

20. Personal Conclusion

Throughout my research journey, I have gained a deeper understanding of the concept of embeddedness and its relevance to the financial industry.

I have explored the various dimensions of embeddedness and how they intersect with the Sustainable Finance Disclosure Regulation, specifically in relation to the factors that contribute to embedding the financial industry. By conducting interviews with auditors who specialize in SFDR disclosures, I was able to gain valuable insights into the positive and negative factors associated with the SFDR's implementation. These insights have not only expanded my knowledge of the topic but have also highlighted the complexities and challenges of incorporating sustainability factors into the financial markets.

During the course of my research, I had the opportunity to acquire valuable experience in conducting a qualitative study and utilizing the Gioia method for interview analysis. This proved to be an essential part of my journey towards understanding how the SFDR contributes to embedding the financial industry. Conducting a qualitative study allowed me to delve deep into participants' perspectives and gain comprehensive insights on this important topic. Additionally, employing the Gioia method provided structure and rigor in analyzing interview data, enabling a meaningful interpretation of key findings.

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Appendix 1: Gioia Coding

Positive:

#	Source	1st Level Code	2nd Level Code	3rd Level Code
1	IT1	"[...] lots of funds, for example, wants to invest in social products, in social and environmental products because they know that for their economy, it's it's like it's a good thing to do because now investors, they like they really want to invest on products which are sustainable."	More availabity of Sustainable products	Shift to more Sustainability Integration
	IT 5	"There's the shift in terms of these Article eight and Article nine funds are appearing [..] there is, I say, availability to create this fund and interest in doing them. So there definitely there are shifting, there are creating more."		
	IT 6	"Instead, particularly in the case of impact funds, whose main existential reason is to create impact, then we see that there they do actually try to put more emphasis on exactly what they do"		
	IT 5	"There's the shift in terms of these Article eight and Article nine funds are appearing. So there is interest from the market and there is also, I say, availability to create this fund and interest in doing them. So there definitely there are shifting, there are creating more."		
2	IT 5	"It's I think it's really pushing banks to think about new problematics that they never mentioned before. I think it's really along with other regulation and such, such as MiFID for example. But it's really forcing the bank to integrate ESG data within their systems. So so they need to contract some data providers or to go get look at the data and find it and then. It makes them integrate ESG within their systems. "	ESG integration	
	IT 2	", like you would say, that SFDR like is good. It's more positive than negative. I mean, there are some complications about data and everything, but the reasoning behind the directive is very good. And then it promotes ESG, of course, in the final."		
	IT 2	"[...] you have a bank, you have a core banking system. You're going to have to think, okay, what do we put the ESG data or do we process it? Et cetera. So it really integrates ESG within all the core systems, I would say		
3	IT 3	And because at the end, if everybody is publishing the data a company a say, okay, wow, Company B has a, I don't know, uh, emission like much less than mine. So maybe I should be aligned to this, I mean, to the indicator of the peers of the sector, you know, and at the end, in a way it kind of push the corporates to behave, to be more aware of their impact and even to be more committed to reduce or to mitigate the impact that they have	Reputation and Peer pressure	Increased accountability
	IT 3	"And it's more a pressure coming from the market, coming from the regulation, coming from you know, so at some point, you know, people, people, investors, asset managers will be more motivated to to be committed to have like a sustainability not as a first goal but integrated in the strategy of the of the portfolio.		
4	IT 5	"So big players, yes, they do this, but I think it's because of a reputational point"		
5	IT 2	" What is sure is that it promotes transparency"	Increased transparency and avoding greenwashing	
	IT 2	"So for me is really about showing transparency on what you are doing"		
	IT 3	"So basically at the beginning there were a lot of Article nine or Article eight, but we have been observed that over the time these funds have been downgraded [...] . So if you're going to say that to Article nine, you need to guarantee some disclosure on"		
	IT6	"What they want to achieve is transparency"		
	IT 6	"Within the disclosure, if you feel that something is not applicable, could not be applicable to your product for whatever reason you can explain this is about transparency. It's not about having to answer every specific question to the full expectation. If there is something you cannot answer, you can say this is not applicable to me and you give an explanation because ultimately it's about transparency."		
	IT 4	"So in SFDR, the full purpose is to provide transparency on the disclosure and consistency. "		
6	IT1	" I think it's a very good way to avoid greenwashing"		
7	IT 4	" The Regulation [...] trying to create this shift, this shift in the mentality [...]"	Change in Mentality	Increased Awareness
	IT 5	"But um, I think that part of what I see on a daily basis through my work, the best thing to make it part of society, to make it something that everyone really touches and has the possibility to see is through regulation, at least at the beginning, because we've seen that there can be voluntary aspects to it, but it's not enough. If you don't create change through that, you need some regulation"		
8	IT5	"But at the same time, I think it forces the banks to think about how they integrate ESG, because basically you have very technical question"	Forced to think about ESG	
9	IT 4	"I think it's providing some support and it's providing some some guidelines to other market players that wanted to introduce this within their strategy but didn't really know how to."	Guidance	Changing Strategies and Processes
	IT 4	"I think it, it makes, um, funds understand what other players are doing and how they're integrating sustainability topics within their strategy. It gives also the availability of information on how to disclose on KPIs and to do this monitoring system, which I think at the moment because it's such a new so it's such a new field and a lot of funds and investment managers were struggling to see how to, how to do this. "		
10	IT 2	"And it means that in one year we had three different versions of templates that banks have to fill. And to me it's I mean you are just done a completing one compulsory template and they send you a new version and then you have to start it over all over again. "	Constantly updated templates	
11	IT 3	"Because at the end there's a lot of clarification given from ESMA, which is the well, from the European superior supervisory authorities. So every two months they just give clarification or they answer to the questions raised [...]"	Giving clarity	
	IT 6	"[...]Q and A's that have been released over the last year and a half, um, a difference in different instances"		
12	IT 2	"So it's really a big question about who's taking the decision on ESG. How do we organize? Do we do a dedicated ESG team? Do we put one person in charge of ESG in each department Who who's the committee that's going to approve all ESG decision, etcetera? "	New organization	Rethinking governance
13	IT 2	"And the second thing is really related on governance and about a bit like the strategic decision and the power of people who is really dealing with ESG."	shift in strategic deicison	

Negative:

#	Source	1st Level Code	2nd Level Code	3rd Level Code
1	IT 3	"In the beginning they [directives] are making a little bit of chaos because nobody knows how to do it"	Lack of Guidance	Changing processes
	IT 4	"the SFDR is deeply related with EU taxonomy and at the moment EU taxonomy is in development and there's not really any concrete guidelines. So market players are also struggling to see how they should be measuring and integrating the KPIs."		
2	IT 6	"And too many clients that we speak to is still a bit of a burden and that should try to be changed"	Burden of reporting	
	IT 6	"And from feedback from clients with whom we work with on a daily basis, unfortunately it's a lot of a compliance exercise is not something that they use to portray who they really are"		
	IT 5	"It's mostly seen as a sort of problem that companies have to deal with. "		
	IT 6	"And too many clients that we speak to is still a bit of a burden and that should try to be changed"		
	IT 6	"One problem could also be behind is that there is not always data to be collected on all aspects"	Lack of Data	Data and Methodology Issues
3	IT 2	"second problem is that you have questions on these documents, so you need to fill in this template to reply to questions, but you need the data to do that. And for example, you have some principal adverse impacts, you know, so you have 18 indicators that companies need to report on. And I have. Not seen any bank on the Luxembourg market right now that has the number for PAI and 17 and 18.Msci is not giving it. Refinitiv is not giving it. Sustainalytics is not giving it. So you have you have to report on numbers and the numbers don't exist basically."		
	IT 2	the data is a challenge and some sections are very often missing"		
	IT 3	"The challenge of all these directives and, you know, and also the achievement of the goal is the fact that we miss data. So that's the point that, uh, we were discussing before KPIs, indicators, measures. So what is, uh, what has been observed from the market is that investors need data to be published by corporates. So if corporates doesn't publish this data, they cannot report them. So that's why CSRD comes into effect just to kind of, uh, um, I mean like it's, it's for corporates to disclose on some KPIs and these KPIs will be used from		
	IT 4	"that a lot of information, a lot of funds have some underlying funds that should, should provide them with the data. So they're struggling with providing some accurate data"		
	IT 2	"and then there is the calculations that you need to make. For example, for the principal adverse impact report that are not so clear. So the objective is to compare between bank, but each bank is basically or each asset manager is having its own way of calculating numbers, is having its own sustainable investment definition. So everybody has a different definition. And then when you calculate the percentage of sustainable investments in projects every time, it's different."	Different calculation methods	
	IT 3	"Yeah, we are running behind more, uh, on quantitative measures instead of qualtitative"		
	IT 2	"So each fund has a each fund or each asset manager has a different approach to calculate numbers. So you can't really compare like it's not giving you great information to compare."		

	IT1	"[...] we check if they are compliant with the regulation, but we don't check what they do concretely. So it's based on their statements, is their statement um, uh, uh, compliant with the with the law. But we don't know if what they disclose is really the case."		

4	IT1	" So I'm not sure that the financial auditors, uh, check, check, yes. Because it's supposed to be in our side and in our side we just check the compliance with the law."	Not audited	Not enough Accountability
	IT1	"I think the bad part is that we, we check the compliance, but we are not going over the the statements and we don't check what they do in reality."		
	IT 5	"Honestly this especially because the SFDR goes in the non audited part. Nobody really cares"		
	IT 5	"It goes in the non audited. Okay. I control it to you and I tell you, hey this is wrong. But if it's a minor point and I'm recommending to you, okay, the law says you need to write sectors and subsectors. I'm recommending you to write the subsectors. And you're like, I'm not writing the subsectors. It's technically incompliance with the law, but I don't think anybody is going to say anything. So also the attitude that there is towards this		
	IT 6	"Because just to clarify, this is unaudited information for now, so nobody really checks"		
5	IT 5	"So there is the interest in like saying we do a little bit more but not too much because the feeling that I get also from communication with other clients and associations here in Luxembourg is that there is pure fear of the um of this the, of the disclosures of like too extensive or too ambitious of backfiring that they're going to come and then, oh, you said that and you're not doing this and you're promised this thing and you're not doing that. So investment managers are scared, funds are scared. And so they just like go for the basic"	Being scrutinized	
6	IT 2	"the real problem with ESG today is that it's two sided because you want to I mean, companies don't really want to do ESG so far because, um, the objective, the like, the main objective of a financial market participants is the return"	No financial Materiality	Market mechanisms