ESBG position paper on the SFDR comprehensive review

ESBG (European Savings and Retail Banking Group)
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Savings and retail banks advocate for a clearer, simpler and more consistent SFDR.

The European Savings and Retail Banking Group (ESBG) represents the locally focused European banking sector, helping savings and retail banks in European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. Altogether, ESBG has 24 members in 20 European countries, representing 873 savings and retail banks. ESBG is historically driven by the “three Rs”: retail (since its members are actively providing financial services for people – individual consumers and their households – as well as for SMEs); regional (ESBG members deploy broad distribution networks rooted within the communities they serve, including local and regional outreach in both urban and rural areas) and responsible (social responsibility is a core value of our members, towards their clients, employees, communities and the environment). As such, ESBG welcomes the Sustainable Finance Disclosure Regulation (SFDR) objective to strengthen transparency through sustainability-related disclosures in the financial services sector to support the EU’s shift to a sustainable, climate neutral economy.

As the Commission is currently analysing the answers to its consultation on the SFDR review, this paper aims to bring further clarity on what would be the best way to review the SFDR so it can fulfil its objectives to strengthen transparency through sustainability-related disclosures in the financial services sector to support the EU’s shift to a sustainable, climate neutral economy and to provide comprehensive and comprehensible information on sustainability-related issues to retail investors.

Based on the shortcomings identified on the ground by our members, ESBG proposes the following recommendations to make a success of the SFDR review:

- More consistency with other EU regulations especially regarding the CSRD, MiFID II/IDD and the notion of “sustainable investment”.
- Reducing the current number of mandatory Principal Adverse Indicator (PAI) to simplify the framework and tackle misinterpretations.
- Implementing more flexibility in the new framework, notably by reflecting better the notion of transition or the distinctive features of financial products.
- Some thoughts on the categorisation system suggested by the Commission in its consultation.

We remain at your disposal (adrien.boudet@wsbi-esbg.org or +32 478 84 34 88) should you have any questions or wish to discuss our recommendations.
ESBG assessment: Despite pursuing laudable objectives, the SFDR contains some shortcomings.

In many ESBG members' experience, retail clients struggle to understand the information available. While advising clients, investment firms place a particular emphasis on ensuring that the investment's sustainability features are credible, traceable and transparent. Nonetheless, these efforts are impacted by the fact that many EU initiatives (Taxonomy, SFDR, MiFID II and IDD) utilise different definitions of sustainability and that their respective regulatory frameworks are only connected in an insufficient manner. This can result in inconsistencies, double reporting, legal uncertainties, low acceptance rates and even accusations of greenwashing, which may in turn potentially lead to civil ramifications. For instance:

- Regarding the CSRD, on 31 July 2023 the European Commission adopted the European Sustainability Reporting Standards (ESRS) which are applicable to all companies subject to CSRD. Finally, the Commission adopted ESRS 1 and ESRS 2 as mandatory standards, while the remaining standards are subject to sustainability assessment on a case-by-case basis.
- Regarding MIFID and IDD, it is worth reiterating the problems arising from the lack of alignment of the information provided under SFDR and that required from investors under MiFID II/IDD (which, moreover, is overly complex for retail investors). The confusion for retail investors may be further exacerbated by the proposed amendment of the KID for Packaged Retail and Insurance-based Investment Products (PRIIPs) in the context of the European Retail Investment Strategy (RIS). The information on sustainability in the PRIIPs-KID should be aligned with the information on sustainability preferences that is required from retail investors according to MiFID II/IDD.

Moreover, ESBG believes that the mass of information requirements for financial market participants and financial advisers under the SFDR and their complexity do not fully take account of the needs and limitations of consumers. Indeed, ESBG members assess that even investors interested in sustainability matters in their daily life are unable to cope with notions of Taxonomy-aligned investments, sustainable investments under SFDR or consideration of PAIs. On top of that, following up on SFDR requirements is quite resource intensive, affecting internal priorities and causing lack of resources for other engagement work.

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2 According to Delegated Regulation (EU) 2021/1257 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributor.
ESBG recommendations to make a success of the SFDR comprehensive review.

First, ESBG would like to insist on the fact that the SFDR level 1 review should notably focus on enhancing legal clarity for key definitions, such as “sustainable investments” (including its components contributions, DNSH, and good governance). ESBG believes that a harmonisation and a simplification of the existing regulatory sustainability definitions would be in the best interest of customers, investment firms, as well as those entities developing financial products.

- Consistent regulatory frameworks for financial products with sustainability features is the key requirement to enable the credible, transparent and legally reliable integration of sustainability into financial products and investment advice. Therefore, the pre-contractual information according to SFDR could clearly and in detail indicate the fulfilment of the MiFID II or IDD sustainability preferences by a product.
- Disclosure requirements and PAI definition for financial market participants under SFDR at entity level needs to be aligned with the definition of the corresponding KPI in the disclosure rules for corporates elaborated by EFRAG. In our view, sustainability-related disclosures at entity level should be streamlined by a horizontal application of CSRD reporting requirements in line with the double materiality principle across all sectors, including the financial services sector.
- The precontractual and periodic information for products with sustainability-related claims should be streamlined and focused on the key features of an investment. Duplications or overlaps of information for the purpose of website disclosures should be avoided.
- ESBG does not support the introduction of uniform disclosure requirements relating to sustainability matters for all financial products. We would prefer to maintain the current concept of sustainability-related disclosures where detailed disclosure requirements apply only to products with explicit sustainability claims (current Article 8 and 9).

This should go hand in hand with a simplification of the current SFDR framework through reducing the current number of mandatory PAI indicators and transparency requirements in general to a small set of generally relevant ones that are less prone to misinterpretations by investors. This would be highly beneficial for the general understanding by distributors and end-investors. This is especially crucial given the current limitations in data quality creating methodological problems in relation to the PAI indicators for the principle of Do No Significant Harm (DNSH), which first and foremost requires improvements in data coverage to ensure more reliable results. When reviewing the SFDR, the Commission should also clarify the methodology of calculating sustainable investments. In this regard, ESBG supports the proposal of the ESAs in their Final Report on how to calculate the proportion of sustainable investments.

Moreover, ESBG would like to advocate for more flexibility of the new framework to be adopted. In this regard, one might think that to provide a fair, clear and not misleading information to retail investors, SFDR should, where appropriate, allow for different approaches between different types of products. This is especially relevant for individual portfolios. The classification of managed portfolios as financial products under Article 2 (12)(a) SFDR poses challenges to financial market participants that offer portfolio

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3 To be more precise, we notably assess that exposure to companies active in the fossil fuel sector; GHG intensity of investee companies and Carbon footprint; Annex 1, Table 1, PAI 1-6.; PAI 10 (Violations of UN GC Principles) and PAI 13 are the most useful ones.

management services. Also, for flexibility's purpose, ESBG strongly believes that **the next SFDR framework should better promote the notion of transition** since the current approach is too binary (for example sustainable vs non-sustainable investment).

Finally, we would like to comment on the Commission's proposals regarding **the possibility to introduce a categorisation system** (question 4.1.2 of the consultation issued in September 2023). It is important to bear in mind that **possible alignments should be explored to avoid fragmentation of the market** and further confusion in marketing that would generate distrust on the part of investors in the schemes. In this regard, ESBG stresses that the understanding of products that are labelled as “sustainable” must be as clear as possible and consistent alongside all relevant pieces of EU law, especially with regard to the consideration of sustainable preferences according to MiFID II/IDD. It is of utmost importance to **ensure that the criteria to underpin the existing concepts do not introduce totally new approaches**. Should new product criteria be introduced, **ESBG would like to ask for a sufficiently long transitional period**. A high share of the financial products currently discloses under Article 8 or 9 SFDR and would need to be evaluated and possibly adapted to the new system. Such adaptation will often involve modifications to the product terms, product names and potentially also renewal of product authorisation. A clear focus on product categorisation for the retail market would help to keep transitioning efforts manageable.

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**About ESBG (European Savings and Retail Banking Group)**

ESBG represents the locally focused European banking sector, helping savings and retail banks in 20 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. Advocating for a proportionate approach to banking rules, ESBG unites at EU level some 873 banks, which together employ 610,000 people driven to innovate at 50,000 outlets. ESBG members have total assets of €6.38 trillion, provide 313 billion euros in loans to SMEs, and serve 163 million Europeans seeking retail banking services. ESBG members commit to further unleash the promise of sustainable, responsible 21st century banking.

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