Brussels, December 2023

EACB position paper on the Commission's targeted consultation on the implementation of the Sustainable Finance Disclosures Regulation

December 2023

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EACB AISBL – Secretariat • Rue de l'Industrie 26-38 • B-1040 Brussels
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www.eacb.coop • e-mail : secretariat@eacb.coop

General comments

The EACB submitted its response to the Commission's targeted consultation on the review of the SFDR. An EU level framework for sustainability-related disclosure remains extremely pertinent today. The SFDR has had an undeniable positive impact: increased transparency and dialogue with clients, prioritization of ESG topics, increased corporate awareness. Nevertheless, implementation of the requirements has raised numerous challenges and concerns among authorities, financial market participants and investors. To fully harness the regulation's potential in combating greenwashing and promoting the redirection of capital towards sustainable endeavors, several weaknesses need to be addressed.

We therefore welcome the efforts to clarify disclosure requirements under and to align with existing sustainable finance legislation. As included in our response to the Commission's questionnaire, we wish to take this opportunity to flag the points listed hereunder.

1 – Current requirements of the SFDR

Unclear definitions ("sustainable investment", "promotion of E/S characteristics", Article 8/9 distinction, 100% threshold) create difficulties in interpretation by NCAs, inconsistent enforcement, lack of comparability, and confusion among financial market participants. In addition, the requirement disclosures are **complex and extensive**, and as such are often **not easily grasped by the end-investors.** The aim should be to achieve quality disclosures rather than quantity. A distinction between retail and institutional investors could be useful, as institutional investors are now used to the disclosure and ask for it in order to fulfill their own SFDR obligations.

The usefulness of **entity-level disclosure for investors**, in particular retail investors, can be questioned. Investors decide to invest in a fund, not in an asset manager: entity-level disclosure do not allow them to compare funds. We understand that the initial objective of such disclosure was to allow investors to better assess what the asset management is doing more globally in terms of ESG but the SFDR PAI statement have failed to reach this purpose.

Data gaps are a key issue in the implementation the SFDR. The recent decision to reduce the scope of companies subject to non-financial reporting obligations under the CSRD will not help this; even for companies still subject to the CSRD reporting, the latest clarification from the European Commission that corporates are able to report only information that are material for their business will increase those data gaps and make it very difficult for asset managers to report, especially for KPIs that were considered as always material by the ESAs as well as asset managers.

Furthermore, in line with green goals and in particular with the Commission's recommendation on facilitating finance for the **transition** to a sustainable economy (June 2023) we consider that transition finance should be more clearly accounted for in the SFDR. To better achieve this, **Article 2(17) should introduce binding and measurable objectives at the financial product level, instead of applying at issuer level**. The SFDR should introduce category of financial transition products, measured against the investment fund's commitment (eg. Net Zero aligned

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funds, decarbonation funds, transition-linked-bonds, sustainability-linked-bonds, Paris Aligned Benchmarks, Climate Transition Benchmarks, …).

Machine-readable formats ease the collection and assessment processes of data published by issuers and investee companies. In order to facilitate data transfers between financial product manufacturers and financial product distributors (or any other intermediaries needing product data), the financial industry coordinated as part of the FinDatEx organization to create a machine-readable format of product information manufacturers need to communicate to distributors: the European ESG Template (EET).

We would take this opportunity to underline that **any future modifications should be analysed in detail to avoid adding an extra layer of complexity** to the current framework which would make implementation more difficult for market participants, cause customer fatigue with new information/requirements in a short period of time, and generating an increase in manufacturing and distribution costs that could eventually result in higher prices for financial products.

1.1 – Disclosure of principle adverse impacts

At **investee company level**, based on the ESRS, disclosures and datapoints within each standard may be subject to a materiality assessment by the reporting entity, including the PAI and transition plans/target disclosures and data points. Explanations as to why the reporting entity has considered a disclosure "not material" is optional. This can create **permanent data gaps between CSRD and SFDR**.

Consequently, **some indicators may be difficult to collect, measure or quantify, making it difficult for financial market participants to report on them accurately**. Requiring all indicators to be considered material for entity-level disclosures could result in inaccurate reporting, which could be misleading for investors. Instead, financial market participants should be allowed to focus on the indicators that are most relevant and significant to their business and financial products, while still providing sufficient coverage of the principal adverse indicators.

Data gaps make it very difficult for financial institutions to publish relevant information on the KPIs considered always material. Underlying information should be made available by the investee companies, and clear guidelines should be provided on how to take "non-material" information into account for each and every mandatory PAI indicators.

1.3 – Data and estimates

The current **misalignment of SFDR and CSRD timelines generates data gaps** which will only be reduced once CSRD fully applies to underlying undertakings (at least for European investments – the difficulties for investment products investing in different regions or globally will remain). The current data gaps affect the accuracy and reliability of results, even when best efforts are made to collect or estimate the data.

In addition, the **lack of standardized reporting**, especially out of the scope of the CSRD, prevents the direct use of reported data. The use of data derived from reported metrics should be allowed for a better development of estimates. For example, as regards the estimation of compliance with minimum social safeguards, while the use of controversies should not be encouraged to show compliance, it could be useful to demonstrate a misalignment with this criterion.

Clear guidance is needed as to **how to deal with "non material" information** from investee companies for the purposes of SFDR level 2.

Data availability may vary depending on the KPI in question and also the type of company invested in. In particular, if data is rather highly available on GHG emissions for large cap public companies, it is not the same for private markets and smaller companies. KPIs that particularly suffer from availability: gender pay gap, biodiversity/land protection, energy consumption (renewable vs. non-renewable). When data is not directly available from corporates, estimates may be used.

Regarding the proportion of taxonomy-aligned investments at product-level, data availability depends on the type of market: while it is less challenging for public markets than for private markets, it remains a big issue, particularly due to the limited scope of sectors covered by the Taxonomy.

In terms of **data quality**, very few tools are available to ensure the quality of data bought externally or even provided bilaterally by companies (through questionnaires). Consistency checks can help to make sure that the data is relevant. Some affiliates have developed their internal methodologies and use their own data to determine eg. Contribution to environmental objectives.

When it comes to assessing **PAIs including DNSH**, the issue is more one of methodology and definitions. The industry broadly adopted similar methodologies to implement the DNSH criteria, which only require straightforward and mostly available data (controversies analysis + exclusions).

As regards **good governance practices**, information on investee companies is rather easily accessible on public markets. However, once again, the issue of definition of good governance practices may be the main concern.

Finally, banks do engage with investee companies on different items, including in some cases to ask for further disclosures; however missing data is not, at this stage, a trigger for investment activities.

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2 – Interaction with other sustainable finance legislation

The EACB recognizes the efforts to correlate reporting under different regulations. However, it would be helpful for indicators relevant to the SFDR, the EU Climate BMR, Pillar 3 disclosures and other investor information regulations to be disclosed by in-scope companies on a mandatory basis. **Different sustainability reporting regulations can lead to double reporting, creating administrative barriers for different actors, duplication, contradictions, and confusion**. The SFDR review is an opportunity to rectify inconsistencies affecting the sustainable finance framework/consider revisiting other regulations to ensure they are duly aligned.

We welcome the clarification that Taxonomy-aligned activities can automatically be considered environmentally sustainable for SFDR purposes. It is still unclear how the share of sustainable investment should be calculated at company level, since Taxonomy alignment only applies at activity level. The social taxonomy is still to be determined, resulting in imbalance in the number of funds addressing the social dimension compared to the environmental one.

The **client sustainability preferences assessment** carried out by financial advisors under MiFID and IDD is not necessarily aligned with SFDR Art. 8/9 categorisation. These inconsistencies and the complexity of the applicable framework generate confusion among investors. This may be further exacerbated by the proposed amendment of PRIIPs in the context of the Retail Investment Strategy, which should take into account this revision of SFDR. Sustainability preferences should be recalibrated to better fit in the sustainable finance framework.

Regarding both **index tracking products and active benchmarked products**, ambiguities remain when qualifying each individual portfolio constituent as a sustainable investment. As a result, **SFDR requirements have hindered new asset gathering and conversions, which had gained momentum in 2020-2021, and is restraining the adoption of PAB/CTBs**. The SFDR generated confusion in the design of PAB/CTB indexes used as underlying of passive/ETF management, as well as for benchmarking. Alignment or at least consistency between SFDR disclosures for investment managers and BMR disclosures for index administrators would increase transparency and facilitate reporting. PAB/CTBs must apply DNSH in accordance with the Taxonomy Regulation: for PABs, DNSH triggers exclusions (action at company level) while the Taxonomy definition of DNSH applies at activity level. An oil company's investment in renewables can be considered Taxonomy-aligned in application of DNSH, and increase a portfolio's CapEx exposure to renewables under the SFDR; however, the company cannot be included in a PAB index. In this case, the PAB is counter-productive to Taxonomy and SFDR objectives to boost investment in activities that are aligned.

As regards the **ESRS**, banks rely on information provided by corporates. **To avoid problematic data gaps, financial and non-financial requirements must be well aligned.** As data gaps subsist, banks increasingly depend on data providers, increasing the burden on issuers facing multiple data requests.

Investee companies are only required to disclose indicators that they consider material, but asset managers must disclose all mandatory indicators, leading to a timing issue (it was expected that investee companies would disclose their indicators before asset managers). This has also affected the disclosures shared with clients.

Even if the ESRS links ESRS datapoints and SFDR indicators, there are cases where they do not exactly match:

> PAI6: Energy consumption intensity per high impact climate sector: The ESRS requires a breakdown per NACE while SFDR requires detail per sector.
>
> PAI3: Number of days lost to injuries, accidents, fatalities or illness: SFDR does not define whether this covers employees and non-employees

There are still markets that fall outside the CSRD. The framework would benefit from greater flexibility in some respects, eg. concerning social funds: in some cases, certain environmental factors may not be applicable, or data may not be available for certain companies. **The one-size-fits-all approach creates unnecessary restrictions and can hinder innovation**.

Entity level disclosures enable investors to better appreciate the ambition of FMPs. They should be streamlined, particularly given that CSRD reporting should cover all information to be disclosed under Art. 3, 4(2)(b) and 5 SFDR with consistent requirements for all companies and sectors. **Where a FMP is required to report under the CSRD on its assets under management and advisory, then it should be exempt from reporting under SFDR**. If not, it should be subject to SFDR reporting requirements.

In addition, we would underline that under the SFDR, each regulated entity has to publish its own PAI statement. It would be much more efficient to regroup these under a consolidated one, like under the CSRD.

3 – Potential changes to disclosure requirements for financial market participants
3.1 – Entity-level disclosures

Entity-level disclosures are mostly useful for investors to assess the sustainability factors linked to the FMP in question. This enables the goals of the SFDR to support sustainable goals at entity level.

It would be necessary to find an **appropriate balance between comparability and flexibility of the information to be reported to ensure that such information makes sense to the investor receiving it and, in particular, to retailers**.

It is useful to have access to comparable information in the area of transparency for sustainability preferences. In this regard, entity level disclosure requirements are a positive tool to avoid

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potential greenwashing effects. Nonetheless, there is still room for improvement, as **some of these disclosures might not be relevant for investors when it comes to the cost-efficiency of processing such information**.

Information on PAI is easier to understand and to convey to clients, compared to information related to the sustainability risks. The Taxonomy Regulation has helped financial institutions create a better understanding, for clients, of ESG-related topics and impacts. ESG risks, although very important to consider in investment choices and disclosures, are a little too theoretical, more difficult to define and assess in order to guide the investment decision-making process of a market participant. ESG risks disclosure should be tackled with more decision and with far more accurate indications by the EU regulator. Also, Article 5 requirements are not, by themselves, appropriate and effective in order to influence the remuneration policies of the financial market participants.

We find that the most useful indicators are those that are coherent with the wider sustainable finance framework, ie., renewable energy, UN Guiding Principles; exposure to companies active in the fossil fuel sector; GHG intensity of investee companies and Carbon footprint.

Some other indicators could be improved upon to increase their usefulness. Data availability remains an obstacle for a number of indicators, making them difficult to use in practice. In this regard, we would mention in particular the following PAIs:

5. Share of non-renewable energy consumption and production
6. Energy consumption intensity per high impact climate sector
7. Activities negatively affecting biodiversity-sensitive areas
8. Emissions to water
9. Hazardous waste ratio
12. Unadjusted gender pay gap

Regarding those same PAIs, it should also be mentioned that FMPs can have different interpretations of what the PAIs encompass. In addition, data is not always standardised, making the respective PAIs difficult to compare. We would mention in this regard PAIs 6 (Energy consumption intensity for high impact climate sectors); 8 (Emissions to water) and 9 (Hazardous waste ratio) and 12 (Unadjusted gender pay gap). These three PAIs are complex to report, which may further decrease their comparability and therefore usefulness.

Due to the different ratios contained in certain PAIs, those PAIs cannot be properly compared. PAI 1 on GHG emissions is related to assets under management or to the FMP's balance sheet. A bigger balance sheet will naturally reflect a greater absolute value of GHG emissions. PAI 2 (calculated per amount invested) and PAI 2 (per amount of sales) allows for more meaningful comparisons.

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Several positive changes have been proposed by the ESAs in their RTS review, most notably the clarifications relating to PAI 5 on board gender diversity, PAI 6 on share of non-renewable energy consumption and production (in line with the EET), PAI 16 on investee countries subject to social violations, now based on exposures.

The conceptual complexity of the definitions contained in SFDR and its RTS, and the many cross-references it contains, entails interpretation issues for FMPs and clients. We consider it necessary to simplify disclosure requirements, addressing the most urgent and relevant issues. Retail customers find it difficult to understand all the information available in the market due to the complexity of the disclosures. In addition, it should be noted that sustainability information is currently reported separately from the other documentation that financial products must provide to the markets. **An integrated report would provide investors with a holistic view, simplify reporting and reduce costs for the entities subject to these obligations.**

We also consider it relevant to highlight the challenge for institutions to access reliable data, especially outside the EU, as well as the methodological problems faced by institutions in relation to the PAI indicators for the principle of no significant harm to the environment (DNSH), due to lack of data and the use of estimates.

It is necessary to reflect on the requirements for the consideration of PAIs and, in particular, on what this information provides at entity level, as it can be very difficult to understand for retailers and contradictory to the information provided at product level, which is (a priori) the most relevant for the investor.

There is a clear opportunity to streamline sustainability-related entity level requirements in particular with the CSRD given that CSRD will encompass the disclosures under Art 3, Art 4(2)(b) and Art 5 SFDR. We take the view that FMPs reporting their assets under management and advisory should be exempted from corresponding CSRD requirements.

In addition, it is worth noting that the CSRD allows for consolidated statements with subsidiaries. We would support a similar functioning of the SFDR (single PAI statement at group level).

3.2 – Product-level disclosures

Overall, SFDR requirements have elevated the expectations of professional clients concerning transparency, establishing a new market standard for asset managers. Institutional clients have experienced a significant surge in direct inquiries to market participants regarding sustainable information, with the number increasing by more than sixfold since 2020. This uptick is largely attributed to the highly customized requirements of institutional clients. SFDR has acted as a catalyst, intensifying transparency demands, however it remains that standard SFDR requirements may not entirely fulfill these evolving needs.

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Applying **uniform disclosure requirements to all financial products offered in the EU would level the playing field and help streamline and simplify the framework**, enhancing accessibility and comparability of products.

We take the view that disclosure criteria should be harmonised at EU level, but that disclosures should be based on the pertinence and features of each product.

The main goal of standardized product disclosures should be to provide retail investors with clear, accessible and meaningful information that helps them make informed decisions. In that respect, it is important that the chosen approach serves this core objective ensuring that the essence of ESG products is accurately communicated and not misunderstood or oversimplified with uniform disclosure requirements.

Disclosure requirements relating PAIs that are commonly accepted as material for financial products and FMPs (GHG emissions, human rights violations) should apply to all products.

Financial market participants must disclose extensive information in the pre-contractual documents and periodic reports as regards Art 8 and 9 products. The complexity of the information conveyed can discourage end-investors from investing in more sustainable products, which is clearly opposite to the desired effects of the SFDR.

We would argue that **product disclosures should aim to properly inform investors with clear indications of the sustainability objectives and level of ambition, without over-burdening financial market participants**. A single template, instead of the pre-contractual disclosures, including identical sections for each product but with flexibility in filling them out; clear and readily understandable explanations should be included, rather than disclosing only against set technical criteria.

Managing disclosure requirements for a specific set of financial products, such as those with assets under management surpassing a specified threshold or exclusively designed for retail investors, proves overly intricate. The primary rationale behind extending disclosure obligations to encompass all financial products is to ensure a level playing field for these products. Imposing disclosure requirements solely on a subset of products would undermine this objective, introducing additional complexity and confusion to the markets, and hindering comparability.

We support the recommendations of the Platform on Sustainable Finance, that **reporting requirements should prioritize the most pertinent information for measuring sustainability and impact, ultimately benefiting investors engaged in green and sustainable activities**. We consider it necessary to simplify information requirements, to address the most urgent and relevant aspects. Retail customers find it difficult to understand all the information available in the market given the complexity of the disclosures.

Dispersion of product-related information across these three locations can be appropriate, if the pre-contractual and periodic disclosures are simplified. As stated above, the current complexity of disclosures often proves challenging for end-investors to comprehend. This intricacy runs the risk of discouraging investors from reallocating their savings towards a more sustainable economy, rather than assisting them in establishing clear sustainable preferences that can guide their choice of suitable products.

Furthermore, simplification would enable informed investment decisions, enhance comprehension of financial products, and prevent an undue burden on financial market participants. Consequently, **we propose that pre-contractual and periodic disclosures be streamlined, focusing on key features such as sustainability objectives and characteristics, binding elements of the investment strategy, main KPIs for measuring sustainability performance, and establishing a clear link between pre-contractual commitments and periodic reporting.**

There should not be a duplication but a minimum interoperability between entity-level and product-level disclosures, taking into account the specificities of each product, while respecting the hierarchy of entity products. Product disclosures should not be conditional on entity disclosures as they do not relate to the same level of sustainability consideration. A product may take into consideration certain aspects that are not considered at entity level. Indeed, each product can have a different sustainable strategy that won't apply to the entire FMP. For example, considering decarbonisation targets, disclosures at the entity and at product level should be completely independent and uncorrelated for fair competition reasons.

We acknowledge that the CSRD will enhance access to harmonized sustainability information, however the scope of the CSRD is limited to only some companies. In addition, FMPs will continue to struggle accessing some non-financial data of companies subject to the CSRD due to the decision to make all topical ESRS subject to the materiality assessment. Therefore, information that was assessed as non-material will not be available to FMPs for their own reporting under SFDR.

While we welcome some clarification provided by the EC in the Q&A published together with the ESRS Proposal, it is not clear how FMPs should consider a "non-material" information for their own reporting purpose. We understand that clarifications will be provided in the sectoral ESRS and we take this opportunity to remind that if undertakings do not report on some PAI indicators because they are deemed not material, financial institutions should also be able to consider that such information is not material for their own reporting requirement.

4 – Potential establishment of a categorisation system for financial products

Customers have just begun to understand the current Art. 8/9 categorization, therefore it seems that **a total overhaul at this stage would be very burdensome and confusing**. We would advise against a hasty revision of the framework, however we agree that SFDR has not achieved its intended effects and that a revision of Articles 6, 8 and 9 will be needed. It is necessary to create a framework that is understandable by all investors, differentiating between the information needs of institutional and retail investors. A more efficient approach would be to remove the blurry notions of "promotion", "characteristics" and unclear definitions. **Clear information should be conveyed to end-investors, showing the level of commitment toward disclosed objectives. Transition should also be properly accounted for**, as a fundamental aspect for reaching environmental goals.

We value the reflection that the Commission is carrying out that shows the need to review and improve some aspects of the Regulation. However, only two years after its entry into force, we believe that a cost-benefit analysis should be carried out, taking into account the advantages and disadvantages of any new implementation or development, as this may generate greater uncertainty in the market and confusion for investors. Moreover, we understand that, to establish conceptually easy-to-understand product categories for investors**, it is necessary to conduct practical tests with actual distribution channels and consumers, that should be done before finalizing any categorisation system**. Such testing should serve to ensure that categories are not only theoretically sound but also workable in practice.

Product categorization can be helpful in recommending products to customers who do not have clear sustainability preferences or are unable to define them. As such, a revised framework could refine the categories to better reflect financial products' strategies, distinguishing products with contribution strategies, transition strategies, and those which can demonstrate binding ESG factors embedded in their investment process applicable to their entire portfolio.

In addition, different levels of ambitions should be allowed for financial products, provided that their end objective is clearly disclosed. Products not related to any measurable, binding ESG objective should not make any sustainability claims. Products exceeding applicable benchmarks could be deemed to have a "significant objective", and those exceeding such benchmarks by far, could be deemed to have a "very significant objective". The different levels of ambition could be assessed in the context of the universe chose by the investor, against existing regulatory benchmarks, or market benchmarks that are widely accepted in practice. Alternatively, specific thresholds could be agreed to define the objective levels.

We take the view that the SFDR requirements should evolve, according to a constant dialogue between regulators and industry.

Finally, there is a strong **need to avoid fragmentation in product categorisation**. Developments are currently underway in several jurisdictions, for example in the United States and the United Kingdom. Even within the European Union itself, there are initiatives by some Member States to pursue a separate classification system for financial products, so 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.

Finally, we believe that a cost-benefit analysis should be carried out, taking into account the advantages and disadvantages of any new implementation or development, as this may generate uncertainty in the market and confusion for investors. We would highlight that the implementation of changes comes with high economic costs, requiring considerable investment of resources as well as costly IT adaptations.

For further information, please contact:

Pauline Hascoet, Adviser Sustainable Finance (pauline.hascoet@eacb.coop)

Francesca Palladino, Adviser Financial Markets (Francesca.palladino@eacb.coop)