BEUC The European Consumer Organisation

BF BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

Finance Watch
Making finance serve society

Joint response to the proposal of the Platform on Sustainable Finance on categorisation of products under the SFDR

The European Commission is expected to publish a proposal for the review of the SFDR in Q4 2025. This position paper provides an overview of BETTER FINANCE, BEUC and Finance Watch proposed adaptations to the SFDR, following recommendations from the Platform on Sustainable Finance to the European Commission. As defenders of individual investors', consumers' and the civil society's interests we are committed to enabling a more sustainable financial system, while ensuring the best interest of European citizens as financial services users.

PROPOSAL

In response to the European Commission's assessment of the SFDR, the **Platform on Sustainable Finance** published a briefing note outlining their proposal for a new categorisation system. Aiming to address market fragmentation and enhance individual investor understanding of sustainable investments and needs, the Platform outlines three categories:

1. Sustainable: products aligned with the EU taxonomy and sustainable investments
2. Transition: investments supporting the transition to a net-zero and sustainable economy
3. ESG collection: products excluding harmful investments or applying various sustainability criteria

Within this scope, all other products would be "unclassified". The proposal also introduces mandatory minimum criteria and binding elements to prevent greenwashing.

We welcome the Platform on Sustainable Finance's proposal on the categorisation of products under the SFDR, and its ambition to address the regulation's shortcomings. In particular, we support the clearer product categorisation, prioritising individual investors' needs at its core. We also appreciate the ambition to tackle the SFDR's flaws, which have negatively affected investors' trust in sustainable and ESG products as well as overall sustainable finance capital flows, due to greenwashing and misselling.

However, as advocates of the best interest of individual investors and consumers, we wish to raise some concerns regarding the **ESG collection category,** and the framing of **engagement**

as an optional element for investors or their representatives to develop a transition investing strategy.

- **A separate ESG collection category should be removed to prevent continued greenwashing**

The ESG collection category aims to *"select or exclude sectors or companies based on ESG performance"*[1] by avoiding significantly harmful investments and/or investing in assets with better ESG performance within their sector. Although we acknowledge the intent of this category, several aspects raise significant concerns regarding greenwashing.

Firstly, the absence of a requirement for direct positive environmental or social impact leads to ESG considerations being incorporated in a variety of ways, as is being done under the current SFDR (with Article 8 and 9). The tendency from investment advisors to simplify explanations will lead investors to believe that they are financing meaningful change when their money may still be invested in companies with only marginal ESG improvements.

Secondly, the non-intuitive category name and the broad definition of this category as well as the absence of clear ESG criteria, may lead to the use of vague or weak ESG standards, and divergent and contradictory ESG ratings or scores (e.g. based on financial materiality only). This misleads financial users in their investment choices[2]. It also allows products with minimal sustainability impact to be marketed as "ESG-friendly". This risks repeating the same shortcomings of Articles 8 and 9 of the current SFDR, where products claim to promote sustainability, but allow for poorly-founded claims of ESG performance - despite this being what individual investors expect from ESG funds[3]. This broad category would be the natural home for many existing Article 8 products, of which many are not viewed as sustainable[4].

Thirdly, this category would not allow an exhaustive distinction between harmful products and other products. As a result, investment advisors could encourage retail clients to invest in unclassified products under the rationale that ESG considerations could be integrated.

[1] Categorisation of products under the SFDR: Proposal of the Platform on Sustainable Finance
[2] BETTER-FINANCE-summary-EC-SFDR-targeted-consultation-December-2023.pdf
[3] Ibid.
[4] EU Funds: Is regulation impacting climate performance? Assessing the climate performance of EU-domiciled funds in the context of SFDR and ESMA's fund naming guidelines

Ultimately, it is important to consider that it would be significantly difficult for individual investors and others alike to differentiate between the first category (sustainable) and ESG collection.

- **Engagement should be mandatory and not an optional element for transition investing**

As advocates for a sustainable financial system and supporters of a much-needed energy and environmental transition, we were disappointed to see that the substantial role of engagement was not duly put forward. The proposal recognises the need for clear sustainability goals, but contradicts itself by failing to enforce a crucial mechanism – engagement –to ensure those goals are met.

The proposal's non-binding approach of engagement does not consider its essential role in the environmental transition. This allows for passive ownership, ultimately increasing the risk of greenwashing rather than preventing it. Mandatory engagement is crucial, as reflected in Article 4 of the SFDR, which requires FMPs to disclose their due diligence policies regarding adverse sustainability impacts, including engagement policies in accordance with Directive 2007/36/EC. Similarly, the Corporate Sustainability Due Diligence Directive (CSDDD) underlines the importance of stakeholder engagement in its Article 13. These provisions highlight that engagement should not be an optional element but rather a requirement.

Making engagement voluntary means that asset managers can avoid actively exercising their investor rights and engaging with investee companies while still marketing funds as "transition investing". Research has shown that the most effective fund investment strategies derive from engagement[5]. Therefore, funds should be required to actively engage. Simply excluding certain investments does not equate to financing real change. Without engagement, investments remain passive, failing to push companies towards meaningful sustainability improvements. Individual investors must be confident that their transition investments are actively promoting positive change, rather than just being marketed as such.

To ensure that the core objective of the SFDR - contributing to one of the EU's big political objectives: attracting private funding to help Europe make the shift to a net-zero economy - is met, we call on the European Commission to remove any confusing categories (ESG Collection), and to make engagement a binding element, at least for the transition category.

[5] *Shifting the Trillions | Why will private investors play a key role?*

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BACKGROUND

The **Sustainable Finance Disclosure Regulation (SFDR)** was introduced as a transparency framework for individual non-professional ("retail") investors and other stakeholders alike about the sustainability characteristics of financial products, requiring financial market participants (asset managers such as AIFMs and UCITS managers) to provide prescript and standardised disclosures on how sustainability factors are integrated at both an entity and product level. The SFDR also aims at strengthening investor protection and making it easier for investors to compare financial products and services on their sustainability claims, with a view to guiding their investment decisions.

Three Articles under the SFDR classify products based on how their approach to sustainability is presented:

- Article 6: funds with no public intention to consider sustainability concerns and that may invest in stocks that do not respect minimum ESG criteria (such as excluding tobacco)

- Article 8: funds that promote environmental or social characteristics, whereby companies into which the fund invests follow good ESG practices

- Article 9: funds that have sustainability investment as objective

However, since the SFDR was designed as a disclosure-related regulation aimed at increasing transparency, rather than a formal labelling requirement with set criteria, there are various ways in which fund managers have been interpreting promotion of environmental and social characteristics, which has raised major concerns regarding greenwashing.[6] Misusing Article 8 and 9 as product labels and switching between them following any additional Regulatory Technical Standards[7] and Q&A[8] has caused confusion and mistrust in such products.[9] In December 2022, the European Commission announced a comprehensive assessment of the SFDR framework and following its targeted consultations[10], it revealed that 84% of respondents found SFDR disclosures

[6] https://www.morningstar.co.uk/uk/news/216818/the-great-reclassification-how-sfdr-is-changing-funds.aspx

[7] https://www.esma.europa.eu/sites/default/files/2023-12/JC_2023_55_-_Final_Report_SFDR_Delegated_Regulation_amending_RTS.pdf

[8] https://www.esma.europa.eu/sites/default/files/2023-04/Answers_to_questions_on_the_interpretation_of_Regulation_%28EU%29_20192088.PDF

[9] https://www.ft.com/content/0eb64160-9e41-44b6 -8550-742a6a4b1022

[10] https://finance.ec.europa.eu/document/download/0f2cfde1-12b0-4860-b548-0393ac5b592b_en?filename=2023-sfdr-implementation-summary-of-responses_en.pdf

insufficiently useful to investors, and 82% of respondents stated that SFDR requirements and concepts lack clarity. With financial market participants (FMPs) the largest subgroup of respondents, it is clear these concerns are shared within the industry also. This showed the widespread concerns regarding the regulation and supports the current need for revisions.