

Comments

Association of German Banks

Targeted Consultation

on the implementation of the Sustainable Finance Disclosure Regulation (SFDR)

14 December 2023

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Comment on Question 3.2.9

We are against the introduction of a scale, as it is a tool that cannot possibly be suitable for representing the variety of sustainability strategies in a meaningful way. A scale only appears superficially to lead to simplification, in fact, however, it would create new problems and risks.

In the event that the introduction of a scale continues to remain under consideration despite these fundamental reservations, there are a wide range of issues to consider. In particular, the fact that, pursuant to MiFID II, investors define their own preferred minimum proportion of sustainability as part of the sustainability preference questionnaire, must be taken into account. After all, each investor has their own subjective definition and understanding of sustainability.

In the sustainability preference questionnaire pursuant to Article 2 (7) of the Delegated Regulation 2017/565 MiFID II, clients are asked whether they wish to invest in a financial instrument for which they determine that a minimum proportion shall be invested in environmentally sustainable investments pursuant to the taxonomy regulation (point a) or a financial instrument for which they determine that a minimum proportion shall be invested in sustainable investments pursuant to SFDR (point b) or financial instruments that consider principal adverse impacts on sustainability factors (point c).

If the individual points on the scale represent quotas that are excessively high, this could lead a situation in which the investment is sustainable pursuant to the client's preferences but not pursuant to its classification on the scale. This discrepancy must be avoided at all costs, as it would certainly lead to confusion on the part of the client.

Not only that, the fact that entities are, de facto, unable to achieve thresholds that are set to high must be taken into account. At present, only approximately 30 percent of all economic activity in the EU is taxonomy-eligible, and only 7 percent is taxonomy-aligned.

Quotas that are too high can lead to risk clusters when creating portfolios, as there are only a small number of taxonomy-aligned products that can be included in a portfolio. The risk, therefore, would be that such a portfolio would include only a small number of assets, which would in turn increase the overall default and/or loss risk for the investor.

There is currently no consistent method of calculation on the market for determining which products are taxonomy-aligned. For example, some approaches only take the share of turnover into account, while others consider the entity as a whole.

In addition, there may be products that unintentionally invest in taxonomy-aligned entities, and as such the product would, more or less by coincidence, have a higher taxonomy quota or a higher number of shares with sustainable investment objectives than was originally intended, even though the investment strategy is not, in and of itself, sustainable. This creates the risk that this product will be 'accidentally' assigned to a more sustainable point on the scale, even though that point does not reflect the product strategy. This effect, in which a fundamentally non-sustainable product is placed on a sustainable point on the scale, could lead to greenwashing.

An additional difficulty, should such a scale be introduced, would arise in the event that the scale was solely binary, that is it would only show if an investment was sustainable or not. This approach would neglect the fact that the transition towards sustainability should also be taken into account, in order to foster the economic transformation.

If the idea to introduce a scale continues to be considered, even in light of the many reservations raised, then the PRIIPs-KIDs would be the only suitable medium for transmitting information. This is because the PRIIPs-KIDs are to be used to provide

information on the product, and because the purpose behind the proposed scale is to demonstrate to retail investors how sustainable an investment product is. As such, a regulation to this effect would have to be added to the PRIIPs regulation, including an authorisation for detailed design on level 2 – but not, however, on level 1.