A sustainable finance disclosure and labelling regime that is simple and works for the retail investor

The current SFDR regime marks indeed a breakthrough in regulating market participants and financial products on sustainability aspects. In Austria, for example, sustainability has evolved to the mainstream in financial markets – 75% of Austrian insurance companies that offer financial products already incorporate sustainability into their product design and almost all asset managers offer sustainability products with 43% of the total fund volume is managed under sustainability criteria (with an even higher proportion of 58% among retail funds). In this context, the SFDR focus on transparency and disclosure is a good starting point. However, current regulations have produced a set of very complex rules that may not lead to the desired outcomes to provide retail investors sufficient guidance and information to make informed decisions and to prevent greenwashing.

Therefore, we propose a **radical simplification of sustainable finance regulation**, which **focusses on the viewpoint of the retail investor**. This includes abolishing the distinction of Article 8/9 financial products for disclosure purposes, which are widely misused as being labels. Instead, there should be only one general sustainability disclosure regime that works for different product categories. The current regime overburdens those financial market participant and financial products that take sustainability factors into account. Rather, disclosure requirements should be applicable to all financial market participant and financial products, including the mandatory requirement to disclosure principle adverse impacts.

An important issue is the complexity of the current Sustainable Finance regulation, which should be **simplified and streamlined for clarity and consistency**. The usefulness and understandability for investors of disclosed information should be the prime focus in this process. In our experience, many (even key) concepts of the current sustainable finance disclosure regulation are not well understood by market participants and less so by retail investors. We regularly encounter even financial market professionals who misinterpret basic aspects, such as the nature of Article 8/9 SFDR financial products. Indeed, there are several complex aspects of the current sustainable finance disclosure regulation. Besides the nature and distinction of Article 8/9 SFDR, the distinctions between “environmentally sustainable” defined by the Taxonomy Regulation (TR), “sustainable investments” and “promotion of environmentally and/or social aspects” defined by the SFDR are hardly understandable for ordinary investors and burdens sound investment advice. There are also inconsistencies between SFDR and TR, e.g. the interaction between the principle of principal adverse impact and the principle of do no significant harm. That is, we propose not only to abolish the Article 8/9 SFDR distinction, but also the concept of sustainable investments defined by SFDR altogether. Every part of a new disclosure regime should be scrutinized whether it is truly simple, clear and not misleading from the viewpoint of the retail investor.

Besides a simple and clear disclosure regime, **regulatory minimum standards for sustainable financial products that are mandatory are needed, i.e. a regulatory labelling regime**. From a supervisory point of view, the lack of a mandatory labelling regime for sustainable financial products is a major challenge to prevent greenwashing. In this respect, EU regulation on sustainability labels is needed. EU Markets are fragmented due to insufficiently harmonized sustainability labelling. The proposal brought forward by ESMA’s consultation paper on funds’ names is a good starting point, however, we need legal clarity by a binding Level I labelling framework – without clear legal definitions of “green products”, supervisors cannot successfully prevent greenwashing. Therefore we propose to change the current “Sustainable Finance Disclosure Regulation” (SFDR) to a “Sustainable Finance Labelling and Disclosure Regulation” (SFLDR). In effect, even the current SFDR is already (mis-)used as a labelling regulation since the market needs such categories, even though this was not intended by the SFDR. In designing such a labelling regime, several considerations should be taken into account.

- To gain legal clarity, the labelling regime for sustainable financial products must be implemented by Level I changes and can be further specified by Level II.
- The labelling should not be a voluntary one, but mandatory covering any financial product that takes ESG factors in its investment objective into consideration. In Austria, we have the Austrian Umweltzeichen for sustainable financial products (Ecolabel) in place, which is one of the oldest national eco-labels in Europe (2004) and is well known and accepted in Austria by investors. However, this is only voluntary and not within the remit of the supervisor.
- The design of the labels for sustainable financial products should be simple, transparent and easy to understand for investors. In this context, as a supervisor, we do not propose specific sustainability labels at this point in time. Rather, they should be designed based on needs of the market and retail investors – prior consumer research and testing should be applied when designing a new disclosure and labelling regime.
- The designed labels should be mutually exclusive and form a “grading” system of sustainability that retail investors understand, which itself could be disclosed in SFDR disclosures and also PRIIPs-KIDs.
- Harmonization should occur across different financial products (with the same criteria applying for funds, insurance-based investment products or pension products, etc.)
- Harmonization should not prevent market participants from setting even higher standards.
- In line with proposals already brought forward by ESMA’s consultation paper on funds’ names, mandatory minimum thresholds for investments should apply for some sustainability labels; technical details to calculate these must be included (e.g. on the use of derivatives).
- A mandatory European labelling approach should set common minimum criteria, however, should not prevent the use of already accepted national labels that are voluntary, such as the Austrian Umweltzeichen (Ecolabel), which can address specific sustainability preferences of national markets (e.g., in the Austrian case the exclusion of nuclear energy).

In addition, **simplified rules on investment advice** (MiFID II, IDD) should be linked with a new labelling and disclosure regime of SFDR. In particular, rules on investment advice should be constructed bottom-up based on the needs of investors, in terms of their needs on different labels for financial products and disclosure. The current rules on sales and distribution of financial products, to the contrary, are defined top-down with reference to other (complex) rules on sustainable finance, having the focus on legal aspects and less the perspective and needs of retail investors. In the end, the purpose of a regulatory regime on labelling, disclosure and investment advice is to enable retail investors to make informed decisions.

In order to foster a level-playing-field, a new labelling and disclosure regime should also include a harmonised regime on supervisory powers, enforcement and sanctions. Currently, it does not only vary for jurisdictions but based on sectoral transposition in national law, the same breach of law is dealt with differently depending on the sector of the financial market participant.

Finally, we understand that changing the regulatory regime for financial market participants and sustainable financial products implied some costs for market participants, which have implemented existing rules in their processes and systems. However, this should not prevent to improve sustainable finance regulation for the better in the long-term. Finally, we need a regulatory regime on sustainable finance on disclosure, labelling and investment advice that is simple and works for the retail investor.