

# Commission Consults on Changes to the Sustainable Finance Disclosures Regulation

22 September 2023

The Sustainable Finance Disclosure Regulation<sup>1</sup> (the “SFDR”) applies from March 2021. On 14 September 2023, the European Commission (the “Commission”) launched the first stage in its review of the SFDR by means of a public [consultation](#) aimed at a broad set of stakeholders. The consultation covers a large number of topics on implementation of the SFDR and its overall effectiveness, with the Commission asking for views on a number of concrete improvements. The Commission’s work covers current areas of uncertainty and reflects its continuing concerns on greenwashing. As expected, the consultation proposes, among other things, a new categorisation system for funds, reflecting the SFDR’s development into a “labelling and marketing tool” beyond its originally intended use as a disclosure framework.

This Update outlines the key points of interest for fund managers.

**Broad Issues Consulted On.** The broad issues on which the Commission consults include principal adverse impact (“PAI”) reporting, areas of uncertainty (such as the “sustainable investments” definition) and data gaps. Specifically, the Commission asks whether all the PAI factors should be subject to a materiality test for the purpose of the entity-level disclosures and whether challenges arise in taking account of PAI factors in the do-no-significant harm (DNSH) assessment. In addition, the Commission invites views on data gaps and whether the SFDR is sufficiently flexible to allow firms to make estimates and on the lack of ESG data in common machine-readable format. On a similar theme, there is a question on streamlining (making more consistent) the disclosure requirements of the SFDR and the Corporate Sustainability Reporting Directive (the “CSRD”) and its underlying reporting standards. This may in time address the challenges faced by fund managers regarding the lack of access to good-quality data.

The Commission also asks for views on costs incurred by stakeholders to comply with the SFDR and whether those costs are proportionate. The Commission sees an uncertainty in the market as to the treatment of transition assets in the SFDR, inviting

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<sup>1</sup> Regulation (EU) 2019/2088.

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views on whether SFDR effectively captures investments in transition assets and supports shareholder engagement to support transition activities.

SFDR contains an empowerment to publish regulatory technical standards on how marketing communications should be presented, which has not yet been used. ESMA published in February 2023 a consultation and draft rules on funds' names using ESG- or sustainability-related terms. In relation to ESMA's work on rules for fund names, we expect ESMA to circulate a revised version shortly, but the details of the requirements remain to be seen, as well as whether the requirements will be limited to retail funds. In parallel to this work, the Commission's consultation includes a question on the use of sustainability-related names.

**Entity-Level Disclosures.** The Commission raises questions as to the usefulness of the entity-level disclosures required under SFDR. There are certainly open questions in the market as to the purpose of the aggregated PAI data that managers report at the entity level and whether investors can make useful comparisons between the PAI disclosures of different managers given the variety of managers' data sources and the current different levels of data availability. There are also questions about the usefulness of firms of publishing aggregated PAI data across all their funds.

The Commission also points to the obligations that managers will have to publish entity-level data under the CSRD, which may involve duplication with SFDR entity-level data, depending on the CSRD reporting standards, which are under development.

**Adapting Existing Product-Level Disclosure Requirements and New Categorisation System for Financial Products.** The Commission is aware that Articles 8 and 9 of SFDR have become *de facto* product labels and points to the proliferation of national labels for ESG or sustainable products. In response, the Commission seeks views on both adapting the existing product-level disclosure requirements and developing an EU-level product-categorisation system based on new criteria.

In terms of adapting the existing requirements, the Commission puts forward the possibility of imposing uniform disclosure requirements for all financial products offered in the European Union (which would describe "the sustainability profile of the product"), regardless of sustainability claims. This might include: disclosure on a limited number of principal adverse impact indicators; Taxonomy-related disclosures; engagement strategies; and information about exclusions or how ESG-related information is used in the investment process. The Commission also asks about changes to the current "break-down" of information spread across pre-contractual disclosures, periodic reports and websites and raises the possibility of requiring product-level information under SFDR to be in machine-readable format. It also raises the possibility of all product information being placed in the forthcoming European Single Access

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Point (the “ESAP”) for CSRD data, underlining the prospective important role of the ESAP as a database of ESG data published under the broad EU ESG disclosure and reporting framework.

In further terms of adapting existing requirements, the Commission proposes converting Articles 8 and 9 into formal product categories by adding additional criteria to support the existing concepts, particularly the “sustainable investment” and “do-no-significant harm” concepts. There are also proposals to specify minimum criteria for Article 8 funds that promote environmental and social characteristics and the possibility of specifying a minimum proportion of investments in Taxonomy-aligned activities for Article 8 or 9 funds.

As an alternative to adapting existing requirements, the Commission suggests a new categorisation system for sustainable products based on four sustainable investment strategy categories, including “products aiming to meet credible sustainability standards” and “products with a transition focus”. Any such system could be directed at retail and/or professional investors. The criteria for such categories could be based on matters such as degree of Taxonomy alignment, engagement strategies, exclusions or pre-defined and measurable environmental or social outcomes, such as minimum year-on-year improvement of chosen KPIs. There is also a suggestion that product categorisation would require third-party verification and a proposal that terms such as sustainable, ESG, green and net-zero should be only allowed for use by funds in the new categories of sustainable products. As expected, there are some parallels between the Commission’s proposal and the FCA’s proposed Sustainability Disclosure Requirements. Looking into the future, managers may face three separate labelling regimes under SFDR, the FCA’s forthcoming Sustainability Disclosure Requirements and the SEC’s proposed labels, with related concerns of the interoperability of the various regimes and potential investor confusion.

Lastly, the Commission signals its awareness of different approaches in the market in publishing confidential product-related information on websites, asking whether and how product-level information under the SFDR should be made public. It also seeks feedback on whether product-level information should be expressed on the basis of an established scale, for instance between one and 10, and is open to suggestions on how such a scale could be established.

The Consultation is open until **15 December 2023**, and the questionnaire can be found [here](#). The Commission can be expected to publish a proposal to revise SFDR in 2024, which will be subject to further consultation and the usual scrutiny process between the EU institutions.

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Please do not hesitate to contact us with any questions.



**Patricia Volhard**  
Partner, London, Frankfurt,  
Paris  
+44 20 7786 5505  
+49 69 2097 5150  
pvolhard@debevoise.com



**Jin-Hyuk Jang**  
International Counsel, Frankfurt  
+49 69 2097 5115  
jhjang@debevoise.com



**John Young**  
International Counsel, London  
+44 20 7786 5459  
jyoung@debevoise.com



**Eike Björn Weidner**  
Associate, Frankfurt  
+49 69 2097 5220  
ebweidner@debevoise.com