

The European Commission consults on sweeping changes to SFDR

On 14 September 2023, the European Commission launched its long awaited consultation on the implementation and potential shortcomings of SFDR, including its interaction with other parts of the EU sustainable finance framework and potential options to improve the framework.

The consultation is part of the Commission's comprehensive assessment of the SFDR framework, regarding issues such as legal certainty, usability and how it can play its part in tackling green-washing. The consultation could be the beginning of a major overhaul of the SFDR framework and comes on the back of the Commission's realisation that SFDR is not achieving its main objective of being a transparency and disclosure regulation but that it is instead being used as a *de facto* labelling regime.

The consultation has been structured in two parts, with a **public consultation** covering:

1. current requirements of SFDR
2. interaction with other sustainable finance legislation

and a **targeted consultation** looking to the future:

3. potential changes to the disclosure requirements for financial market participants
4. potential establishment of a categorisation system for financial products.

The **public consultation** asks a number of questions about the functioning of SFDR, such as whether the main objectives of SFDR are still relevant, whether the transparency through sustainability-related disclosures that it seeks to achieve supports the EU's shift to a climate neutral economy and whether it is effective in increasing transparency towards end investors regarding the integration of sustainability risks and the consideration of adverse sustainability impacts. Questions are also asked about the usefulness of disclosures under SFDR and whether key terms are sufficiently clear, e.g.: the concepts such as "sustainable investments" and the requirements around principal adverse impacts. In addition to questions around the cost of disclosures under SFDR and data challenges, the consultation also covers perceived inconsistencies and misalignments in SFDR's interaction with other sustainable finance legislation.

The **targeted consultation** is forward looking and contains questions about potential options to address the various shortcomings. Proposals for changes to the existing disclosure requirements contain potentially mandatory **standardised product disclosures** for either all financial products or only some who would exceed certain to be defined thresholds. The

proposed standardised product disclosures could include the following: *taxonomy-related disclosures, engagement strategies, exclusions and information about how ESG-related information is used in the investment process etc.*

The fact that Articles 8 and 9 of SFDR are *de facto* being used as a labelling regime, and the apparent market demand for such labels, has led the Commission to consult on a voluntary **product categorisation** system that would be based on minimum criteria to address the risks of greenwashing. Two approaches are being considered: The first one would build on and develop the existing distinction between Article 8 and 9 products with some complementary minimum criteria. The second approach would instead focus on the type of investment strategy (such as positive contribution, transition, exclusions etc.) and could result in the current distinction between Articles 8 and 9 of SFDR being removed altogether. Certain minimum criteria would again apply, such as taxonomy-alignment, engagement strategies, exclusions and pre-defined, measurable, positive environment, social or governance-related outcome.

Next steps:

The deadline for participating in both consultations is 15 December 2023.

For any further information please contact us or visit our website at www.elvingerhoss.lu.

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