

European Supervisory Authorities' Joint Opinion on SFDR 2.0

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On 18 June 2024, the European Supervisory Authorities (the “**ESAs**”) published a joint [opinion](#) (the “**Opinion**”) on their recommendations for the next iteration of the Sustainable Finance Disclosure Regulation (“**SFDR**”).

As we reported [here](#), the SFDR has undergone wholesale consultation with the European Commission having sought feedback on whether the entire regime should be overhauled, or whether there should be an evolution of existing elements of the regime. The European Commission recently published a summary of [feedback](#) from respondents to the consultation papers, which set out a clear majority for a categorisation system of financial products with sustainability-related investment strategies, but divided opinion on whether this should build on the existing Article 6 (sustainability risks disclosures only), Article 8 (promotion of environmental and/or social characteristics, plus good governance) and Article 9 (sustainable investment objective), or introduce entirely new categories.

We set out here the ESA’s Opinion, which is strongly in favour of the latter with a fresh outlook on new SFDR categories. For new sustainability-related investment strategies for EU funds or non-EU funds to be marketed into the EU, the evolution of SFDR and the ESMA fund name [guidelines](#) are recommended to be monitored to support future-proofing strategies and to minimise the need for later updates.

What are the categories proposed by the ESAs?

The Opinion sets out two proposed categories, which the ESAs note are not intended to be “labels of excellence” or “best in class”, but rather to set minimum criteria:

- Sustainability:
 - Intended for financial products that invest in economic activities/assets that are already environmentally and/or socially sustainable.
 - For environmentally sustainable products, the ESAs propose a minimum threshold of investments in Taxonomy Regulation-aligned economic activities

(although have not specified what this threshold would be).

- Any non-Taxonomy Regulation-aligned investments should follow “do no significant harm” (“**DNSH**”) concepts and good governance requirements, with the caveat that the ESAs propose that both should have more prescribed requirements.
- The Article 2(17) SFDR definition of “sustainable investment” is also commented on in the Opinion, with the ESAs requesting that the parameters become prescriptive to ensure a more uniform approach to sustainable investments across the EU. One option proposed is that if the economic activity of the investment is set out in the Taxonomy Regulation, it can only be considered a “sustainable investment” if it meets the Taxonomy Regulation requirements. If the economic activity is not listed in the Taxonomy Regulation, then it could rely on the SFDR sustainable investment definition, providing that has updated minimum prescribed requirements.
- Transition:
 - Intended to have a focus on investments in economic activities, assets or portfolios, not yet sustainable, but aiming to become sustainable over time. The category is expected to support investments that will help deliver on the ‘Fit for 55’ package – the EU commitment of climate neutrality by 2050 and the limiting of global warming to 1.5 degrees.
 - The investment strategies could mix on a build of Taxonomy Regulation KPIs, transition plans of underlying assets, decarbonisation trajectories of the fund and mitigation of principal adverse impact (“**PAIs**”) indicators (the mitigation requirements should in the ESAs’ view also be specified in the regulation). Exclusions could also be featured in this category.
 - The ESAs set out that there should be clarity in the level of ambition and performance intended in both the short and long term — including quantitative targets and intermediate milestones.
 - There is no envisaged requirement to apply DNSH to all investments, as some may be transitioning from a harmful threshold and others may be permanently harmful.

The ESAs are not settled in the Opinion on the benefits and drawbacks of requiring a share of investments to comply with the requirements of the transition product category, with the option to subsequently increase that share over time. Instead, they request the European Commission reflects on this. Similarly, the Commission is requested to reflect on whether there could be a sub-category of “transition” for impact funds that offer solutions to sustainability-related problems, with a positive measurable impact on an environmental or social objective alongside a financial return.

With regards to social sustainable investments, the ESAs suggest that the European Commission sets sustainability metrics. Those suggested are the social PAI indicators, the European Sustainability Reporting Standards social data points (which would provide some alignment with the EU’s Corporate Sustainability Reporting Directive) and building out the good governance requirements (or a combination thereof).

What about funds that are not categorised?

The ESAs set out that there would be sustainability disclosures for uncategorised financial products that would vary depending on whether they had any “sustainability features” present. Those with sustainability features would be required to disclose those in pre-contractual disclosures, and those without would be required to have a prescribed disclaimer. The Opinion adds that such a disclaimer could be supplemented by some minimal disclosure on the product’s negative impact on sustainability.

What is the sustainability indicator proposed by the ESAs?

The ESAs also propose a potential “sustainability indicator” to be considered for inclusion in a new SFDR regime, which could cover environmental or social sustainability, or both, illustrating to investors the sustainability features of a financial product in a scale that could simplify complex sustainability information in an easily digestible format for consumers.

They propose a variety of options for what such a sustainability indicator could cover, but do not land on a settled position. The ESAs also note that the development of a sustainability indicator is “not without risks and technical challenges”.

What is the interaction between the sustainability indicator and the proposed categories?

The Opinion sets out three options with regards to the sustainability indicator and proposed categories:

1. Framework consisting only of the new product categories.
2. Framework consisting only of a sustainability indicator.
3. Framework combining both the new product categories and sustainability indicator.

As with many areas, they leave these options to the European Commission to consider in terms of merit.

What about sustainability risks disclosures?

The Opinion sets out that the disclosures on how sustainability risks are integrated into investment decisions remain relevant and should continue to be disclosed for all financial products as they are now under Article 6 of SFDR.

What about retail vs. professional investors?

The ESAs set out that there should be a prioritisation of only essential information for retail investors in simple, unambiguous, non-technical language, with an acknowledgement that professional investors may benefit from detailed, technical information. The ESAs also note their support of the establishment of a new system in SFDR that will aid in not giving false impressions about sustainability to end investors, and guide consumers in selecting financial products that meet their sustainability preferences.

It is unclear if the ESAs would prefer the European Commission to mandate the information requirements for both types of investors. Similarly, it is unclear whether the sustainability indicator, which is noted to be of particular intended benefit for retail investors, would be an envisaged requirement for professional investors as well.

What did the Opinion cover on principal adverse impacts?

The ESAs consider there to be merit in considering two approaches to PAIs:

- “Consideration” of PAIs — the Opinion sets out this would intend to capture both disclosure and mitigation of the PAIs of investment decisions on sustainability factors; and

- “Information” on PAIs — this would exclude a requirement to mitigate them, but still provide useful information so that investors have a better idea about the negative consequences of potential investments.

The European Commission is requested to deliberate on making “consideration” of PAIs on sustainability factors compulsory for the proposed “Sustainability” product category, with “information” on PAIs being mandatory for the proposed “Transition” product category.

We note that they also suggest minimal disclosures to cover “information” about select key PAIs (which they do not specify in the Opinion) on priority indicators mandatory for all financial products — if this comes into force, it would increase the disclosure requirements for the current Article 6 products and many Article 8 products by compelling some PAI disclosures.

What’s next?

There is no set timeline for the European Commission to publish a proposed SFDR 2.0. We retain a watching brief on the next steps and any regulator papers on this position. However, with new categories proposed by the ESAs and also the [French regulator](#) (albeit with different categories), the momentum could now be gathering for the exit of Article 8 and Article 9 financial products and the entrance of a new categorisation system.

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