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SFDR Overhaul Could Be Coming

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Earlier today, the European Commission published two linked consultations on the current performance and future shape of the EU's Sustainable Finance Disclosure Regulation (SFDR). The "targeted consultation" is most relevant to asset managers and other users of the SFDR. The "public consultation" seeks more general feedback from a wider range of interested parties. With the announcement, the Commission appears to be contemplating a substantial, or even a complete, overhaul of the current SFDR framework that is likely to take effect through the introduction of new legislation within the near to medium-term. Early indications point toward a revised regime that looks much more like the U.K.'s proposed Sustainability Disclosure Requirements (SDR).

There are a number of possible permutations that are likely to have a significant bearing on the way in which funds approach marketing of sustainability-related aspects of their strategies in the EU going forward (including funds that are currently "Article 6 funds"). While final rules are likely a couple of years away, the extent of the revisions implied by the consultation papers means that early engagement with this topic is important. Key initial takeaways from the publication include:

- **Mandatory PAIs.** There is a suggestion that certain minimum disclosures of principal adverse impacts (PAIs) should be mandatory for all firms, rather than just being required for firms with over 500 employees as is currently the case. This could affect disclosures at both the entity level (subject to the point below) and at the product level. It seems likely that the minimum PAIs would include GHG emissions for fund portfolios.
- **Minimum sustainability disclosures**. There is a suggestion that all funds should have to make the same minimum sustainability information available regardless of their sustainability-related ambitions. This will have the greatest impact on Article 6 funds and may also affect "light green" Article 8 funds.
- **Product categorization**. Related to the above, there is a suggestion that the distinction between Article 8 and Article 9 could "disappear altogether," so that all funds become subject to the same minimum disclosures, with certain funds meeting minimum criteria being able to elect to use a sustainability label as part of a new set of product categorizations. Two options for a system of product categorizations are suggested: (i) introducing more granular subsets of the Article 8 and 9 "classifications"; or (ii) a distinct new set of product categorizations. The

suggested categories appear to be very similar to those proposed by the U.K. FCA as part of the U.K.'s forthcoming domestic SDR regime.

- **Entity level website disclosures**. The Commission queries whether SFDR is the right place for entity level disclosures (as opposed to sectoral legislation). To the extent a revision would allow a more nuanced approach to entity level disclosures for different types of financial services firms, this change could provide funds with additional flexibility.

We will provide regular updates as this consultation process proceeds. In the interim, funds should continue to have regard to the existing disclosure standards for new and existing funds, including guidance published by the European Commission relating to Article 8 and Article 9 requirements.

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