SFDR review: timeline and priorities

Introduction

The Chair noted that SFDR is a key pillar of the EU sustainable finance regulations and has been in place for more than four years. The Commission has launched a consultation on the review of SFDR, and a proposal is expected to follow soon.

1. Assessment of the implementation of SFDR

The Chair emphasised that the original purpose of SFDR was to enable investors and consumers to more easily compare investment products and their sustainability profiles.

A consumer representative observed that SFDR is a first step in providing transparency for investors. However, it has not delivered what retail investors wanting to invest in products associated with positive environmental and social impacts would have hoped for. In several cases, products classified as green included exposures that were incompatible with climate and social objectives.

There are three main areas where improvement is needed. First, the definition of sustainable investment needs to be clarified. A consensus is emerging that two clear categories of 'sustainable' and 'transition' would be a more useful approach. These categories would be mutually exclusive. Secondly, product categories in SFDR should be aligned with how investors' sustainability preferences are defined in the legislation. The review of the sustainability preferences as per the Markets in Financial Instruments Directive (MiFID) and the Insurance Distribution Directive is relevant here. Finally, product disclosures should be aligned with the intended SFDR categories and the sustainability preferences, making them accessible and easy to understand for retail investors. The most appropriate way to do this would be by incorporating this information into the key information documents (KIDs) on the sustainable products.

An industry representative stated that BNP Paribas supports SFDR as a positive step in the transition to a more sustainable economy. However, there have been implementation challenges. SFDR implementation was extremely resource intensive. Access to sufficient good quality data is key and is often limited. Reporting is currently too extensive, and the templates require a great deal of useless information. Some information is only applicable to certain sectors so transversal information would be more useful. In addition, excessive levels of granularity are sometimes required. For example, it is very difficult to collate data breaking down sustainable investment into environmental and social categories. Expectations on reporting differ between different competent national authorities.

What is missing for the Article 8 and 9 classification is minimum criteria to identify which products can qualify. As a consequence, there are too many article 8 products. The notion of transition is a major omission.

A regulator commented that SFDR was intended to achieve first transparency and harmonisation of disclosures. SFDR has performed relatively well on transparency, with combined assets in article 8 and 9 products in Q2 2025 representing over 59% of the EU fund market. However, results on harmonisation have been more mixed. Disclosures follow pre-contractual and periodic templates, but a significant amount of flexibility is being provided to financial market participants (FMPs) on how to complete these templates, leading to divergence. A robust regulatory framework with clear requirements that do not leave room for interpretation is vital for harmonised supervision and implementation.

Clarity is still missing on the foundational concepts of regulation, for example there is no agreed definition of a sustainable investment. Also, different methodologies are used to calculate the proportion of sustainable investments in portfolios across the industry. The treatment of derivatives has not been standardised. The additional guidance provided by the European Commission and the European supervisory authorities (ESAs) has not been sufficient to achieve the necessary harmonisation. The lack of harmonisation is unfortunate, as SFDR is a major regulation intended to finance the EU Green Deal, thus addressing a global challenge.

Implementation of the SFDR level 1 and 2 texts has been resource intensive not only for the industry but also for supervisors. Article 8 is too broad, accommodating a broad range of investment strategies, potentially leading to investor confusion. The regime has been used as a labelling scheme, which it was not intended to be. The lack of minimum criteria for the current SFDR categories prevents comparison of products. These issues result in a regime that is not fully functioning.

A public representative stated that benchmarking and reporting will be key to the success of sustainable finance. Over the next 20 years, ecological instability will be more of a threat than financial instability. The financial community must be provided with the tools to address this approaching ecological instability.

Work originally began some years ago in the Parliament, and is still ongoing, to develop a system for sustainability. ESG data is not standardised and is therefore difficult to interpret. An early proposal was to combine a broad SFDR in the same package as the corporate sustainability reporting directive (CSRD), because they have complementary roles. However, this proposal was not progressed due to member state reluctance.

Although the current situation is not what was initially envisaged, there are five pieces of sustainable finance regulation: CSRD, SFDR, taxonomy, green bonds and due diligence. This addresses most of what the Parliament asked for. Going forward, the aim should be to harmonise the standards, data and European supervision and introduce integrated reporting. A single access point should be introduced for data comparability. The current situation is not perfect and there have been some setbacks, but there are still opportunities for improvement, for example through an accounting directive.

The Chair noted that, although SFDR was intended as a disclosure regime, it is also being used as a labelling tool. This can enable greenwashing, for example if article 8 products are perceived as 'green' despite the lack of minimum criteria.

2. The impact of ESMA guidelines on fund names

The Chair noted that ESMA has published naming guidelines for funds to address greenwashing concerns.

A regulator noted that data for her country (a small country with a relatively small market in comparison to the EU as a whole) shows that almost 50% of National data on Undertakings for the Collective Investment in Transferable Securities (UCITS) and alternative investment funds, excluding private equity and venture capital, measured by net assets, are article 8 but less than 1% are article 9. Article 9 funds are lower than EU average and article 8 are around average.

Following the publication of the ESMA guidelines, number of asset managers changed the name of funds, for example to remove a reference to sustainability or replace it with ESG references, but. in some cases, a change in investment strategy led to a reclassification from article 8 to article 9. The market reaction shows the importance of having clear rules and guidance.

Through supervisors highlighting deficiencies to supervised entities and areas of non-compliance during the implementation of SFDR, the quality of information disclosed in the national asset management sector has improved somewhat.

Nevertheless, supervisors have faced challenges, such as obtaining the necessary expertise for very specific technical points and data availability. SFDR is very complex in some areas, with vague concepts resulting in different interpretations by different financial institutions. Furthermore, EU ESG regulation is not fully aligned. Different concepts are used in different regulations, which is a barrier to effective supervision. In this process, national supervisors should be aware of the wider European context and have regular communication with other supervisors to guarantee a level playing field.

Against this background, the ESAs, notably ESMA, have provided important support, such as Q&As, supervisory briefings and the previously mentioned guidelines. The SFDR review should ensure more convergence at the European level. The ESMA guidelines should be considered in the SFDR review, thus improving consistency between fund naming, ESG claims, investment strategies and product categories.

3. The reform of SFDR

An industry representative remarked that, in addition to building real categories of sustainable products under SFDR to replace article 8 or 9, the disclosures must also be redefined. The two aspects must be considered together. The focus should not be on the names of the products but instead on their substance and the accessibility of the information that is disclosed. When creating real categories, it must be remembered that SFDR was not originally intended as a tool for categorisation but instead to increase transparency.

The need for minimum criteria is clear. These minimum criteria should be robust and less flexible than the current framework. Article 8 in particular is very flexible, and many assets and products can be included. The methodology or criteria around categories must accommodate the nuances of different asset classes. For example, there have been challenges in relation to sovereign debt private assets. SFDR does not currently consider transitional assets, and this must be addressed. The new categories need to be robust, enforceable and easy to understand. At present, many retail investors lack the understanding to make real use of the disclosures.

A regulator advised that a cautious approach should be taken to incorporating the ESMA guidelines on fund names into the SFDR review. The ESMA guidelines apply to only some of the products in scope of SFDR and to funds, which has potentially led to market fragmentation. Instead, a comprehensive review of the framework is needed so that any standards or guidelines apply to all products in scope. In addition, several key concepts are still not defined in the ESMA guidelines, for example the list of terms that trigger the application.

In addition, the ESMA guidelines pose operational challenges to asset managers. For example, a limited number of index derivatives comply with the criteria of the guidelines. Asset managers would therefore be unable to install appropriate hedging arrangements for their portfolios. Great care needs to be taken before using these criteria in any redesign.

At least two categories are needed: the sustainable category and the transition category. The transition category reflects the fact that greening the economy is not a linear process. A possible third category with lower sustainability ambitions could then capture those products that did not fall into the sustainable or transition categories. The Commission has proposed that this be named the ESG basics or collection category. To address the market concerns that this third category would replicate the shortcomings of the current article 8 products, clear and science-based minimum criteria need to be developed. Taxonomy alignment should also be considered.

The Chair noted that, in the context of the current geopolitical situation, a separate category for the defence industry to encourage investments in this area has been proposed.

A consumer representative advised that it is important to consider which objectives are being targeted with which tools. SFDR does not need a defence category. Investors are free to choose to invest in sectoral products dedicated to defence, but this is not within the remit of the sustainable finance framework. Sustainable finance aims to channel capital to activities associated with climate, the environment and social objectives. Many defence investments would not fulfil the criteria in the environmental taxonomy, although some might. Stating that all defence investments are sustainable would undermine the sustainable finance framework.

The tension in this area largely stems from the priority currently given to defence in political discussions. Additionally, returns accruing in the defence sector are competing with sustainable finance investments, which are struggling to become more attractive for the private sector.

The Chair summarised that, although a consumer representative does not believe that defence should be a separate category, there is already some flexibility in the framework to support the capital flow towards the defence industry.

An industry representative emphasised that minimum, objective, measurable and binding criteria are needed and should be adapted for different asset classes. The categories will only be successful if they are used in ESG preferences. Developing categories under SFDR without modifying the current sustainable preferences would be ill advised. The categories should be mandatory and not voluntary, with only categorised products allowed to make ESG claims. The purpose should be to increase clarity for end investors.

A public representative proposed a transition-plus category, with a move into the sustainable category after accounts are audited and there is evidence that the transition plan has been followed. The categories should also develop through time and technological advancements: for example, , blue hydrogen could be regarded as better than natural gas and therefore be forever considered as transitional and labelled as green. More flexibility will be needed around innovation. Within the categories, there should be an overall compass. For example, where there are increased risks a black or brown classification could be used, with green where there are fewer risks. There should be no defence category. Defence should be appreciated for what it is and not classified as sustainable. The taxonomy should follow the categorisation.

4. Simplification agenda and SFDR

The Chair stated that simplification is currently a major priority. The Commission's proposed in Omnibus to simplify CSRD reporting, the due diligence directive and EU taxonomy. These pieces of legislation will be simplified in terms of not only how many firms are required to report but also the amount of reporting that is necessary. This simplification agenda will impact SFDR.

A public representative commented that the Omnibus and the political situation in the European Parliament and member states might lead to regulation resembling a Halloween pumpkin: totally empty and with a nice smile.' Companies need clarity and better regulation, not just deregulation. Therefore, we should have found a solution beyond a choice between tolerating imperfection or ending up with another Halloween pumpkin.

An industry representative noted that asset managers and investors are already fatigued. Implementation has been resource intensive. A thoughtful review of the regulation, with simplification as an overall goal, should first consider the overlap with other pieces of regulation. Duplicate requirements must be eliminated. Input should be sought from all the different stakeholders. Any modifications should fulfil the aim of providing investors with more useful information.

The Chair noted that the definition of sustainable investments under SFDR is principles based.

In answer to a question on whether there should be more alignment between the concept of sustainable investment in SFDR and the definition under the EU taxonomy, which is more prescriptive and rigid, an industry representative stated that there is value in maintaining the concept of sustainable investment, despite the different proprietary methodologies. Full harmonisation of the definition of sustainable investment would be useful but would mean using the EU taxonomy. However, using only the EU taxonomy is an issue. Presently, and likely more in future, it will be very difficult to obtain information about alignment with the EU taxonomy as the current Omnibus 1 package proposal is to make taxonomy reporting optional under a specific condition. As only using the EU taxonomy is not a solution, full transparency on the methodologies used and introduction of common principles should be envisaged.

A relative approach could neutralise the differences between methodologies. This would apply to most, but not all, products and asset classes. The relative approach involves benchmarking the ESG performance of a product within its investment universe as frequently used in asset management. This could be achieved with, for instance, a selectivity approach or a best-in-class approach.

A regulator proposed that the review of the SFDR should focus on four main principles. First, it should guarantee that the information to be disclosed is useful for investors need. Just to give an example, potential product categorization has been discussed, but it is vital that investors understand which products are in each category. Secondly, costs for FMPs should be minimised by focusing on the necessary information (and by keeping in mind that changing regulation also imposes costs). Thirdly, key concepts of the regulation should be clarified, thus providing legal certainty, decreasing fragmentation and improving compatibility. Clarity will increase trust and attract investors to the market, thus fulfilling one of the main objectives of the regulation.

Fourthly, all the legislation that applies to ESG-related issues applicable to the financial sector should be consistent. Against this background, the SFDR review should reflect discussions around the Omnibus and ensure that there is no duplication or overlap.

In terms of the simplification that could be introduced, without losing important information, SFDR entity-based disclosure requirements should be streamlined. This part of the legislation is relatively complex, for example regarding the information required on the principle of adverse impacts on entity-related information. A great deal of information is required for these disclosure requirements and there is no guarantee that the ESG data being used is standardized.

Conclusion

The Chair concluded that there is a clear need for simpler and more meaningful disclosures. It is hoped that the Commission will develop a proposal that delivers this.