

## SFDR REVIEW TIMELINE AND PRIORITIES



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### SFDR 2.0: delivering a more effective framework

The SFDR's entry into force in March 2021 marked a significant milestone in the EU sustainable finance journey. It encouraged market participants to bolster their offer of sustainability-related products. However, the SFDR implementation proved challenging, due to the absence of clear definitions of foundational concepts such as "sustainable investment". The SFDR RTS added further complexity, to the framework through highly detailed precontractual and periodic disclosure requirements, creating interpretative challenges – such as determining the Taxonomy alignment of sovereign bonds – and placing strong emphasis on data-driven disclosures, while (reliable) ESG data was still lacking. After nearly five years of application, it became evident that the framework required substantial revision to function effectively. Furthermore, the framework may not have been conducive to fostering supervisory

convergence. Against the backdrop, the European Commission's SFDR 2.0 proposal is a welcome development as it aims to address the shortcomings of the current regime, while moving towards greater simplicity.

SFDR being a disclosure regulation, it is key for its design to enable investors to navigate the sustainability product offering and to make an informed decision of the investments that are proposed to them. The establishment of product categories with clear and objective criteria is a significant step towards achieving this objective. The threefold regime proposed by the European Commission – comprising a sustainable category, a transition category and an ESG basics category – helps to eliminate the excessive flexibility currently offered under SFDR. The introduction of a transition category constitutes a recognition that greening the economy is not a linear process. The ESG basics category ensures broad market coverage, while delineating the scope of the category, thereby addressing the shortcomings of the current Article 8 under SFDR. The proposal also foresees reducing the disclosure templates to a two-page format, representing a significant simplification effort. To address the ESG data challenge, the European Commission permits the use of estimates and sets out corresponding guardrails governing their use. Leveraging the provisions of the ESMA Fund Naming Guidelines for the definition of exclusions potentially limits market disruptions for asset managers.

That said, although the overall direction of travel is welcome, the difficulties lie in the details. First, it is surprising that the European Commission has not incorporated into its proposal the clarifications it published in its FAQs on the scope of the SFDR – for example regarding registered AIFMs – even though the scope is at the core of the framework. Assessing Level 1 texts without corresponding Level 2 specifications is challenging. This is particularly relevant as several key concepts introduced at Level 1 require further clarification at Level 2, like for instance what constitutes a credible transition plan or the contours of the pre-set impact theory. Some elements remain unclear or may prove operationally unworkable. The identification of non-categorised products based on the volume of sustainability claims in

pre-contractual documents is not an investor-oriented solution and may merely introduce additional burdens for market participants and supervisors. A disclaimer stating that the product is non-categorised appears to be a more effective solution. Elements that remain unclear from a supervisory perspective are the references to the management of PAB and CTB indices, the catch-all provision for eligible investments under Articles 7 and 9, the expectations regarding the remaining 30% of the portfolio.

Open questions persist on the treatment of derivatives under SFDR and on how exclusions should apply to derivative positions. Asset managers highlight the operational burden of applying exclusions to index derivatives used for hedging or efficient portfolio management, a challenge that has not affected benchmark administrators, likely due to the limited use of derivatives in the construction of PAB/CTB indices. This shows that the provisions of the benchmark regulation may not be directly transposable to SFDR products and that further adjustments to the exclusion framework are needed for a fully functioning regime. Finally, further specification on the disclosures of Principal Adverse Indicators (PAIs) of investments is needed, as the SFDR proposal is unclear as to whether these disclosures are mandatory or voluntary and on which indicators should be used. To ensure harmonisation and reduce burden, the disclosure could instead focus on a limited set of PAIs applicable to all investment strategies.

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The SFDR proposal offers a renewed opportunity to significantly improve the regime and to place investors at its core. Ensuring that previous challenges are not repeated, and that any remaining shortcomings are effectively addressed, will be essential for the framework's success.



## MARTIN MERLIN

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### SFDR reform: a clearer and more usable framework for sustainable products

The EU sustainable finance framework was the first of its kind globally. It positioned Europe as a leader in mobilising private capital towards sustainable economic activities in support of the European Green Deal. The Sustainable Finance Disclosure Regulation (SFDR), in application since 2021, became the first pillar of the framework and has since played a pivotal role in reshaping the EU's sustainable investment landscape. By introducing harmonised sustainability disclosures for financial market participants and products, the SFDR enabled investors to better understand the sustainability profiles of products and allowed providers to communicate their sustainability strategies more clearly. By the third quarter of 2025, more than half of EU products made disclosures under the SFDR, accounting for around 60% of assets under management in the EU. The framework also encouraged sustainability-related disclosures from non-EU products that want to be distributed in the EU.

However, despite these achievements, the Commission's comprehensive as-

essment of the SFDR implementation identified several limitations and unintended effects that required action. Disclosures proved overly complex and difficult to interpret and compare, particularly for retail investors. Moreover, the framework did not always provide effective protection against greenwashing, which undermined trust in sustainable investments. Simultaneously, compliance costs as well as diverging national rules and supervisory approaches risked weakening the competitiveness of EU financial markets.

These challenges emerged at a time when strengthening the EU's competitiveness, including that of its financial market, had become a key strategic priority, which made a revision of the SFDR even more urgent. However, it was important to do so without undermining the ambition or credibility of the EU's sustainable finance agenda. As a consequence, **bringing together simplification and stronger rules against greenwashing became the core objective of the review.** In addition, reforming the SFDR was an opportunity to encourage greater retail participation in capital markets and to support the emergence of a genuine EU single market for ESG financial products, in line with the objectives of the Savings and Investment Union.

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The 2023 public consultation and extensive stakeholder engagement provided clear guidance on the necessary changes. Although views diverged on some technical details, two strong messages emerged. First, disclosures should be simpler and more meaningful, supporting informed decision-making without excessive complexity. Second, disclosures alone are insufficient to fight greenwashing, and categories with ESG minimum criteria are needed to address the de facto use of the SFDR as a labelling regime and to reduce national fragmentations.

The proposed reform of the SFDR, presented by the Commission in November 2025, builds directly on this input. Its central element is the creation of three sustainability-related products categories – sustainable, transition and ESG basics – supported by clear and proportionate criteria. These categories aim to reinforce

the framework's anti-greenwashing safeguards without imposing overly rigid or excessive requirements that could hinder innovation. Each category is accompanied by mandatory exclusions, such as activities related to coal or human right violations, and a requirement that at least 70% of the products' assets support the stated sustainability objective.

The categories are designed to play a central role in ESG marketing and naming rules by limiting ESG claims to categorised products. They should also support distributors by providing a clear framework to match retail investors' sustainability preferences.

Finally, the reform reduces disclosure requirements by focusing on product information that is meaningful and understandable for retail investors. This significant reduction in ESG disclosures aligns with the February 2025 Omnibus on sustainability reporting and adapts the SFDR to the amendments to the EU Taxonomy Regulation and the Corporate Sustainability Reporting Directive (SFDR).

Looking ahead, the proposed SFDR reform is designed to provide long-term regulatory stability and predictability. It aims to support the development of a credible and competitive EU market for sustainable finance products by anchoring key requirements at Level 1 and limiting reliance on detailed Level 2 measures. Drawing on the lessons of the SFDR 1.0, the proposal aims to remain robust over time while retaining flexibility for market innovation. A review clause three years after application will allow the framework to evolve with sustainable finance practices.

As the legislative negotiations begin, we call upon co-legislators to preserve the proposal's dual objectives of simplification and effective investor protection, as well as the careful balance struck between the two.



## DELPHINE DIRAT

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### SFDR reform: recognising multiple approaches to climate transition

The Sustainable Finance Disclosure Regulation ('SFDR') reform offers a welcome revamp of ESG fund categories, cutting ambiguity and creating a clearer, more practical, market-aligned framework that boosts transparency and supports the climate transition.

#### Clarity Through a Three-Category Architecture

The European Commission proposes a system designed around three clear categories: sustainability leaders, transition strategies, and ESG basics. This should address some of the issues of the current SFDR which has generated uncertainty and inconsistency across ESG products. This system reflects more accurately how investment strategies are constructed and allow investors to distinguish between portfolios already aligned with high sustainability standards, those measuring improvement, and those integrating ESG risks within traditional mandates.

For this framework to function effectively, it must be embedded in an architecture that balances ambition with functionality. Categories should be robust enough to restore credibility and comparability, yet flexible enough

to accommodate diverse asset classes, geographies, and investment styles and objectives. Investors should retain discretion to define methodologies, select relevant KPIs and PAI indicators, and calibrate portfolio construction tools according to their mandates.

Interoperability with the UK's Sustainability Disclosure Requirements (SDR) labels is equally important to avoid fragmentation and ensure cross-border consistency.

#### Transition as the Strategic Core

Among the three categories, the transition bucket must become the strategic focal point, as it is where most ESG products will be concentrated and where capital is most urgently needed.

#### *How the Transition Should Be Approached*

It is important to recognize that there is no single "right" way to assess climate ambition or transition readiness, and investors have diverse priorities and objectives. Fund providers should therefore explain transparently how they evaluate these factors and how this is reflected in their investment strategy. The framework should preserve diverse approaches, supported by a standardised way of disclosing methodologies.

At the same time, companies should be encouraged to publish strategic, decision-useful transition plans setting out science-based targets, governance oversight, and measurable interim milestones. Aligning these expectations with the CSRD and ISSB frameworks will help ensure coherence between issuer-level disclosures and product-level classifications. This alignment will also materially reduce greenwashing risks by directing capital toward verifiable and credible transition pathways.

#### *Practical Feedback on the Proposed Transition Category*

The flexibility offered regarding KPIs and different transition approaches is welcome.

Nonetheless, there are a few practical considerations to consider:

While thermal coal extraction is a standard exclusion across many sustainable indices, the proposed >1% revenue threshold is particularly strict and risks significantly narrowing the investment universe.

Likewise, the exclusion of companies involved in developing new fossil-fuel, hard coal or lignite projects is difficult to operationalise at this stage. The underlying data are still new, scarce and

inconsistent across the market, making it challenging for investors to identify such activities reliably and implement the exclusion in a consistent manner.

**If these exclusions are adopted, investors would face very limited access to transition products,** making it significantly harder to attract capital toward this category and, ultimately, to support the climate transition.

Given these constraints, it may be more appropriate to introduce such exclusions as phase-in requirements.

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#### Testing Criteria to Ensure Market Relevance

Before implementation, proposed thresholds, KPIs, and portfolio constraints must be rigorously tested. It is necessary to consult asset managers across strategies and asset classes to confirm operational feasibility and data reliability. Criteria that are conceptually robust but impractical would undermine the reform's effectiveness.

Benchmark administrators must also be involved, given the growing scale of passive investment. Simulation exercises should assess impacts on index composition, sector allocation, liquidity, concentration risk, and tracking error. Without empirical validation, new rules could unintentionally shrink investable universes or exclude sectors essential to the transition.

A reform grounded in clarity, centred on credible transition finance, and validated through systematic testing would transform SFDR into a coherent classification framework. Properly designed, it can restore confidence, strengthen comparability, and accelerate capital flows toward Europe's climate objectives.



## LAURENCE CARON-HABIB

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### How to move smoothly from a disclosure regime to a categorisation framework?

The long-awaited legislative proposal of the European Commission on the review of the SFDR was published on 20 November 2025 and is broadly aligned with what was expected. More concretely, the approach is a clear move from a disclosure regime to a categorisation framework while drastically simplifying the disclosure requirements. The direction of travel initiated by the European Commission is welcome, provided that it results in effective simplification of the existing framework and enables end-clients to have a clearer understanding of the ESG features of products they can invest in, and all the information they need to make informed investment decisions.

In more detail, the European Commission's approach for defining the three categories (Sustainable, Transition and ESG Basics), each with a similar structure - i.e. a list of exclusions, criteria for eligible assets & investments and disclosure requirements - is key to ensuring that common minimum binding criteria will apply for each category. This should facilitate comparison between and better understanding of categorised products. At the same time, for certain

types of assets not covered by the current proposal, some flexibility in the assets eligible for each category is also necessary and a more specific approach should be allowed. In such cases, it will be essential that sufficient transparency is provided to end-investors on the methodology used, with relevant indicators.

Clearly there will be intense discussions on how each category is defined, to obtain further clarity on certain aspects. Regarding the exclusions, the key point is ensuring that these do not reduce the investment universe for each category too much. This notably applies to the Transition category, where it is important not to exclude companies that have a true transition path to ensure that this category is not reduced to a "niche" category. That would contradict the strong priority given to this transition concept, seen by all stakeholders as a factor in the new SFDR's success. Another issue is around the possibility of investing in sovereign bonds, which is limited to the ESG Basics category in the Commission's proposal. Many governments are active in the sustainable transition, both at national and international level. It seems relevant to take these commitments into consideration when defining investments eligible for the Transition category, provided it can be demonstrated that a robust and credible methodology is applied.

#### One of the most positive evolutions is the strong simplification of the disclosure requirements.

One of the most positive evolutions is the strong simplification of the disclosure requirements, as strongly recommended by the industry. Limiting the pre-contractual template and periodic reporting to two pages should allow a focus on the most relevant information while facilitating understanding of ESG-related information by end-investors. Reference to the pre-contractual template for the website disclosure is also a welcome change. A good way to encourage comparability between products in the same category would be to enforce a common limited set of principal adverse impacts (PAIs) for which data is available and that would make sense for all products.

Other elements need to be improved to make this revision even more valuable. First, it is necessary to reconsider the new provisions on estimates. As currently drafted, they put responsibility

for the quality of data provided by external data providers on financial market participants. This responsibility should instead lie with the ESG data providers themselves, who are currently totally unregulated. A solution for this is urgently needed, for instance a recital indicating that a code of conduct should be adopted, as is already the case in many jurisdictions.

Finally, this revision will only be successful if the following conditions are met. First, financial market participants must have sufficient time to adapt to the new framework. This means that the Level 1 text can only begin to apply once implementing standards have been adopted, and after sufficient time for adaptation by financial market participants. Articulation between the current and the new SFDR must be properly addressed to avoid any disruption for end-investors. Similarly, sustainable preferences will have to be reviewed to take into consideration the new SFDR categories and the removal of the criteria currently used (such as the "sustainable investment" concept and the consideration of PAIs). It is crucial that the new SFDR and the revised sustainable preferences begin to apply at the same time, once again for sake of a smooth transition.



## HOWARD RISBY

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### Embed stewardship in SFDR 2.0 to unlock the EU's sustainable transition

The EU has a bold ambition to improve competitiveness while promoting sustainability standards and solutions. These ambitions are embodied in strategic initiatives such as the European Green Deal, the Clean Industrial Deal and Competitiveness Compass.

The EU's sustainable finance framework, including EU Taxonomy, Sustainable Finance Reporting Directive (SFDR) and the Corporate Sustainability Reporting Directive, established a set of policies intended to direct capital to activities aligned with these aims.

SFDR has, in the Commission's view, been successful in reducing ESG risk and improving investment due diligence and governance practices. However, their review also concluded that it "was not fully effective in delivering on its broad aim to... mobilise private funds towards... sustainability aims".<sup>1,2</sup> This was in part due to fund disclosure requirements being long, complex and hard for investors to interpret.

We welcome the changes in SFDR 2.0 that aim to address these problems by improving clarity and reducing administrative burden. However, the changes are a missed opportunity to

influence the acceleration of capital deployment to activities that have the most opportunity to support the EU's ambitions.

In SFDR 2.0, funds in the "Transition" category are intended to support companies or activities that are not yet sustainable, but are on a credible, measurable transition pathway. However, this categorisation remains largely focused on what funds hold, rather than what change they enable. This static emphasis limits the SFDR's ability to incentivise real-world outcomes and does not recognise the contribution of investor stewardship to the transition.

Embedding stewardship - defined as active, outcomes-focused engagement with companies - as a core requirement would transform the Transition category from a passive label into a credible driver of real-economy transition. Transition investing is fundamentally about supporting companies that are not yet sustainable but have the potential to become so. However, credible transitions rarely happen smoothly or in isolation. They require structured pressure, guidance and accountability, all of which effective stewardship can help to provide.

Stewardship can support these outcomes, first, as engagement with companies helps to strengthen their transition plans through ongoing oversight, dialogue and challenge. This helps companies understand investors' perspectives and reduces potential financial and execution risks from transitioning. This in turn increases confidence to invest further.

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**Transition investing  
is about supporting  
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Second, strong stewardship improves visibility of transition progress. Engagement encourages companies to report on their own activities and facilitates reporting through the investment chain. Companies that report on progress against transition plans - on climate risk management, protecting the natural resources on which companies depend, or boosting productivity through worker engagement - demonstrate the outcome of company boards' capital allocation decisions. This can attract additional capital, reinforcing a positive cycle of investment and improvement.

Third, stewardship supports multiple stakeholders working toward a common goal. Stewardship increases the transparency of the challenges companies and investors face, in turn facilitating collaboration - whether between policy makers, financial services, corporates, research & technology providers, and consumers - to work together on solutions in a mutually beneficial way to overcome these challenges.

All of this contributes to long-term sustainable value creation and supports the EU's goals of increased and sustainable competitiveness.

This approach is not just theoretical - it is proven through Federated Hermes' 20 years of embedding stewardship into every aspect of our investment process. Our stewardship-led approach has consistently helped companies manage the risks and opportunities of the transition, creating long-term value for companies and their investors.

We don't just apply our stewardship approach to our own funds. EOS, Federated Hermes' stewardship service, was formed to help our clients improve the long-term fundamental performance of their investment portfolios through engagement with companies and policymakers, aligning their decisions and the outcomes they achieve with investors' long-term financial interests. EOS' approach - measured through milestone progress and outcomes reporting - demonstrates delivery of improved real world sustainability outcomes and enhanced long-term value creation<sup>3</sup>.

Embedding engagement and stewardship within SFDR 2.0 would align the Regulation more closely with the EU's overarching goals of systemic risk reduction, long-term competitiveness, and investor protection.

1. *Commission proposes improvements to SFDR - Finance - European Commission*
2. *EU SFDR 2.0 - Sustainable Finance Disclosure Regulation review - what changes are on the horizon?*
3. *EOS 2024 Annual review p14*



## THOMAS BÉHAR

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### SFDR review: a blind spot for insurance life products

In the transition toward a more sustainable economy, European insurers play a central role, both as insurers and as long-term responsible investors, managing nearly €10 trillion in assets<sup>1</sup>. This position is key in financing the economy, sovereign debt, the transitions, and reflects the fact that the sustainable finance framework is integrated across all layers of the insurance sector. The Sustainable Finance Disclosure Regulation (SFDR) is one of the key components of this framework, implemented by the insurance sector to enhance transparency for customers on how sustainability risks and factors are integrated into financial products.

Four years after its entry into force, the SFDR framework has shown its limitations. Articles 8 and 9, which were never designed to serve as a genuine product classification but rather as disclosure requirements, lack clear criteria and now cover an overly broad range of products. This situation undermines the framework's clarity and makes a review necessary to strengthen product transparency in terms of sustainability.

In this regard, the Commission's proposal brings improvements, with a more readable architecture built around three categories: Sustainable (Article 9),

for products investing in sustainable economic activities; Transition (Article 7), for those pursuing a clear and measurable transition objective linked to sustainability factors; and ESG Basics (Article 8), for products integrating ESG criteria through binding elements of the investment strategy. The introduction of a common 70% threshold for investments aligned with the targeted category, together with specific exclusions, raises the level of ambition within the transparency framework.

However, the proposal contains a significant blind spot: the absence of explicit treatment for insurance-based investment products (IBIPs), including popular life insurance multi-option products (MOPs) in France and in other Member States such as Belgium, Luxembourg and Italy. MOPs offer policyholders a choice to invest in a combination of a capital-guaranteed euro fund and unit-linked options (with risks borne by the customer) and are currently addressed in the delegated regulation<sup>2</sup>. Despite the opportunity presented by this review, they are absent from the proposed Level 1 text. Given their scale, it would be appropriate to include them explicitly at Level 1, through a categorisation of investment options that also encompasses euro funds.

For MOPs, it must be possible to categorise euro funds. As drafted, the revision makes this difficult, due to insufficient consideration of sovereign debt and a lack of appropriately adjusted exclusion rules.

**Multi-option products, sovereigns, exclusions: Three key challenges for insurers in the SFDR Review.**

Sovereign debt represents nearly one-third of the assets which compound the euro funds. Therefore, it cannot be excluded from the scope of transparency. Even though the proposal makes sovereign debt eligible for the ESG Basics category, meeting the 70% threshold will require a clearer and more operational methodology. Such a methodology could build on existing labels or eligibility criteria, enabling product comparability within a Member State and improving readability and transparency for consumers. Without such clarification, euro funds and MOPs would lose their ability to be categorised, not because they lack sustainability

characteristics, but due to the absence of an appropriate methodology.

The other concern applies to the exclusions, which have become more restrictive. While they raise the ambition of the framework, applying them to 100% of assets would create significant challenges for fund-of-funds and UCITS investments, especially without transitional periods. Moreover, the 1% threshold for coal may prove overly restrictive for euro funds, given the difficulty of ensuring compliance across all underlying exposures and could be adjusted, at least for the ESG Basic category, to align with existing reference frameworks, such as the French SRI label (Label ISR)<sup>3</sup>.

The SFDR review is part of the broader effort to simplify European sustainability legislation, alongside the CSRD and the Taxonomy Regulation. While simplification is essential, it must not come at the expense of sustainable finance ambition. The review should build on what has already been implemented. Insurers' investments must not be set aside; they form the basis of an effective transparency framework that must ultimately benefit our clients.

1. *Statement to the Economic and Monetary Affairs Committee of the European Parliament – November 2025 – European Insurance and Occupational Pensions Authority, link*
2. *Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council, link*
3. *The Label ISR (Investissement Socialement Responsable) is a French government label, created in 2016, which distinguishes savings funds that rigorously integrate environmental, social and governance (ESG) criteria. For more information: the official Label ISR website*