

# The usefulness of the Sustainable Finance Disclosure Regulation - An explorative study into its shortcomings and challenges

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## Abstract

The Sustainable Finance Disclosure Regulation (SFDR)<sup>1</sup> aims to enhance transparency and curb greenwashing by standardizing sustainability disclosures. Despite its ambitious goals, the SFDR faces challenges and criticisms regarding its practical implementation and effectiveness. This article delves into these issues through an exploration of the European Commission consultations, articles, and recommendations from entities such as the Platform on Sustainable Finance (PSF), the European Sustainable Investment Forum (Eurosif), and the Dutch Authority for the Financial Markets (AFM). Our study identifies key areas where the SFDR currently falls short while suggestions for improving the effectiveness of disclosures are provided.

## Relevance to practice

By dissecting the SFDR's effectiveness and areas needing enhancement, this article aims to raise awareness on the current developments of this Regulation. It highlights the practical implications of adhering to SFDR mandates, aids in navigating its complexities, and suggests improvements to foster clearer, more effective disclosures. By understanding these dynamics, practitioners can better align their strategies with regulatory requirements and investor expectations, ultimately facilitating a more transparent and sustainable financial environment.

## Keywords

SFDR, sustainable finance framework

## 1. Introduction

As an important part of the European Commission's ('EC') Action Plan on Sustainable Finance, the Sustainable Finance Disclosure Regulation ('SFDR'), effective as per 10 March 2021, imposes rules on Financial Market Participants ('FMPs') and Financial Advisers ('FAs') to harmonise sustainability-related disclosures to end investors. On 14 September 2023 the EC launched two consultations – one public and one targeted – to assess the implementation of the SFDR. The aim of these consultations is to evaluate limitations related to legal certainty, the useability of the SFDR and its ability in combatting greenwashing.<sup>2</sup>

In this context, our article aims to conduct a circumscribed analysis of the SFDR by examining inputs from the consultations, and other relevant publications. We aim to identify the shortcomings and challenges underlined during this consultation process. Our research question is:

*What common shortcomings and areas for improvement have been identified in the responses to the EC consultations on the SFDR?*

To answer this, we examined the responses to the Commission's consultation from the Platform on Sustainable

Finance ('PSF'), the European Sustainable Investment Forum ('Eurosif') and the Dutch Authority for the Financial Markets ('AFM'). The selection of stakeholders was based on choosing one representative from expert groups (the PSF combines expertise on sustainability from the corporate and public sectors, academia, civil society, and the financial industry), one representative from the sustainable investment industry (the Eurosif, a partnership of Europe-based national Sustainable Investment Fora, whose network includes institutional investors, asset managers, financial services, index providers, and ESG research and analysis firms), and a representative from a national competent authority. The Dutch Authority was chosen because non-financial information disclosure in the Netherlands began earlier compared to most EU countries (Hubers and Thijssens 2020; Kolk et al. 2001).

After this introduction, we will describe in section 2 the current state of the SFDR including its embedding in the Action Plan on Sustainable Finance, its main requirements and the reasons for the Commission's consultations. In section 3 we will describe our research method, followed by an analysis in section 4 in which we respond directly to the research question. We will conclude with some final observations.

## 2. Current state of the SFDR

### 2.1. SFDR landscape: context and developments

At the European Union ('EU') sphere, the history of the SFDR starts in March 2018, when the European Commission adopted the Action Plan on Sustainable Finance. The strategy to connect finance with sustainability included key actions divided into three categories:

- 1) reorienting capital flows towards a more sustainable economy;
- 2) mainstreaming sustainability into risk management; and
- 3) fostering transparency and long-termism.

The last category is tied to disclosure and accounting because investors and other stakeholders should be provided with information to assess companies' long-term value creation and their sustainability risk exposure.

In December 2019, the Commission presented the European Green Deal, an ambitious roadmap aimed at transforming Europe into the world's first climate-neutral continent by 2050. In this context, sustainable finance plays a key role supporting the policy objectives of the European Green Deal by steering private investment towards the transition to a climate-resilient, resource-efficient, and fair economy, complementing public funding.<sup>3</sup> The SFDR contributes to these objectives by laying down harmonised rules for FMPs and FAs concerning transparency in integrating sustainability risks and considering adverse sustainability impacts in their processes. Additionally, it

sets rules for presenting sustainability-related information regarding financial products.<sup>4</sup>

The SFDR has been applied since 10 March 2021, and as an EU-Regulation (2019/2088) adopted by the European Parliament and the European Council based on a Commission proposal, it is also referred to as SFDR *level 1*. In order to specify the details of the information required by the SFDR level 1, the European Supervisory Authorities ('ESAs') developed draft Regulatory Technical Standards ('RTS') which were endorsed by the Commission as the SFDR Delegated Regulation (2022/1288) known as *level 2*, and applicable since 1 January 2023. Given that the SFDR was one of the first elements of the EU sustainable finance framework, it is also one of the first to undergo a review to evaluate the fitness for its intended purpose.<sup>5</sup>

### 2.2. EU co-legislators' intentions

The essential objective pursued by a legislative act is primarily explained by the so-called recitals in EU law (Den Heijer et al. 2019). Therefore, the aim of the co-legislators with the SFDR level 1 can be found in its recitals, specifically recital 8, which outlines the scenario by highlighting the catastrophic consequences of climate change and other sustainability-related issues, and the need to steer capital from the financial services sector. This is achieved by requiring FMPs and FAs to disclose specific information regarding their integration of sustainability risks and the consideration of adverse sustainability impacts.

Furthermore, recital 9 explains the situation that arises in the absence of harmonised EU rules on sustainability-related disclosures to end investors. This lack of uniformity makes it difficult to compare financial products, creates an uneven playing field, and poses further internal market barriers, as disclosure standards and market practices vary widely. Busch (2024) notes that divergent national rules and market practices can confuse investors and may result in investments being promoted as sustainable when they are not, the so-called greenwashing.

In addition, recital 10 reveals the goal to diminish information asymmetries in relationships between principals (end investors) and agents (FMPs or FAs), i.e. information on the integration of sustainability risks, consideration of adverse sustainability impacts, and information through pre-contractual and ongoing disclosures. Another objective of the SFDR is the introduction of a mandatory due diligence regime for all large FMPs with respect to the principal adverse impacts of investment decisions on sustainability factors<sup>6</sup> (Lovisolo 2024).

Furthermore, the SFDR aims to harmonize sustainability-related fiduciary duties, as explained in recital 12. 'Fiduciary duty' mandates institutional investors and asset managers to act in the best interest of their end-investors or beneficiaries (European Commission 2018). Among the goals of the Action Plan on Sustainable Finance, there is increasing transparency towards end-investors regarding how sustainability factors are integrated into investment decisions, including in terms of exposure to

sustainability risks.<sup>7</sup> Under the SFDR, FMPs and FAs are required to integrate and continuously assess all relevant sustainability risks in their due diligence processes.

Recitals are the primary, but not the only, source for explaining why an act is adopted; the Commission's impact assessments, explanatory memoranda, and the wording of the actual enacting provisions also provide the underlying reasons for the regulations (Den Heijer et al. 2019). Article 1 of the SFDR level 1 is clear on the subject matter of the SFDR, which is to define harmonised rules for FMPs and FAs on transparency regarding (i) the integration of sustainability risks, (ii) the consideration of adverse sustainability impacts in their processes, and (iii) the provision of sustainability-related information with respect to financial products.

It is widely recognized that regulators often act upon incomplete information, as inaction could lead to even greater negative impacts. As Grünewald et al. (2023) articulate in another context, but also applicable here, it is better to be roughly right than exactly wrong. The European Commission (2023) in its targeted consultation acknowledges the market demand for tools to communicate the sustainability performance of financial products. At the same time, it recognizes the concerns around the current market use of the SFDR as a labelling regime leading to risks of greenwashing, because the existing definitions were not conceived for that purpose. As the consultation remarks, the intention was to encompass as wide a range of products, so that any sustainability claims had to be substantiated. In the next section, we will present some of the current misapplications of the SFDR and the reasons behind the Commission's consultation.

### 2.3. Experiences with the application of SFDR

The SFDR was established to standardize disclosures to end investors in investment decision-making and in advisory processes on the following items:

- 1) integration of sustainability risks
- 2) consideration of adverse sustainability impacts
- 3) sustainable investment objectives, or promotion of environmental or social characteristics<sup>8</sup>

The SFDR applies to two groups of entities: FMPs<sup>9</sup> and FAs.<sup>10</sup> Both are required to disclose detailed information in pre-contractual documents<sup>11</sup>, websites and periodic reports, as ongoing disclosures to end investors minimizing information asymmetries in principal-agent relationships.<sup>12</sup> In other words, FMPs and FAs operating as agents of end investors acting as principals.

Furthermore, as set out in recital 12 of SFDR Level 1, the SFDR upholds the requirements for FMPs and FAs to act in the best interest of end investors. This includes conducting adequate due diligence before making investment decisions or advises on behalf of or towards these investors. To fulfil their responsibilities, FMPs and FAs must integrate all relevant sustainability risks into their

processes, including in their due diligence processes. They must continually assess these risks, which may have a significant negative impact on the financial return of an investment or advice, in addition to all relevant usual financial risks. As a result, FMPs and FAs are required to outline in their policies how they integrate these sustainability risks and make these policies publicly available.<sup>13</sup>

As explained in the previous section, despite the primary aim of the SFDR being to harmonize sustainability transparency – meaning that the SFDR was built as a transparency and anti-greenwashing regime (Zukas 2024) – the disclosure requirements formulated in Article 8 and Article 9 of the SFDR level 1 have been used as sustainability labels and understood as such by investors (European Supervisory Authorities 2024a). Aware of this misapplication, the targeted consultation itself recognizes that Articles 8 and 9 have been used as *de facto* product labels (European Commission 2023), which might lead to risks of greenwashing.<sup>14</sup>

In order to understand the current discussions on a potential establishment of a categorisation system for financial products, we have to understand first how the SFDR has been applied as a labelling regime in market practice. In short, when it comes to financial products, there are different levels of sustainability ambition, which in practice have been labelled as Article 6, Article 8 and Article 9 products, as summarized in Table 1.<sup>15</sup>

**Table 1.** Overview SFDR articles.

SFDR articles	Overview
<b>Article 6</b>	All financial products, regardless of their sustainable nature, have to disclose how sustainability risks are integrated into their investment decisions, and the likely impacts of these sustainability risks.
<b>Article 8</b>	A financial product that promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.
<b>Article 9</b>	A financial product that has 'sustainable investments' as its objective.

As observed by Ramos Muñoz et al. (2024), it is acknowledged that the SFDR has become a *de facto* labelling scheme. From this perspective, the disclosure rules might not be sufficient to protect investors, ensure comparability, or steer capital towards sustainable investments. Consequently, for example, more than 40 per cent of the investment funds that present themselves as sustainable have invested in companies deriving a significant part of their revenues from fossil fuels, as demonstrated by *The Great Green Investment Investigation*,<sup>16</sup> where Follow the Money, Investico and nine leading European media gathered the portfolios of almost 1,300 funds containing 300,000 investments with a total value of 525 billion euro. In section 4, we will delve deeper into the current flaws observed in the SFDR application, which the Commission has tackled in its consultation under analysis.

An important aspect to consider is that the EU has implemented its sustainable finance agenda by not only adopting the SFDR but also the Taxonomy Regulation, the Benchmark Regulation, the European Green Bond Regulation, and the Corporate Sustainability Reporting Directive ('CSRD'). The sustainability concepts interactions – underpinning this framework – have been clarified by multiple Commission FAQs and ESAs publications.<sup>17</sup> Noteworthy, the Taxonomy Regulation also lays down a disclosure framework, in addition on being a common dictionary for environmentally sustainable economic activities.<sup>18</sup>

Another fundamental concept introduced by the SFDR is the so called Principal Adverse Impact (PAI)<sup>19</sup>, defined as 'those impacts of investment decisions and advice that result in negative effects on sustainability factors'.<sup>20</sup> For large FMPs<sup>21</sup>, it is mandatory to integrate in their due diligence processes the procedures for considering the PAIs alongside the relevant financial and sustainability risks. PAI disclosures are required at entity level and product level. The first applies to both FMPs and FAs by publishing an annual PAI statement on their websites, following the template provided by SFDR level 2. The second applies only to FMPs that publish an entity level PAI statement by including in the pre-contractual documentation of their financial products a clear and reasoned explanation of whether, and, if so how, the financial products consider PAIs on sustainability factors.<sup>22</sup>

#### 2.4. Consultations of the EU Commission

Both the targeted and the public consultation cover the following two topics: (i) current requirements of the SFDR, and (ii) interaction with other sustainable finance legislation. Since the targeted consultation was designed to gather input from stakeholders more experienced in the SFDR, it covers two additional topics: (iii) potential changes to the disclosure requirements for financial market participants; and (iv) potential establishment of a categorisation system for financial products.

The targeted consultation aimed to collect input from public entities and stakeholders with a thorough understanding of the SFDR in the context of the EU's sustainable finance initiatives or an extensive knowledge or practical experience with sustainable finance disclosure practices. The Commission encouraged contributions from diverse stakeholders, such as financial market participants, investors, non-governmental organizations, national competent authorities, and others affected by the SFDR either directly or indirectly.

In May 2024, a summary report on the public and targeted consultations was published.<sup>23</sup> According to this document, 324 organisations and individuals contributed to the targeted consultation. Of these respondents, 63% were FMPs and FAs, consisting mostly of asset managers (75%), insurance companies (14%), and banks (10%). The second most represented group of respondents were NGOs, making up 11%. The summary report indicates

that 51 respondents contributed to the public consultation, and this group is predominantly composed of FMPs and FAs (37.3%) and NGOs (15.7%).

The purpose of the consultations, as explained by Commissioner Mairead McGuinness, is to conduct a detailed evaluation of the SFDR in order to identify any potential deficiencies, with a focus on ensuring legal clarity, enhancing the regulation's usability, and reinforcing its effectiveness in preventing greenwashing.

### 3. Research approach

Considering that the Commission's consultations specifically address the SFDR level 1, this study primarily concentrates on that tier. References to SFDR level 2 are explicitly stated; otherwise, any mention of 'SFDR' throughout this article should be understood to pertain to SFDR level 1. We have assessed the main points raised by the selected stakeholders, identifying common themes and overarching trends in the feedback. In doing so, recurring motifs and predominant tendencies have been identified within the feedback, thereby elucidating main themes and insights central to the stakeholders' perspectives. This analysis aids in capturing the collective sentiment and strategic directions implied by the stakeholder responses.

We have limited our review of the responses to the consultation to three stakeholder groups that we consider as key stakeholder. Firstly, we have selected the Platform on Sustainable Finance ('PSF'), an advisory body established under the Taxonomy Regulation.<sup>24</sup> The primary role of the PSF is to advise the European Commission on the practical application and effectiveness of the sustainable finance framework. Secondly, we have selected the European Sustainable Investment Forum ('Eurosif'), the pan-European association that promotes sustainable finance at the European level - including the EU, the wider European Economic Area, and the United Kingdom. Eurosif has been chosen for this analysis based on its substantial contributions to public policy and research on the sustainable investment market. Finally, we have reviewed the feedback of the Dutch competent authority ('AFM') given the jurisdictional relevance for many readers of this journal.

The goal is to capture a snapshot of the current landscape of the SFDR and explore possibilities to address its shortcomings. This is not intended to provide an exhaustive list of articles and publications on the SFDR, but rather to present insights from stakeholder groups selected for their relevance and up-to-date content. As addressed in section 2.4, the targeted consultation also anticipates future scenarios by examining options to address potential deficiencies. The consultation acknowledges that there are interconnected aspects across different sections. Therefore, in the next section, we will follow the four groups of the questionnaire, ensuring we avoid repetition of topics that fall under multiple categories.

## 4. Main topics covered in the consultations

Table 2 outlines the topics addressed in the public or targeted consultations as indicated. This section explores some common shortcomings and challenges identified in the responses from the PSF, Eurosif, and AFM, following the research approach. It is important to reiterate that the aim of this article is not to comprehensively address each shortcoming and challenge identified in the selected responses, nor does it seek to analyse all cross-references to other EU legislation listed under the second main topic covered in the questionnaire.<sup>25</sup>

**Table 2.** Addressed topics in the public or targeted consultations.

EC Consultation	Main topics covered in the questionnaire
Public and targeted consultations	1. Current requirements of the SFDR
Public and targeted consultations	2. Interaction with other sustainable finance legislation
Targeted consultation	3. Potential changes to the disclosure requirements for financial market participants
Targeted consultation	4. Potential establishment of a categorisation system for financial products

### 4.1. Common shortcomings identified

#### 4.1.1. Categorisation system

In line with the EU Commission<sup>26</sup>, the PSF agrees that the product classification under the SFDR has been misunderstood or misapplied, serving as a form of categorisation or labelling. Analogously, Eurosif supports the introduction of a formal product classification system since the current use of the SFDR as such reflects a demand for instituting sustainability-related product categories. Likewise, the AFM's response addresses the misuse of Articles 8 and 9 as labels and stresses the need for consumer-friendly product classifications.

The PSF advocates for a common categorization scheme that is structured in an easily understandable manner for retail investors. Additionally, the PSF suggests ranking financial products according to their level of transparency. This is in line with the precautionary principle<sup>27</sup>, which mandates that disclosures should neither overstate positive nor understate negative information. It ensures that environmental integrity takes precedence when interpreting regulatory requirements or assessing compliance, especially when data is ambiguous or requires discretionary judgment.

A common categorisation scheme would address the inappropriate use of SFDR disclosure requirements, tackle the multiple national labelling regimes, and reduce fragmentation in the European market. Such a scheme should improve clarity, comparability, and consistency. In this scenario, the PSF recognises the need for refinements to enhance accessibility for retail investors, advocating for the retention of the distinction between Article 8 and 9. Additionally, it

acknowledges that eliminating Articles 8 and 9 would lead to significant changes and incur substantial costs for FMPs.

Hence, the PSF proposes to the Commission a hybrid approach which neither continues Articles 8 and 9 as product categories nor introduces an entirely new labelling scheme. Instead, the proposed hybrid solution maintains a transparency-based structure while establishing a formal product classification system. This system could provide according to the PSF a clear explanation of the underlying investment processes, such as best-in-class, climate transition, and social impact focus.<sup>28</sup>

In its response to the Commission's targeted consultation, Eurosif also suggests implementing a hybrid approach that leverages the existing SFDR framework to create three distinct product categories: 'sustainable investments', 'transition investments', and 'binding environmental and/or social factors'. Any products that do not meet the criteria of these categories should explicitly indicate this in their pre-contractual disclosures. Furthermore, these products that do not fall within any of the three proposed categories should be prohibited from making claims related to sustainability, transition, or any other ESG references.

Similarly, in its position paper on improving the SFDR, the AFM formulates understandable sustainable product labels, including 'transition', 'sustainable' and 'sustainable impact', to align sustainability profiles of financial products with the expectations and objectives of investors. By contrast, one of AFM's key proposals is to remove the existing 'Article 8' and 'Article 9' designations to address their current misuse as substitute labels.

#### 4.1.2. Minimum criteria

The future product categorization system could refine the distinctions between Articles 8 and 9 by developing precise minimum criteria<sup>29</sup>, i.e., clear minimum parameters to delineate the products falling within different product categories. The PSF addresses the importance of employing a nuanced approach when setting minimum criteria for different types of financial products under the SFDR framework.

The PSF emphasizes the distinction between mandatory and optional commitments, and mandatory and optional reporting, highlighting how these should be managed to ensure meaningful and effective disclosure. The PSF's recommendations outline various product types and suggest specific minimum criteria for each, ranging from Taxonomy alignment to measurable and positive outcome. The aim is to ensure that the products not only comply with regulatory requirements but also effectively contribute to sustainability objectives.

Similarly, Eurosif endorses the establishment of formal product categories grounded in the demonstration of sustainability objectives, supported by stringent minimum criteria and accompanied by specific disclosure requirements. Additionally, Eurosif asserts that products failing to meet the minimum criteria outlined in the reviewed SFDR categories should explicitly state this non-compliance in the pre-contractual documentation.

Furthermore, such non-compliant products should be prohibited from making sustainability, transition, or other ESG-related claims, ensuring consistency across product-level documentation, websites, and marketing communications. In its position paper, the AFM also advocates for the establishment of sustainable financial product categories, underscored by minimum criteria, as a critical milestone.

#### 4.1.3. Marketing communications and product names

Article 13 of the SFDR addresses marketing communications, explicitly prohibiting any inconsistencies between these communications and the disclosures mandated by the regulation. Nonetheless, the consultation seeks to ascertain whether the SFDR constitutes the appropriate legal framework to address the accuracy and fairness of marketing communications and the use of sustainability related names for financial products.<sup>30</sup>

One of the key recommendations from the PSF to improve the effectiveness of the SFDR is to ensure that there is consistency between the product's name, its sustainability marketing claims, and the actual investment strategy – especially with regard to the method of stock selection and defining the investment portfolio. There should be thorough consistency across the product and complete transparency regarding any adverse impacts from the product's elements that are not subject to mandatory disclosures.

As previously mentioned, Eurosif argues that products not falling within any sustainable category should not be allowed to make sustainability claims or promote sustainability, transition, or ESG-related characteristics. In such cases, consistency is expected between product-level documentation, website disclosures, and marketing communications. Typically, marketing rules fall under the purview of national competent authorities, which may have different interpretations of what constitutes marketing communications.

Finally, the AFM's position paper suggests that products failing to meet the criteria for sustainability labels should still be able to present their ESG features, though with a more simplified set of disclosure requirements. However, such products should not be permitted to communicate adherence to any sustainability label. Furthermore, in its response to the consultation, the AFM elucidates that, in instances of potentially misleading communications, supervisors may invoke provisions within the Markets in Financial Instruments Directive (MiFID) and the Insurance Distribution Directive (IDD), which stipulate that information must be "fair, clear, and not misleading."

## 4.2. Common challenges

### 4.2.1. Entity level disclosures

In response to the question whether the SFDR would be the right place to include entity level disclosures<sup>31</sup>, the PSF recommended evaluating the degree to which the disclosure of PAIs at the entity level could be incorporated into

the European Sustainability Reporting Standards (ESRS)<sup>32</sup> disclosure requirements for FMPs that fall within the scope of both the SFDR and the CSRD. Hence, the PSF believes that there is room for streamlining sustainability-related entity level requirements across different pieces of legislation.

Regarding the minimum safeguards at the entity level within the EU Taxonomy<sup>33</sup>, the PSF calls for full alignment between the social and governance PAI indicators of the SFDR level 2 and the minimum safeguards as they stand in the EU Taxonomy, aiming to create a unified set of safeguards. Disclosures regarding the degree of alignment with the Paris Agreement represent an area for improvement at the entity level<sup>34</sup>, whereas the PSF acknowledges that such disclosures are not currently mandatory.

Eurosif supports the maintenance of entity level PAI disclosures, though revised and improved, because they believe these disclosures should specifically address the sustainability due diligence policies FMPs have in place regarding environmental and social adverse impacts across their complete portfolio of financial products. Eurosif agrees with the Commission's assertion that certain indicators should invariably be deemed material for FMPs when reporting at the entity level, while other indicators should undergo a materiality assessment.<sup>35</sup>

In its response to the consultation, AFM elucidates that entity level disclosures can be beneficial for providing PAI insight. However, AFM questions the practicality of entity level PAI disclosures for informed investment decision-making. AFM suggests an alternative approach: mandating all products to report on a subset of the most critical PAI indicators. This method would maintain the objective of understanding the adverse impacts across all investment portfolios, while enhancing the relevance and utility of the disclosures for investment decisions, which are ultimately concentrated on products.

It is worth noting that one argument in favour of maintaining the existing set of entity level disclosures under the SFDR is that they provide valuable information to investors and civil society. This information enables the assessment of FMPs sustainability ambitions. On the other side of the debate, the argument against these entity level disclosures is that they are not useful for end-investors focused on their decisions to invest in specific financial products, with observations indicating that such investors rarely request comprehensive sustainability-related information at the FMP level.<sup>36</sup>

### 4.2.2. Product level disclosures

Should the EU impose uniform disclosure requirements for all financial products offered in the EU, regardless of their sustainability-related claims or any other consideration? The PSF would agree, since it advocates for mandatory minimum ESG reporting requirements, such as GHG (greenhouse gases) emissions and the EU Taxonomy disclosures, for all financial products in the long run. The PSF recommends that to make the SFDR work better, the sustainability performance of a product should

be entirely reported. Just sharing information about part of the fund is not enough.

Sometimes, the negative impact of one stock in a fund might be more significant than all the sustainability efforts of the fund, jeopardizing its sustainability credibility. The PSF also stresses the importance of disclosing PAI at the product level, which should cover the entirety of the product. The PSF acknowledges that data providers implement the consideration of PAI in varied ways and suggests that additional guidance on the definitions of process descriptions (for instance, PAIs related to biodiversity and pollution) and the frequency of necessary updates would be beneficial.

Eurosif understands that disclosures on PAIs gain particular significance at the product level. At this level, relevant PAI indicators can be selectively applied based on the product's objective and the type of investment strategy it involves. In essence, PAI indicators ought to be included as part of the minimum criteria for future classifications within a revised SFDR framework. Eurosif advocates for the creation of a set of minimum disclosure requirements applicable to all financial products, which would facilitate the comparability of information and foster a level playing field. Such minimum disclosures ought to encompass how ESG factors, entailing sustainability risks, are embedded within the investment process, along with the consideration of all mandatory PAI indicators.<sup>37</sup>

The AFM also supports this viewpoint, as one of its core proposals is to establish a level playing field by mandating minimum disclosure requirements for all financial products, irrespective of their sustainability characteristics. Amongst such minimum mandatory disclosure requirements, there would be the obligation to report on negative impact indicators, such as GHG emissions, biodiversity, human rights, and labour rights (based on the PAI indicators of the SFDR level 2). In addition to these minimum disclosure requirements for all products, the AFM also suggests minimum quality requirements for products that aim to qualify as a specific type of sustainable product. By attaching minimum quality and minimum disclosure requirements to each sustainable product label recommended by the AFM, the approach would address greenwashing risks and ensure that classification under one of these labels is meaningful in market practice.

## 5. Concluding remarks

An ambitious review of the SFDR has been conducted by the European Commission, aiming to address the current shortcomings and challenges of the existing framework. We have explored in section 4 selected aspects of this review, including the current and potential categorization system, minimum disclosure requirements for all products, specific criteria for sustainable products, marketing communications, and disclosures concerning PAIs. Based on the analyzed feedback, some common recommendations have emerged:

- i) Emphasis on making financial products categories easily understandable for retail investors, advocating for clear and comparable disclosures.
- ii) Minimum disclosure requirements for all products (including PAI indicators) and clear minimum criteria for sustainable products.
- iii) The SFDR is the suitable legal framework to address the reliability and validity of marketing communications and the use of ESG or sustainability-related names for financial products (together with the ESMA guidelines on funds' names and expected coherence with the reviewed SFDR).
- iv) There is a demand for PAI entity level disclosure requirements to be simplified and streamlined across the sustainable finance framework, with concerns noted about potential overlaps with transparency requirements under the SFDR and reporting obligations under the CSRD.
- v) There is support for imposing uniform disclosure requirements for all financial products offered in the EU, regardless of their sustainability-related claims.
- vi) There is a need for clear guidance on how FMPs should handle materiality concerning PAI disclosures.

It is noteworthy that both Eurosif and the PSF have reiterated their support for the further development and application of a social taxonomy that could mirror the role of the EU Taxonomy for environmental objectives by defining socially sustainable economic activities. Within the European regulatory framework, consistency and coherence among the SFDR, the EU Taxonomy, and the CSRD should in our view remain a priority for regulators.<sup>38</sup>

To summarize, a clear, but refined, categorization of financial products aligning the sustainability profiles of financial products with the expectations and objectives of investors, is broadly supported as an outcome of the review of the SFDR. Furthermore, the visibility and comparability of negative effects on sustainability factors should be increased by enhancing PAI disclosures at product level. Additionally, legal clarity should be improved by ensuring that the rules governing the future categories have clear objectives and criteria to minimize the risk of greenwashing. This also aligns with a recent Joint ESAs Opinion (2024a) expressing their support for product categories to address greenwashing issues derived from the misuse of the SFDR, with the goal of fostering clarity, particularly for retail investors.

The experiences of the SFDR show that there is a tendency in the market to interpret disclosure requirements for sustainability purposes as *de facto* sustainability labels and to market these labels as such to end investors. In order to prevent greenwashing, not justifiable claims and misleading labels, objective and verifiable criteria should be set for including investments in any sustainability category to be developed in the next version of the SFDR. These should embed accepted views in society to categorize investments as contributing to important political objectives like those being

included in the Green Deal framework of the European Union. The responses to the Commission's consultation show the above mentioned common recommendations, which can be used to improve the next version of

the SFDR, thereby making the Regulation better serve its purpose: enabling investors and consumers to make more informed investment decisions contributing to the sustainable transition.

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## Notes

1. Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32019R2088>.
2. The ESAs understand greenwashing as 'a practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants' (ESMA 2024a).
3. Estimates suggest that an additional € 180 billion per year will be required by 2030 to meet climate and energy targets. A considerable portion of this funding depends on the private sector, meaning that substantial amounts of private finance must be redirected towards more sustainable investments (Spinaci 2020).
4. Article 1 SFDR level 1.
5. Mairead McGuinness in *The Sustainable Finance Disclosure Regulation (SFDR) - What next?*, European Commission Workshop, 10 October 2023.
6. 'Sustainability factors' mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters, see Article 2(24) SFDR level 1.
7. The SFDR together with Solvency II, IORP II, UCITS, AIFMD and MiFID II requires institutional investors and asset managers to act in the best interest of their end-investors/beneficiaries (Action Plan on Sustainable Finance 2018).
8. Recital 5 SFDR level 1.
9. Pursuant to Article 2 (1) SFDR level 1, 'financial market participant' means an insurance undertaking which makes available an insurance-based investment product (IBIP); an investment firm which provides portfolio management; an institution for occupational retirement provision (IORP); a manufacturer of a pension product; an alternative investment fund manager (AIFM); a pan-European personal pension product (PEPP) provider; a manager of a qualifying venture capital fund; a manager of a qualifying social entrepreneurship fund; a management company of an undertaking for collective investment in transferable securities (UCITS management company); or a credit institution which provides portfolio management.
10. Pursuant to Article 2 (11) SFDR level 1, 'financial adviser' means an insurance intermediary which provides insurance advice with regard to IBIPs; an insurance undertaking which provides insurance advice with regard to IBIPs; a credit institution which provides investment advice; an investment firm which provides investment advice; an AIFM which provides investment advice; or a UCITS management company which provides investment advice.
11. Pre-contractual documentation is referred to in Article 6 (3) SFDR level 1 and relates to various documents for the different financial products within the scope of the SFDR. For example, for UCITS management companies, pre-contractual disclosures are required in the prospectus.
12. Recital 10 SFDR level 1.
13. Recital 12 SFDR level 1.
14. More on the actual greenwashing risks posed by the implementation of the SFDR was examined by Lambillon and Chesney (2023), Scheitza and Busch (2023), Partiti (2023), and Bodellini (2023).
15. As approached by Davison, McNalle, and North (2023), the utilization of SFDR articles as labels for ESG credentials underscores the necessity for clarity in ESG products, regardless of the original intentions of European policymakers in formulating this regulation.
16. See <https://www.ftm.eu/green-deception> (2024 edition).
17. To be concise, it is important to point out the recent ESAs' Consolidated Q&A on the SFDR and the SFDR Delegated Regulation (JC 2023 18) of 25 July 2024, and the Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the SFDR (2023/C 211/01) of 16 June 2023.
18. Recital 55 EU Taxonomy Regulation.
19. In short, the SFDR requires FMPs and FAs to publish an annual PAI statement on their website at the entity level. Additionally, FMPs must publish PAI information in pre-contractual documentation at the product level. In December 2023, the European Supervisory Authorities (ESAs) proposed the Regulatory Technical Standards (RTS) JC 2023 55 on the review of PAI and financial product disclosures in the SFDR Delegated Regulation, which is still pending to be adopted by the EC.
20. Recital 20 SFDR level 1.



21. Article 4(3) SFDR level 1 states that financial market participants exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall publish and maintain on their websites a statement on their due diligence policies with respect to the principal adverse impacts of investment decisions on sustainability factors. For financial market participants which are parent undertakings of a large group, see Article 4(4) SFDR level 1.
22. Article 7 SFDR level 1.
23. See [https://finance.ec.europa.eu/regulation-and-supervision/consultations/finance-2023-sfdr-implementation\\_en](https://finance.ec.europa.eu/regulation-and-supervision/consultations/finance-2023-sfdr-implementation_en)
24. Recital 50, EU Taxonomy Regulation.
25. The questionnaire's topic "Interaction with other sustainable finance legislation" covers the following: the Taxonomy Regulation, the Benchmarks Regulation, the Corporate Sustainability Reporting Directive (CSRD), the Markets in Financial Instruments Directive (MiFID II), the Insurance Distribution Directive (IDD), and the Regulation on Packaged Retail Investment and Insurance Products (PRIIPs). Our article focuses on the interactions with the Taxonomy Regulation and the CSRD. While we acknowledge the necessity of assessing the consequences for other sustainable finance legislation if the SFDR were to be amended following the consultation processes, this current article does not aim to undertake such an analysis. Future research may find considerable value in delving into this topic.
26. "The fact that Articles 8 and 9 of the SFDR are being used as *de facto* product labels, together with the proliferation of national ESG/sustainability labels, suggests that there is a market demand for such tools in order to communicate the ESG/sustainability performance of financial products." EU Commission, Targeted Consultation Document, September 2023.
27. For more information on the principle of precaution, see *Briefing Platform Response to the Joint ESAs Consultation on SFDR RTS*, EU Platform on Sustainable Finance, 4 July 2023.
28. Details of such an approach are in Annex 3 of the Platform Briefing on EC targeted consultation regarding SFDR Implementation (December 2023).
29. The Commission's questions on product categorisation aimed to collect feedback on how minimum criteria should be applied to different types of products. The purpose of establishing minimum criteria is to provide clear, concrete standards that products must satisfy to be considered compliant with different product categories.
30. While the SFDR review may take an extended period to complete, ESMA has published guidelines on funds' names using ESG or sustainability-related terms to address current risks of greenwashing in funds (ESMA 2024b).
31. The SFDR imposes entity level disclosure obligations on financial market participants and financial advisers. They are required to disclose on their websites their policies on integrating sustainability risks into their investment decision-making processes or their investment or insurance advice (Article 3 SFDR level 1). Additionally, they are required to disclose whether and how they consider the PAIs of their investment decisions on sustainability factors. For FMPs with 500 or more employees, disclosing a due diligence statement that includes information on adverse impacts is mandatory (Article 4 SFDR level 1). Moreover, both FMPs and FAs have to disclose how their remuneration policies are consistent with the integration of sustainability risks (Article 5 SFDR level 1).
32. The European Financial Reporting Advisory Group (EFRAG) has been working on developing ESRS sector-specific standards, including those for financial institutions.
33. Article 18 EU Taxonomy Regulation.
34. The PSF explains that FMPs have expressed their alignment with the objectives of the Paris Agreement in a rather vague manner, without identifying the indicators used to measure the decarbonisation progress of their investments.
35. In the same way, the PSF acknowledges that certain indicators are only material for companies involved in specific economic activities, such as PAI 9 (hazardous and radioactive waste ratio), PAI 5 (non-renewable energy consumption and production, specifically for energy production), and PAI 8 (emissions to water).
36. European Commission, Summary Report of the Open and Targeted Consultations on the SFDR assessment, May 2024.
37. "Given the improvements expected in the coming years regarding availability of the sustainability data due to the application of the ESRS, all mandatory PAI indicators included in Table 1 of Annex I of the SFDR Delegated Regulation could eventually be considered by all financial products. However, a phase-in approach may need to be considered, first starting with climate, diversity and human rights indicators." Euro-sif's response to the European Commission targeted consultation on the implementation of the SFDR.
38. For example, the draft Commission Notice, published on 7 August 2024, question 90 explains how FMPs should deal with non-material indicators reported by investee companies applying ESRS in the context of SFDR disclosures.

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