EU Sustainable Finance Disclosure Regulation

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Key points

- This article analyses and discusses the European Union (EU) Sustainable Finance Disclosure Regulation (SFDR). The aim is 2-fold. On the one hand, it explores the main features of the SFDR. On the other hand, it tries to assess whether the SFDR is likely to succeed in harmonizing sustainability-related disclosure rules and fiduciary duties, not only across Member States, but also across financial products and distribution channels.
- The author concludes that there is still a long way to go. Research shows that the phenomenon of greenwashing is still widespread among investment funds.
- Also, the EU is not an island. The author argues that there are roughly two opposite scenarios. In a pessimistic scenario, the more lenient or even non-existent sustainability agenda of other geopolitical powers gives them a competitive edge that is detrimental to the EU. In a positive scenario, the EU becomes a global standard-setter in the area of sustainability.
- The USA's re-entry in the Paris Climate Agreement under the Biden Administration and its recent success in delivering a climate bill as part of the Inflation Reduction Act (IRA) may give us some hope.
- Finally, on 9 December 2022, the UK Government announced a major reform of its financial services regulation 'to drive growth and competitiveness in the financial services sector' (the Edinburgh reforms). In this context, the UK Government 'is ensuring that the financial system plays a major role in the delivery of the UK's Net Zero target, and is acting to secure the UK as the best place in the world for responsible and sustainable investment'.
- Will these developments contribute to the EU becoming a global standard-setter in the area of sustainability? Time will tell.

1. Introduction

The aim of this article

This article analyses and discusses the EU (European Union) Sustainable Finance Disclosure Regulation (SFDR). The aim is 2-fold. On the one hand, it explores the main features of the SFDR. On the other hand, it attempts to assess whether the SFDR is likely to succeed in harmonizing sustainability-related disclosure rules and fiduciary duties, not only across Member States, but also across financial products and distribution channels. Before

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we dive into the details of the SFDR, we first provide a brief outline of (i) the Sustainable Finance Action Plan (SFAP), (ii) the Taxonomy Regulation and (iii) the SFDR itself. We also briefly discuss the importance of reliable sustainability-related company information.

Sustainable Finance Action Plan

The European Commission has pointed out that we are increasingly confronted by the consequences of climate change and resource depletion. It therefore wants more investment in 'green' companies and products. In its initial Sustainable Finance Action Plan (SFAP) of March 2018, the Commission states that as the financial sector acts as an intermediary between users and providers of capital, it has a key role to play in this green transition.[1] The SFAP is an integral part of the Capital Markets Union (CMU) Action Plan and must also be seen in conjunction with the broader European climate plans (the Green Deal and the European Climate Law that forms part of it).[2]

The SFAP has the following aims: (i) reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (ii) manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and (iii) foster transparency and long-termism in financial and economic activity.[3]

The action plan translates these aims into ten concrete measures, including (i) establishing an EU classification system (taxonomy) for sustainable activities; (ii) clarifying the duties of institutional investors and asset managers; (iii) strengthening sustainability disclosure, both for investors and for financial supervisors.[4]

Taxonomy regulation

General

When is a product or business 'green'? That is something we must agree on first. After all, if we in Europe do not have a shared understanding of what is ecologically sustainable, how can we expect to arrange for the supply and demand of green capital to be better matched in Europe? In such a situation, there is the ever-present danger of confusion about terms and even plain deception because activities are presented as greener than they actually are ('greenwashing'). So, it is a good thing that the Commission has decided to give top priority to establishing an EU classification system—or taxonomy—for sustainable activities. Nor has Brussels wasted any time, because the Taxonomy Regulation had already been adopted by 18 June 2020.[5]

1 COM(2018) 97 final, 8 March 2018, 1.

2 See for the latest version of the CMU Action Plan: COM(2020) 590 final, and <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en> accessed on 15 February 2023. The Green Deal was presented by the Commission on 10 December 2019 (COM(2019) 640 final). See for an overview of the Green Deal plans: <https://commission.europa.eu/strategy-and-policy/priorities-2019-2024/european-green-deal_en> accessed on 15 February 2023. The European Climate Law has been adopted as Regulation (EU) 2021/1119.

3 COM(2018) 97 final, 3.

4 COM(2018) 97 final, 4–11. See also the follow-up FSAP: COM(2021) 390 final.

5 Regulation (EU) 2020/852 (below: the Taxonomy Regulation).

Six environmental objectives

The Taxonomy Regulation contains uniform criteria for determining whether an economic activity qualifies as environmentally sustainable. The Regulation identifies six environmental objectives: (i) climate change mitigation; (ii) climate change adaptation; (iii) the sustainable use and protection of water and marine resources; (iv) the transition to a circular economy; (v) pollution prevention and control; and (vi) the protection and restoration of biodiversity and ecosystems.[6]

Criteria for environmentally sustainable economic activities

An activity qualifies as an 'environmentally sustainable activity' where it contributes substantially to one or more of the environmental objectives set out above and does not significantly harm any of the other environmental objectives.[7] Also, the economic activity concerned must be carried out in compliance with the required minimum safeguards, including human rights and labour rights.[8]

Taxonomy Climate Delegated (Amendment) Act

But that is not sufficient in itself. In order for an economic activity to qualify as an 'environmentally sustainable activity', it is *in addition* required that the activity concerned complies with detailed technical screening criteria.[9] The Commission is currently in the process of drawing these up, to identify which actual activities can be classified as sustainable. This concerns six series of sustainable activities, each series corresponding to one of the six environmental objectives mentioned above. The first two series were adopted on 4 June 2021 as the Taxonomy Climate Delegated Act and correspond to the environmental objectives referred to at (i) and (ii) above.[10] At that time it was not possible to reach an agreement on the inclusion of nuclear energy and state-of-the-art natural gas power stations.

However, on 9 March 2022, an amendment to the Taxonomy Climate Delegated Act was adopted at the Commission's initiative, qualifying nuclear energy and natural gas as environmentally sustainable, subject to strict conditions.[11] This was much to the surprise of the EU platform for sustainable finance (the Commission's adviser) and certain Member States. In February 2023, Greenpeace announced that it would file a lawsuit against the European Commission with the European Court of Justice for labelling nuclear energy and

6 Art 9, Taxonomy Regulation.

7 See art 3, opening words, and (a) and (b) Taxonomy Regulation.

8 See art 3, opening words, and (c) Taxonomy Regulation. More specifically, the economic activity concerned is carried out in compliance with the required minimum safeguards if there is alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights. See art 18(1) Taxonomy Regulation.

9 See art 3, opening words, and (d) Taxonomy Regulation.

10 The Taxonomy Climate Delegated Act (Regulation (EU) 2021/2139) establishes 'technical screening criteria' for determining the exact conditions under which a concrete economic activity qualifies as contributing substantially to (a) climate change mitigation or (b) climate change adaptation, and for determining whether that economic activity causes no significant harm to any of the other environmental objectives.

11 The Taxonomy Climate Delegated Amendment Act (Regulation (EU) 2022/1214).

gas as sustainable economic activities. In October 2022, the Austrian government sued the European Commission for the same reason.[12]

The Taxonomy Regulation comes into effect in phases. The first two environmental objectives came into effect on 1 January 2022 (and on 1 January 2023 for nuclear energy and natural gas). The other four environmental objectives should have come into effect on 1 January 2023, but are delayed and will come into force at a later stage.[13]

Sustainable Finance Disclosure Regulation (SFDR)—Overview

General

Once we have a shared understanding of what is ecologically sustainable, the next step will be to arrange for financial intermediaries to integrate sustainability considerations into their investment policy and advice, and to provide transparency to the investing public about the extent to which they do this. Many financial intermediaries already did this to a greater or lesser extent, because there has been considerable demand for sustainable investments for some time, but until recently they did not provide transparency on the basis of harmonized rules at the European level. This was changed by the SFDR on 10 March 2021, when most of its rules became applicable.[14]

Financial market participants and financial advisers

The SFDR distinguishes between two types of financial intermediaries: (i) financial market participants (such as asset managers)[15] and (ii) financial advisers (investment and insurance advisers).[16]

12 See <https://www.greenpeace.org/eu-unit/issues/climate-energy/46570/greenpeace-to-take-european-commission-to-court-over-controversial-gas-and-nuclear-greenwashing/> accessed on 15 February 2023; <https://www.ipe.com/news/austria-files-lawsuit-against-taxonomy-with-european-court-of-justice/10062641.article> accessed on 15 February 2023.

13 See for an overview of the current state of play of the Taxonomy Regulation and its level 2 rules: <www.ec.europa.eu/info/law/sustainable-finance-taxonomy-regulation-eu-2020-852/amending-and-supplementary-acts/implementing-and-delegated-acts_en> accessed on 15 February 2023.

14 Regulation (EU) 2019/2088, as later amended by the Taxonomy Regulation (below: SFDR). To complement the SFDR disclosure requirements, sustainability preferences of (potential) clients must be included in individual portfolio management, investment advice and insurance advice with regard to IBIPs. See for the integration of sustainability preferences of (potential) clients in individual portfolio management, investment advice and insurance advice with regard to IBIPs, as well as for other changes to integrate sustainability considerations into the existing MiFID II, IDD, UCITS, AIFMD and Solvency II frameworks: (i) MiFID II Commission Delegated Regulation (EU) 2021/1253; (ii) MiFID II Commission Delegated Directive 2021/1269; (iii) IDD Delegated Regulation (EU) 2021/1257; (iv) AIFMD Commission Delegated Regulation (EU) 2021/1255; (v) UCITS Commission Delegated Directive (EU) 2021/1270; (vi) Solvency II Delegated Regulation (EU) 2021/1256. Cf FE Mezzanotte, 'Accountability in EU Sustainable Finance: Linking the Client's Sustainability Preferences and the MiFID II Suitability Obligation' (2021) 4 *Capital Markets Law Journal* 482.

15 More specifically, art 2(1) SFDR defines 'financial market participants' as (i) insurance undertakings which make available insurance-based investment products (IBIPs); (ii) investment firms and credit institutions providing individual portfolio management; (iii) managers of various collective investment schemes, and (iv) several entities involved in pension products. NB: Member States *may* decide (Member State option) to apply the SFDR to manufacturers of pension products operating 'national social security schemes' which are covered by Regulations (EC) No 883/2004 and (EC) No 987/2009. In such cases, manufacturers of pension products as referred to in art 2(1)(d) SFDR includes manufacturers of pension products operating national social security schemes and of pension products referred to in art 2(8) SFDR. In such a case, the definition of pension product in art 2(8) SFDR is deemed to include pension products with regard to national social security schemes. See art 16(1) SFDR. Member States must notify the Commission and the European Supervisory Authorities EBA, ESMA and EIOPA (the ESAs) of any decision taken pursuant to art 16(1) SFDR (art 16(2) SFDR).

16 More specifically, art 2(11) SFDR defines 'financial advisers' as (i) insurance intermediaries and insurance undertakings providing insurance advice with regard to IBIPs; (ii) investment firms and credit institutions providing investment advice; and (iii)

Aim of the SFDR

The SFDR is an important step forward as harmonized sustainability transparency is a dire necessity, basically because the alternative is not workable. After all, divergent national rules and market practices (i) make it very difficult to compare different financial products, (ii) create an uneven playing field for such products and for distribution channels and (iii) erect additional barriers within the internal market. This in turn leads to confusion for investors and is, at worst, plain misleading because financial intermediaries promote their investments as sustainable when in reality they are not (or much less so) (greenwashing).[17]

Recital (10) SFDR states that the legislation aims to reduce information asymmetries in principal–agent relationships with regard to (i) the integration of sustainability risks, (ii) the consideration of adverse sustainability impacts and (iii) the promotion of environmental or social characteristics as well as sustainable investment by means of pre-contractual and ongoing disclosures to end investors, acting as principals, by financial market participants or financial advisers, acting as agents on behalf of principals.[18]

Against this backdrop, the SFDR lays down harmonized rules for (i) financial market participants and (ii) financial advisers on transparency with regard to (a) the integration of sustainability risks and (b) the consideration of adverse sustainability impacts, both in their processes and in the provision of sustainability-related information with respect to financial products.[19] The SFDR requires financial intermediaries to provide sustainability transparency on their website, in periodic reports, in promotional material and in pre-contractual information (at both entity level and product level).

SFDR Delegated Regulation

On 1 January 2023, the SFDR Delegated Regulation became applicable—with considerable delay.[20] It confirms that sustainability-related information must be provided free of charge and in a manner that is easily accessible, non-discriminatory, prominent, simple, concise, comprehensible, fair, clear and not misleading. Financial market participants and financial advisers must present and lay out the information required by the SFDR Delegated

managers of collective investment schemes providing investment advice. NB: the SFDR does *not* apply to (i) insurance intermediaries providing insurance advice with regard to IBIPs, and (ii) investment firms providing investment advice, if they employ fewer than three persons, irrespective of their legal form, including natural persons (art 17(1) SFDR). Member States *may* however decide (Member State option) to apply the SFDR in such cases (art 17(2) SFDR). Member States must notify the Commission and the ESAs of any such decision (art 17(3) SFDR).

17 Cf recital (9) SFDR.

18 Please note that I quoted Recital (10) as very slightly reformulated in *Joint Consultation Paper, ESG Disclosures, Draft regulatory technical standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a, Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088* (JC 2020 16), on 6.

19 Art 1 SFDR. 'Financial product' is defined as (a) an individually managed portfolio; (b) a collective investment scheme; (c) an insurance-based investment product (IBIP); (d) a pension product or pension scheme; and (e) a pan-European Personal Pension Product (PEPP). NB: Member States may decide (Member State option) to apply the SFDR to manufacturers of pension products operating 'national social security schemes' which are covered by Regulations (EC) No 883/2004 and (EC) No 987/2009. In such cases, manufacturers of pension products as referred to in art 2(1)(d) SFDR includes manufacturers of pension products operating national social security schemes and of pension products referred to in art 2(8) SFDR. In such a case, the definition of pension product in art 2(8) SFDR is deemed to include pension products operating national social security schemes. See art 16(1) SFDR. Member States must notify the Commission and the ESAs of any decision taken pursuant to art 16(1) SFDR (art 16(2) SFDR).

20 Art 68 Delegated Regulation (EU) 2022/1288 (below: SFDR Delegated Regulation).

Regulation in a way that is easy to read, use characters of readable size and use a style that facilitates its understanding. They must provide the information required in a searchable electronic format (unless otherwise required by the SFDR). They must keep the information published on their websites up to date, and must clearly mention the date of publication of the information and the date of any update. Where that information is presented as a downloadable file, financial market participants and financial advisers must indicate the version history in the file name.[21] All in all, the SFDR Delegated Regulation provides more detail on form and substance of sustainability disclosures, including prescriptive templates set out in the Annexes,[22] thus further tightening the reins for those that are subject to the SFDR.

Sustainability risk

Furthermore, it is important to note that the SFDR distinguishes between two key concepts: 'sustainability risk' and 'sustainable investment'. Sustainability risk is defined as an environmental, social or governance event that, if it occurs, could cause an actual or a potential material negative impact on the *value* of the investment.[23]

Sustainable investment

A sustainable investment, on the other hand, is an investment in an economic activity that *contributes* to an environmental *or* social objective, always provided (i) that the investments do not significantly harm any of the other environmental and social objectives, and (ii) that the investee companies follow good governance practices.[24]

Sustainable investment versus *environmentally sustainable economic activities*

In view of the above, the term 'sustainable investment' in the SFDR has a broader meaning than the term 'environmentally sustainable activity' in the Taxonomy Regulation. Under

21 Art 2 SFDR Delegated Regulation.

22 Please note that the content of the templates has been changed partially on 20 February 2023 by the SFDR Amendment Delegated Regulation (Delegated Regulation (EU) 2023/363) to take into account information about the exposure of financial products to investments in natural gas and nuclear energy. This information must be provided under the Taxonomy Climate Delegated Amendment Act (Delegated Regulation (EU) 2022/1214), which contains the technical screening criteria for climate change mitigation and adaptation for additional economic activities in the energy sectors that were *not* included in the Taxonomy Climate Delegated Act (Delegated Regulation (EU) 2021/2139), in particular natural gas and nuclear energy.

23 Art 2(22) SFDR.

24 More specifically, art 2(17) SFDR defines 'sustainable investment' as: (1) an investment in an economic activity that contributes to an *environmental* objective, as measured, for example, by key resource efficiency indicators on: (a) the use of energy, renewable energy, raw materials, water and land; (b) the production of waste; (c) greenhouse gas emissions, and (d) biodiversity and the circular economy, *or* (2) an investment in an economic activity that contributes to a *social* objective, in particular: (a) an investment that contributes to tackling inequality, or (b) an investment that fosters social cohesion, social integration and labour relations, or (c) an investment in human capital or economically or socially disadvantaged communities, provided (i) that the investments set out in (1) and (2) above 'do not significantly harm' any of those *environmental* and *social objectives* and (ii) that the investee companies follow good *governance* practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance. The SFDR Delegated Regulation further specifies (i) the content and (ii) the presentation of the information in relation to the principle of 'do no significant harm' referred to in the definition of 'sustainable investment' set out above. See consideration (22), arts 22, 39, 67, Table I, II and III of Annex I, SFDR Delegated Regulation. Article 5 and recital (19) of the Taxonomy Regulation clarify that 'sustainable investments' include investments into environmentally sustainable activities within the meaning of the Taxonomy Regulation. See also European Commission (Ref.Ares(2021)4556843–14/07/2021) (<https://www.esma.europa.eu/sites/default/files/library/sfdr_ec_qa_1313978.pdf>) accessed on 15 February 2023, at p. 5.

the SFDR, a sustainable investment covers both environmental and social objectives (the 'E' and the 'S' factor), provided that good governance practices are followed (the 'G' factor), whereas the Taxonomy Regulation relates only to environmental sustainability (ie the 'E' factor), at least for the time being.[25]

Article 9, Article 8 and Article 6 products

Further key concepts are Article 9, Article 8 and Article 6 products. Article 8 and Article 9 products either have sustainable investment as their objective (Article 9 products) or they merely aim to promote sustainable investment (Article 8 products).[26] Article 8 products are in practice often referred to as 'light green' products, and Article 9 products as 'dark green' products. These terms are adequate if the financial product concerned invests in economic activities that contribute to an *environmental* objective, but are in fact misleading if they only invest in economic activities that contribute to a *social* objective, such as tackling inequality.

Article 9 products may invest in a wide range of underlying assets, provided that they qualify as sustainable investments.[27] Article 8 products have a sustainability-related ambition that is lower than the ambition of Article 9 products. Where a financial product has an environmental objective but does not meet the 'do no significant harm' requirement as referred to in the definition of sustainable investment, it qualifies as an Article 8 product. Also, Article 8 SFDR does not prescribe certain minimum investment thresholds.[28]

The term 'promotion' within the meaning of Article 8 SFDR encompasses, by way of example, direct or indirect claims, information, reporting, disclosures as well as an impression that investments pursued by the given financial product also consider environmental or social characteristics in terms of investment policies, goals, targets or objectives or a general ambition in, but not limited to, (i) pre-contractual and periodic documents or marketing communications, (ii) advertisements, (iii) product categorization, (iv) description of investment strategies or asset allocation, (v) information on the adherence to sustainability-related financial product standards and labels, (vi) use of product names or designations, (vi) memoranda or issuing documents, (vii) factsheets, (viii) specifications

25 Article 2(17) SFDR; Article 3 Taxonomy Regulation. But please note that the creation of a 'social' taxonomy is envisaged. See Platform on Sustainable Finance, *Final Report on Social Taxonomy* (28 February 2022) (<https://commission.europa.eu/document/d07e1f1e-3a1f-4d55-add4-a130f26b33e3_en> accessed on 15 February 2023). In this document, the Platform on Sustainable Finance proposes a structure for a social taxonomy.

26 See arts 9 and 8 SFDR, respectively.

27 However, an art 9 product, in order to meet requirements in accordance with prudential, product-related sector specific rules may next to 'sustainable investments', also include investments for certain specific purposes such as hedging or liquidity which, in order to fit the overall financial product's sustainable investments' objective, have to meet minimum environmental or social safeguards, ie investments or techniques for specific purposes must be in line with the sustainable investment objective. Since art 9 SFDR remains neutral in terms of the product design, or investing styles, investment tools, strategies or methodologies to be employed or other elements, the product documentation must include information how the given mix complies with the 'sustainable investment' objective of the financial product in order to comply with the 'no significant harm principle' of Article 2(17) SFDR. See European Commission (Ref.Ares(2021)4556843–14/07/2021) (<https://www.esma.europa.eu/sites/default/files/library/sfdr_ec_qa_1313978.pdf>) accessed on 15 February 2023, 5–6.

28 See also European Commission (Ref.Ares(2021)4556843–14/07/2021) (<https://www.esma.europa.eu/sites/default/files/library/sfdr_ec_qa_1313978.pdf> accessed on 15 February 2023), 6–8.

about conditions for automatic enrolment or compliance with sectoral exclusions or statutory requirements regardless of the form used, such as on paper, durable media, by means of websites, or electronic data rooms.[29]

Finally, there are Article 6 products (grey products). They neither promote sustainable investment nor have it as their objective, but they are nevertheless caught by the SFDR in the sense that grey products—just like Article 8 and 9 products—involve reporting on sustainability risks.[30]

Principal Adverse Impacts

Please also note that financial market participants above a certain size must always report on so-called principal adverse impacts (PAIs) of investment decisions on sustainability factors (environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters[31]), also with regard to Article 6 products.[32]

Reliable sustainability-related company information

General

How do financial intermediaries actually get reliable sustainability-related information about the companies in which they invest? The companies themselves will often not have that information readily available at this early stage. Financial intermediaries are dependent for the time being on third parties who claim to have access to this sustainability-related information.

ESG ratings

But that immediately raises a further question: how can financial intermediaries be sure that these data are reliable? According to the Dutch Authority for the Financial Markets (AFM), its French counterpart *Autorité des Marchés Financiers (AMF)* and more recently, ESMA as well, providers of sustainability-related information must be regulated under an EU regulation and be subject to direct supervision by ESMA, just as is already the case with credit rating agencies (CRAs) under the CRA Regulation.[33]

29 See also European Commission (Ref.Ares(2021)4556843–14/07/2021) 8 (<https://www.esma.europa.eu/sites/default/files/library/sfdr_ec_qa_1313978.pdf> accessed on 15 February 2023).

30 See art 6 SFDR.

31 Art 2(24) SFDR.

32 See further Section 2 below (under the heading 'Financial Market Participants: Transparency of Principal Adverse Sustainability Impacts on the Website' and Section 3 below (under the heading 'Financial Market Participants: Transparency on Adverse Sustainability Impact').

33 See 'AFM/AMF Position Paper: Call for a European Regulation for the provision of ESG data, ratings, and related services' (<https://www.afm.nl/en/nieuws/2020/december/reguleer-aanbieders-duurzaamheidsdata> accessed on 15 February 2023). On this subject, see: Daniel Cash, *Calls for ESG Rating Agency Regulation Grows Louder in Europe, But Could It Actually Save the Industry?* (<https://financialregulationmatters.blogspot.com/2020/12/calls-for-esg-rating-agency-regulation.html> accessed on 15 February 2023); ESMA's letter to DG FISMA dated 28 January 2021 (ESMA30-379-423); ESMA, 'ESMA launches call for evidence on ESG ratings' (3 February 2022) (<https://www.esma.europa.eu/press-news/esma-news/esma-launches-call-evidence-esg-ratings#:~:text=The%20aim%20is%20to%20gather,providers%20operating%20in%20the%20EU> accessed on 15 February 2023); ESMA, 'ESMA publishes results of its Call for Evidence on ESG ratings' (17 June 2022) (<https://www.esma.europa.eu/press-news/esma-news/esma-publishes-results-its-call-evidence-esg-ratings> accessed on 15 February 2023).

Corporate Sustainability Reporting Directive

Also, the Corporate Sustainability Reporting Directive (CSRD) will provide for a mandatory disclosure regime for both non-financial and financial companies (listed or non-listed). The idea is that this will provide financial intermediaries with the sustainability information they need to make informed sustainable investment decisions. It covers both (i) the sustainability impact of a company's activities, as well as (ii) the business and financial risks faced by a company due to its sustainability exposures (known as the 'double materiality' concept).[34] However, initially, only large undertakings will be covered by the disclosure regime, and, at a later stage, most SMEs. So micro undertakings are completely out of scope.[35] In terms of proportionality this may seem logical, but it may well have a detrimental effect on the market for microfinancing.

ESAP regulation

Finally, there is the Commission proposal for setting-up of an EU-wide platform to provide investors with 'seamless access' to financial and sustainability-related information on companies (European Single Access Point or ESAP Regulation).[36]

The structure of the remainder of this article

Now that we have a basic understanding of the SFDR and the legal environment in which it is embedded, we can take a closer look at the SFDR disclosure rules. The remainder of this article is structured as follows. First, the main rules on sustainability disclosure at entity level are set out (Section 2), followed by a discussion of pre-contractual sustainability disclosure at product level (Section 3), sustainability disclosure at product level on websites (Section 4) and sustainability disclosure at product level in periodic reports (Section 5). Subsequently, the relationship between sustainability disclosure and marketing communications is addressed (Section 6), followed by some remarks on competent financial supervisors (Section 7). In Section 8, it is assessed whether the SFDR is likely to succeed in harmonizing sustainability-related disclosure rules and fiduciary duties. Finally, Section 9 zooms out again and puts the SFDR in a broader perspective.

34 See COM(2021) 390 final, 3. See for the CSRD itself: Directive (EU) 2022/2464.

35 See art 1 and recitals (17) ff. CSRD (arts 19a and 29a, amending Directive 2013/34/EU [as amended by Directive 2014/95/EU, ie by the Non-Financial Reporting Directive or NFRD)]. The application of the CSRD will take place in four stages: (i) reporting in 2025 on the financial year 2024 for companies already subject to the NRFD; (ii) reporting in 2026 on the financial year 2025 for large companies that are not currently subject to the NFRD; (iii) reporting in 2027 on the financial year 2026 for listed SMEs (except micro undertakings), small and non-complex credit institutions and captive insurance undertakings; (iv) reporting in 2029 on the financial year 2028 for third-country undertakings with net turnover above 150 million in the EU if they have at least one subsidiary or branch in the EU exceeding certain thresholds. See art 4 CSRD and <https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-green-light-to-corporate-sustainability-reporting-directive/> accessed on 15 February 2023.

36 COM(2021) 723 final. The ESAP Regulation was announced as Action 1 of the CMU Action Plan 2020 (COM(2020) 590 final).

2. Disclosures at entity level

General

The first type of disclosure is explored in this section and applies at the entity level.

Transparency of sustainability risk policies on the website

Both financial market participants and financial advisers must publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process (financial market participants) and in their investment advice or insurance advice (financial advisers).[37]

They must ensure that this information is kept up to date. Where a financial market participant or financial adviser amends such information, a clear explanation of such amendment must be published on the same website.[38]

Financial market participants: transparency of principal adverse sustainability impacts on the website

Comply. . .

Where *financial market participants* consider principal adverse impacts of investment decisions on sustainability factors (environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters[39]), they must publish and maintain on their websites a statement on due diligence policies with respect to those impacts, taking due account of (i) their size, the nature and scale of their activities and (ii) the types of financial products they make available.[40] If they consider principal adverse impacts of investment decisions on sustainability factors, they must publish *at least* the following information on their websites:[41]

(a) information about their policies on the identification and prioritization of principal adverse sustainability impacts and indicators;[42]

37 Art 3(1) (financial market participants) and (2) (financial advisers) SFDR. Financial market participants that qualify as Institutions for Occupational Retirement Provision (IORPs) must publish and maintain the information referred to in art 3(1) in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 3(2) SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

38 Art 12(1) (financial market participants) and (2) (financial advisers) SFDR.

39 Art 2(24) SFDR.

40 Art 4(1), opening words, and (a) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 4(1), opening words, and (a) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR.

41 Art 4(2) SFDR, as further specified in arts 4–10 and Annex I (Template principal adverse sustainability impacts statement) of the SFDR Delegated Regulation. On 28 July 2022, the three ESAs published their first annual report on the publication of principal adverse sustainability impacts statements under the SFDR, featuring a provisional, indicative list of best—and bad—practices (JC 2022 35).

42 This is further specified in art 7 and Table 1 of Annex I SFDR Delegated Regulation. Where information relating to any of the indicators used is not readily available, financial market participants shall include in the section 'Description of policies to identify and prioritise principal adverse impacts on sustainability factors' in Table 1 of Annex I details of the best efforts used to obtain the information either directly from investee companies, or by carrying out additional research, cooperating with third party data providers or external experts or making reasonable assumptions (art 7(2) SFDR Delegated Regulation). At this early stage, the data required to calculate adverse impacts according to the relevant indicators will often not be readily available and cannot be obtained directly from investee

(b) a description of the principal adverse sustainability impacts and of any actions in relation thereto taken or, where relevant, planned;[43]
(c) brief summaries of engagement policies in accordance with the Directive on the exercise of certain rights of shareholders in listed companies,[44] where applicable;[45]
(d) a reference to their adherence to responsible business conduct codes and internationally recognized standards for due diligence and reporting and, where relevant, the degree of their alignment with the objectives of the Paris Agreement.[46]

. . . *or explain*

Where they do *not* consider adverse impacts of investment decisions on sustainability factors, financial market participants must publish and maintain on their websites clear reasons for why they do not do so, including, where relevant, information on whether and when they intend to consider such adverse impacts (comply or explain).[47]

Financial market participants above a certain size

In view of the above, financial market participants in principle have a choice *not* to consider adverse impacts of investment decisions on sustainability factors, provided that they give reasons for it. However, since 30 June 2021, financial market participants exceeding (i) on their own balance sheet dates or (ii) where they are parent undertakings of a large group,[48] on their group balance sheet dates, the criterion of the average number of 500 employees during the financial year, must always consider adverse impacts of investment decisions on sustainability factors.[49]

Financial advisers: transparency of principal adverse sustainability impacts on the website

Comply. . .

Financial advisers must publish and maintain on their websites information on whether they consider in their investment or insurance advice the principal adverse impacts on sustainability factors (environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters[50]), taking due account of (i) their size, the

companies, which means that the entities subject to the SFDR will often be dependent on third-party data providers claiming to have access to the required information. See also Section 1 above (under the heading 'Reliable Sustainability-related Company Information').

43 This is further specified in art 6 and Table 1 of Annex I SFDR Delegated Regulation.

44 See art 3 g (Engagement Policy) of Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [2007] OJ EU L184/17, as amended by (1) Directive 2014/59/EU [2014] OJ EU L173/90 and (2) Directive (EU) 2017/828 [2017] OJ EU L131/1.

45 This is further specified in art 8 and Table 1 of Annex I SFDR Delegated Regulation.

46 Ibid.

47 Art (4)(1), opening words, and (b) SFDR, further specified in art 12 SFDR Delegated Regulation. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 4(1), opening words, and (b) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR.

48 As referred to in art 3(7) of Directive 2013/34/EU.

49 Art 2(24) SFDR.

50 Art 2(24) SFDR.

nature and scale of their activities, and (ii) the types of financial products they advise on.[51] If financial advisers consider this in their investment or insurance advice, they use information on principal adverse impacts on sustainability factors that is provided by financial market participants.[52]

. . .*or explain*

Where they do *not* consider adverse impacts of investment decisions on sustainability factors in their investment or insurance advice, financial advisers must publish and maintain on their websites information on why they do not do so, including, where relevant, information on whether and when they intend to consider such adverse impacts ('comply or explain').[53]

In view of the above—and unlike financial market participants above a certain size (see above)—financial advisers *always* have a choice *not* to consider adverse impacts of investment decisions on sustainability factors in their investment or insurance advice.

Transparency of remuneration policies in relation to the integration of sustainability risks

Both financial market participants and financial advisers must (i) include in their remuneration policies information on how those policies are consistent with the integration of 'sustainability risks'[54] and (ii) publish that information on their websites.[55]

This information must be included in remuneration policies that financial market participants and financial advisers are required to establish and maintain in accordance with applicable sectoral legislation.[56]

They must ensure that this information is kept up to date. Where a financial market participant or financial adviser amends such information, a clear explanation of such amendment must be published on the same website.[57]

51 Art 4(5), opening words, and sub (a) SFDR, as further specified in art 11 SFDR Delegated Regulation. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 4(5), opening words, and sub (a) SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

52 See recital (8), first sentence, SFDR Delegated Regulation. Information provided by financial advisers on whether and how they take into account principal adverse impacts on sustainability factors within their investment or insurance advice should therefore clearly describe how the information from financial market participants is processed and integrated in their investment or insurance advice. In particular, financial advisers that rely on criteria or thresholds concerning principal adverse impacts on sustainability factors that are used to select, or advise on, financial products, should publish those criteria or thresholds. See recital (8), second sentence onwards, SFDR Delegated Regulation.

53 Art 4(5), opening words, and sub (b) SFDR, as further specified in art 13 SFDR Delegated Regulation. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 4(5), opening words, and sub (b) SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

54 Art 2(22) SFDR.

55 Art 5(1) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 5(1) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 5(1) SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

56 In particular, Directives 2009/76/EC (UCITS); 2009/138/EC (Solvency II); 2011/61/EU (AIFMD); 2013/36/EU (CRD IV); 2014/65/EU (MiFID II); (EU) 2016/97 (IDD); and (EU) 2016/2341 (IORPs), see art 5(2) SFDR.

57 Art 12(1) (financial market participants) and (2) (financial advisers) SFDR.

3. Pre-contractual disclosures at product level

General

The second type of disclosure set out in the SFDR is explored in this section and concerns pre-contractual disclosures at product level.

Disclosure in accordance with applicable sectoral legislation

The pre-contractual information must be disclosed to end investors in accordance with the applicable sectoral legislation, ie through an extremely broad spectrum of pre-contractual disclosure instruments, ranging from elaborate documents such as prospectuses to very concise documents such as key information documents (KIDs).[58]

Sustainability risks

Comply. . .

Both financial market participants *and* financial advisers must provide pre-contractual disclosures in accordance with the applicable sectoral legislation on:

I the manner in which sustainability risks[59] are integrated into their investment decisions (financial market participants) or into their investment or insurance advice (financial advisers); and

II the results of the assessment of the likely impacts of sustainability risks[60] on the returns of the financial products they make available (financial market participants) or advise on (financial advisers).[61]

58 See art 6(3) SFDR: for (a) alternative investment fund managers (AIFMs), in the disclosures to investors referred to in art 23(1) of Directive 2011/61/EU; (b) insurance undertakings, in the provision of information referred to in art 185(2) of Directive 2009/138/EC or, where relevant, in accordance with art 29(1) of Directive (EU) 2016/97; (c) IORPs, in the provision of information referred to in art 41 of Directive (EU) 2016/2341; (d) managers of qualifying venture capital funds, in the provision of information referred to in art 13(1) of Regulation (EU) No 345/2013; (e) managers of qualifying social entrepreneurship funds, in the provision of information referred to in art 14(1) of Regulation (EU) No 346/2013; (f) manufacturers of pension products, in writing in good time before a retail investor is bound by a contract relating to a pension product; (g) management companies for undertakings for collective investments in transferable securities (UCITS), in the prospectus referred to in art 69 of Directive 2009/65/EC; (h) investment firms which provide portfolio management or provide investment advice, in accordance with art 24 (4) of Directive 2014/65/EU; (i) credit institutions which provide portfolio management or provide investment advice, in accordance with art 24(4) of Directive 2014/65/EU; (j) insurance intermediaries and insurance undertakings which provide insurance advice with regard to IBIPs and for insurance intermediaries which provide insurance advice with regard to pension products exposed to market fluctuations, in accordance with art 29(1) of Directive (EU) 2016/97; (k) AIFMs of European Long-Term Investment Funds (ELTIFs), in the prospectus referred to in art 23 of Regulation (EU) 2015/760; and (l) PEPP providers, in the PEPP key information document referred to in art 26 of Regulation (EU) 2019/1238.

59 Art 2(22) SFDR.

60 Ibid.

61 Art 6(1), opening words, sub (a) and (b) (financial market participants) and art 6(2), opening words, sub (a) and (b) (financial advisers) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 6(1), opening words, sub (a) and (b) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 6(2), opening words, sub (a) and (b) SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

. . .or explain

Where financial market participants or financial advisers deem sustainability risks *not* to be relevant, the pre-contractual disclosures in accordance with the applicable sectoral legislation must include a clear and concise explanation of the reasons ('comply or explain').[62]

The above rules with regard to sustainability risks apply irrespective of whether the financial product is an Articles 6, 8 or 9 product.

Article 6 product

Where a financial product is an Article 6 product (and not an Article 8 or 9 product), the following statement must be included in the pre-contractual disclosures in accordance with the applicable sectoral legislation:

> The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.[63]

Financial market participants: additional pre-contractual disclosures

Financial market participants (unlike financial advisers) are subject to pre-contractual disclosure at product level *in addition to* the pre-contractual disclosure on sustainability risks. This may be explained by the fact that financial advisers use the information that is provided by financial market participants.

Financial market participants: transparency on adverse sustainability impact

Comply. . .

First, for financial market participants who chose to (or must) provide transparency of adverse sustainability impacts at entity level,[64] the pre-contractual disclosures include for each financial product:

I a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors;[65]

II a statement that information on principal adverse impacts on sustainability factors[66] is available in the information to be disclosed in the periodic reports.[67]

62 Art 6(1), second paragraph (financial market participants) and art 6(2), second paragraph (financial advisers) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 6(1), second paragraph SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR. Financial advisers that qualify as insurance intermediaries must communicate the information referred to in art 6(2), second paragraph, SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD), see art 15(2) SFDR.

63 Art 3 Taxonomy Regulation; art 7 Taxonomy Regulation.

64 See Section 2.

65 Art 2(24) SFDR.

66 Ibid.

67 Art 7(1), opening words, and sub (a) and sub (b) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 7(1), opening words, sub (a) and (b) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR.

. . .*or explain*

Financial market participants, who chose (and may choose) *not* to provide transparency of adverse sustainability impacts at entity level,[68] must include for each financial product a statement that the financial market participant does not consider the adverse impacts of investment decisions on sustainability factors and the reasons ('comply or explain').[69]

Financial market participants: Article 8 products

General

Secondly, where a financial product *promotes* environmental characteristics and/or social characteristics (Article 8 products), financial market participants must accompany the pre-contractual disclosures with:

(a) information on how those characteristics are met;
(b) if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics.[70]

In addition, where an Article 8 product promotes environmental characteristics, financial market participants must include in the pre-contractual disclosures:

(a) the information on the environmental objective or environmental objectives[71] to which the investment underlying the financial product contributes; and
(b) a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable;[72] this description must specify the *proportion* of investments in environmentally sustainable economic activities[73] selected for the financial product, including details on the *proportions* of enabling and transitional activities, as a percentage of all investments selected for the financial product.[74]

Also, where an Article 8 product promotes environmental characteristics, financial market participants must accompany the pre-contractual disclosures with the following statement:

> The 'do no significant harm' principle[75] applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities.

68 See Section 2.

69 Art 7(2) SFDR. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 7(2) SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR.

70 Art 8(1), opening words, and sub (a) and (b) SFDR, as further specified in arts 14–17, 20 and the template set out in Annex II and IV SFDR Delegated Regulation.

71 Art 9 Taxonomy regulation.

72 See on this term art 3 Taxonomy Regulation.

73 As defined in art 3 Taxonomy Regulation.

74 Art 6, paragraph 1, Taxonomy Regulation, read in conjunction with art 5 Taxonomy regulation. See, to the same effect, art 8(2a) SFDR, as further specified in arts 14–17, 20 and the template set out in Annex II and IV SFDR Delegated Regulation.

75 The 'do no significant harm' principle is an element in the definition of 'sustainable investment' set out in art 2(17) SFDR.

> The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.[76]

Methodology used for the relevant indices

Financial market participants must include in the pre-contractual information an indication of where the methodology used for the calculation of the index can be found.[77]

Financial market participants: Article 9 products

General

Thirdly, where a financial product has sustainable investment[78] as its objective (Article 9 products) and an index has been designated as a reference benchmark, financial market participants must accompany the pre-contractual disclosures with:

(a) information on how the designated index is aligned with that objective;
(b) an explanation as to why and how the designated index aligned with that objective differs from a broad market index.[79]

Where a financial product has sustainable investment[80] as its objective and *no* index has been designated as a reference benchmark, financial market participants must include in the pre-contractual disclosures an explanation on how that objective is to be attained.[81]

Where an Article 9 product invests in an economic activity that contributes to an environmental objective within the meaning of the definition of sustainable investment set out in Article 2(17) SFDR,[82] financial market participants must include in the pre-contractual disclosures:

(a) the information on the environmental objective or objectives[83] to which the investment underlying the financial product contributes; and
(b) a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable;[84] this description must specify the proportion of investments in environmentally sustainable economic activities[85] selected for the financial product, including details on the proportions of enabling and transitional activities, as a percentage of all investments selected for the financial product.[86]

76 Art 3 Taxonomy Regulation; art 6, second paragraph onwards, Taxonomy Regulation. See, to the same effect, art 8(2a) SFDR, as further specified in arts 14–17, 20 and the template set out in Annex II SFDR Delegated Regulation.
77 Art 8(2) SFDR, as further specified in arts 14–17, 20 and the template set out in Annex II and IV SFDR Delegated Regulation.
78 Art 2(17) SFDR.
79 Art 9(1) SFDR, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.
80 Art 2(17) SFDR.
81 Art 9(2) SFDR, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.
82 Art 2(17) SFDR.
83 Art 9 Taxonomy Regulation.
84 Art 3 Taxonomy Regulation.
85 Art 3 Taxonomy Regulation.
86 Art 9(4a) SFDR read in conjunction with art 5 Taxonomy Regulation, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.

Reduction of carbon emissions

Where an Article 9 product has a reduction in carbon emissions as its objective, financial market participants must include in the pre-contractual disclosures the objective of low carbon emission exposure in view of achieving the long-term global warming objectives of the Paris Agreement.[87]

However, where *no* EU Climate Transition Benchmark[88] or EU Paris-aligned Benchmark[89] in accordance with Regulation (EU) 2016/1011[90] is available, financial market participants must include in the pre-contractual disclosures a detailed explanation of how the continued effort of attaining the objective of reducing carbon emissions is ensured in view of achieving the long-term global warming objectives of the Paris Agreement.[91]

Methodology used for the relevant indices and benchmarks

Financial market participants must include in the pre-contractual disclosures an indication of where the methodology used for the calculation of the relevant indices and the benchmarks can be found.[92]

4. Disclosures at product level on websites

General

The third type of disclosure set out in the SFDR is explored in this section and concerns disclosures at product level on websites by financial market participants. Financial advisers are not subject to these disclosures. This may again be explained by the fact that financial advisers use the information that is provided by financial market participants.

Content

For Article 8 and 9 products, financial market participants must publish and maintain on their websites:

1. a description of the environmental or social characteristics (Article 8 products) or the sustainable investment objective (Article 9 products);
2. information on (i) the methodologies used to assess, measure and monitor the environmental or social characteristics (Article 8 products) or (ii) the impact of the sustainable investments[93] selected for the financial product (Article 9 products), including (a) its

87 Art 9(3), first paragraph, SFDR, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.

88 See art 3(1)(23a) Regulation (EU) 2016/1011.

89 See art 3(1)(23b) Regulation (EU) 2016/1011.

90 Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 (OJ L 171, 29 June 2016, 1).

91 Art 9(3), second paragraph, SFDR, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.

92 Art 9(4) SFDR, as further specified in arts 18–19, 21–22 and the template set out in Annex III SFDR Delegated Regulation.

93 Art 2(17) SFDR.

data sources (b) screening criteria for the underlying assets and (c) the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product;

3. the pre-contractual information on whether a financial product promotes environmental and/or social characteristics (Article 8 products) or has sustainable investment[94] as its objective (Article 9 products);
4. the sustainability information set out in periodic reports.[95]

Financial market participants must ensure that the information set out above is kept up to date. Where a financial market participant amends such information, a clear explanation of such amendment must be published on the same website.[96]

Presentation requirements

The information set out above must be clear, succinct and understandable to investors. It must be published in a way that is accurate, fair, clear, not misleading, simple and concise and in a prominent easily accessible area of the website.[97]

5. Sustainability disclosures at product level in periodic reports

General

The fourth and final type of disclosure set out in the SFDR is explored in this section and concerns disclosures at product level in periodic reports (ie annual reports, PEPP Benefit Statements and other types of periodic reports[98]) by financial market participants. Financial advisers are not subject to these disclosures. This may again be explained by the fact that financial advisers use the information that is provided by financial market participants.

Content

Where financial market participants make available an Article 8 or Article 9 product, they must include a description of the following in periodic reports:

1. for each Article 8 product, the extent to which environmental or social characteristics are met;

94 Ibid.

95 Art 10(1), first paragraph, SFDR, as further specified in arts 24–36 (art 8 products) and arts 37–49 (art 9 products) SFDR Delegated Regulation. Financial market participants that qualify as IORPs must publish and maintain the information referred to in art 10(1), first subparagraph, SFDR in accordance with point (f) of art 36(2) of Directive (EU) 2016/2341 (IORP Directive), see art 15(1) SFDR. According to art 15(2) SFDR, even though insurance intermediaries do not qualify as financial market participants (but as financial advisers), they must communicate the information referred to in art 10(1), first subparagraph, SFDR in accordance with art 23 of Directive (EU) 2016/97 (IDD).

96 Art 12(1) SFDR.

97 Art 10(1), second paragraph, SFDR, as further specified in arts 24–36 (art 8 products) and arts 37–49 (Article 9 products) SFDR Delegated Regulation.

98 See art 11(2) SFDR.

2. for each Article 9 product (i) the overall sustainability-related impact of the financial product by means of relevant sustainability indicators; or (ii) where an index has been designated as a reference benchmark, a comparison between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators;
3. where (i) an Article 9 product invests in an activity that contributes to an environmental objective, or (ii) an Article 8 product promotes environmental characteristics:
   (a) the information on the environmental objective or environmental objectives[99] to which the investment underlying the financial product contributes; and
   (b) a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable;[100] this description must specify the proportion of investments in environmentally sustainable economic activities[101] selected for the financial product, including details on the proportions of enabling and transitional activities, as a percentage of all investments selected for the financial product;
4. where an Article 8 product promotes environmental characteristics, financial market participants must include the following statement:

> The 'do no significant harm' principle[102] applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities.
>
> The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.[103]

Where a financial product is not an Article 8 or 9 product, but instead an Article 6 product, the following statement must be included in the period reports:

> The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.[104]

Disclosure in accordance with applicable sectoral legislation

The information set out above must be disclosed in accordance with the applicable sectoral legislation, ie through annual reports, PEPP Benefit Statements and other types of periodic reports.[105]

99 Art 9 Taxonomy Regulation.

100 Art 3 Taxonomy Regulation.

101 Ibid.

102 The 'do no significant harm' principle is an element in the definition of 'sustainable investment' set out in art 1(17) SFDR.

103 Art 3 Taxonomy Regulation; art 11(1), first paragraph, SFDR, read in conjunction with art 5 and 6 Taxonomy Regulation, further specified in arts 50–67 and Annex IV and V SFDR Delegated Regulation. Financial market participants may use the information in management reports in accordance with art 19 of Directive 2013/34/EU or the information in non-financial statements in accordance with art 19a of that Directive where appropriate (art 11(1), second paragraph, SFDR).

104 Art 3 Taxonomy Regulation; art 7 Taxonomy Regulation.

105 See art 11(2) SFDR: (a) for AIFMs, in the annual report referred to in art 22 of Directive 2011/61/EU; (b) for insurance undertakings, annually in writing in accordance with art 185(6) of Directive 2009/138/EC; (c) for IORPs, in the annual report referred to in art

6. Sustainability disclosures and marketing communications

Without prejudice to stricter sectoral legislation (in particular the UCITS, MiFID II, IDD and PRIIPs legislation[106]), both financial market participants *and* financial advisers must ensure that their marketing communications do not contradict the information disclosed pursuant to the SFDR.[107]

7. National competent supervisors

Member States must ensure that the national competent supervisors designated in accordance with sectoral legislation monitor the compliance of financial market participants and financial advisers with the requirements of the SFDR. They must have all the supervisory and investigatory powers that are necessary for the exercise of their functions under the SFDR.[108]

For the purposes of the SFDR, the national competent supervisors must cooperate with each other and must provide each other, without undue delay, with such information as is relevant for the purposes of carrying out their duties under the SFDR.[109]

8. The harmonizing effect of the SFDR

General

In the previous sections, we explored the main features of the SFDR. In this section, an attempt is made to assess whether the SFDR is likely to succeed in harmonizing sustainability-related (i) disclosure rules and (ii) fiduciary duties, not only across Member States, but also across financial products and distribution channels.

Uniform rules

First of all, the fact that the SFDR and the SFDR Delegated Regulation offer uniform rules included in regulations rather than in directives is clearly a positive feature from the viewpoint of harmonization. After all, the rules contained in a regulation have direct effect, whereas the rules in a directive would have to be transposed into national law to take effect

29 of Directive (EU) 2016/2341; (d) for managers of qualifying venture capital funds, in the annual report referred to in art 12 of Regulation (EU) No 345/2013; (e) for managers of qualifying social entrepreneurship funds, in the annual report referred to in art 13 of Regulation (EU) No 346/2013; (f) for manufacturers of pension products, in writing in the annual report or in a report in accordance with national law; (g) for UCITS management companies, in the annual report referred to in art 69 of Directive 2009/65/EC; (h) for investment firms which provide portfolio management, in a periodic report as referred to in art 25(6) of Directive 2014/65/EU; (i) for credit institutions which provide portfolio management, in a periodic report as referred to in article 25(6) of Directive 2014/65/EU; and (j) for PEPP providers, in the PEPP Benefit Statement referred to in art 36 of Regulation (EU) 2019/1238.

106 Directive 2009/65/EC (UCITS Directive); Directive 2014/65/EU (MiFID II Directive); Directive (EU) 2016/97 (IDD Directive); Regulation (EU) No 1286/2014 (PRIIPs Regulation).

107 Art 13(1) SFDR. The ESAs *may* jointly develop, through the Joint Committee, draft implementing technical standards (ITSs) to determine the standard presentation of information on the promotion of environmental or social characteristics and sustainable investments (art 13(2), first paragraph, SFDR). Power is delegated to the Commission to adopt the implementing technical standards referred to in the first subparagraph in accordance with art 15 of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 (art 13(2), second paragraph, SFDR).

108 Art 14(1) SFDR.

109 Art 14(2) SFDR.

within the national legal order of a Member State with all the risks of implementation differences between the Member States that this entails. Also, both the ESA's and the European Commission have been active in providing guidance on the practical application of the SFDR rules.[110] This will hopefully lead to further harmonization. The following features of the SFDR are less positive from the perspective of harmonization.

Member State options and exemptions

The SFDR contains three Member State options[111] and two exemptions.[112] Both features at least potentially negatively impact the degree of harmonization of sustainability-related disclosure rules and fiduciary duties across Member States, financial products and distribution channels.

Comply or explain

Financial market participants and financial advisers may sometimes choose not to comply with certain sustainability disclosures at entity and product level, as long as they explain why they do not do so.[113] This feature also at least potentially negatively impacts on the degree of harmonization of sustainability-related disclosure rules and fiduciary duties across financial products and distribution channels.

Certain entities and products will be out of scope—both now and in the future

The key terms 'financial market participant', 'financial adviser' and 'financial product' are defined in a closed-ended manner. As soon as a financial entity does not qualify as a 'financial market participant' or as a 'financial adviser', and/or does not render services or perform activities with regard to a 'financial product', that entity or product will fall outside the regulatory perimeter of the SFDR.

This legislative approach runs a real risk of leading to insufficient harmonization and an uneven playing field with regard to sustainability-related disclosure rules and fiduciary duties between, on the one hand, financial entities and products that fall within the scope of the SFDR, and, on the other hand, financial entities and products that fall outside its scope, such as FinTech entities providing services with regard to crypto-assets—both now and in the future.[114]

110 See the letter of the ESAs dated 7 January 2021 to the European Commission, concerning several questions on the application of the SFDR (JC 2021 02); the answers to these questions given by the European Commission (Ref.Ares(2021)4556843–14/07/2021) (<https://www.esma.europa.eu/sites/default/files/library/sfdr_ec_qa_1313978.pdf> accessed on 15 February 2023). On 9 September 2022 (JC 2022 47), the ESAs tabled additional questions on the application of the SFDR. See also the ESA document dated 17 November 2022 (JC 2022 62) containing 'Questions and answers (Q&A) on the SFDR Delegated Regulation (Commission Delegated Regulation) (EU) 2022/1288)'.

111 See art 16(1) and 17(2) SFDR.

112 See art 17(1) SFDR

113 See ss 2 and 3.

114 It should however be noted that the (near) final draft of the Markets in Crypto Assets Regulation (MiCAR) dated 5 October 2022 (2020/0265 (COD)) does subject issuers of crypto assets and crypto asset services providers (as defined there) to certain sustainability disclosures. See recital (5a): 'The consensus mechanisms used for the validation of transactions in crypto-assets might

This risk could perhaps be neutralized by amending the SFDR to the effect that it will delegate power to the Commission to adopt RTSs (drawn up jointly by the ESAs), designating that certain additional types of financial entities/products will also qualify as 'financial market participant'/'financial adviser'/'financial product', to the extent that this is necessary from the viewpoint of harmonization and creating (or preserving) a level playing field. 'Perhaps', because any empowerment under Article 290, TFEU[115] must be limited to non-essential elements. For that reason, the legislators have always refrained from granting delegated powers to the Commission which would change the scope of a regulation where this would imply a policy change or choice. Should this solution for that very reason not be legally viable, it might also be an option to define the key terms 'financial market participant', 'financial adviser' and 'financial product' in a more open-ended manner to make the SFDR future-proof.

A central supervisor is lacking

Having a harmonized set of rules is a necessary precondition for achieving harmonization but is not sufficient in itself. To achieve actual harmonization, supervisory convergence or even centralization of supervision is essential. As it currently stands, supervision and enforcement of the SFDR is a matter for the national competent supervisors.[116] Supervisors in some Member States may be more lenient than supervisors in other Member States. Of course, the national supervisors have a duty to collaborate with each other, and jointly with the ESAs, they can work on common best practices.[117] But this will probably be insufficient to bring about true harmonization. Designating ESMA as the sole supervisor and enforcer of the SFDR would be something to consider.

In the context of the plans for a further integration of the European capital markets (the Capital Markets Union (CMU) Action Plan), convergence and centralization of supervision are quite high on the agenda of the European Commission. Unfortunately, progress on this subject is slow. As long ago as 2017 and 2018, the Commission made an attempt to designate ESMA as the direct supervisor of certain types of investment institution and crowdfunding service providers, and wanted to give it the power to

have principal adverse impacts on the climate and other environment-related impacts. Such consensus mechanisms should therefore deploy more environmentally-friendly solutions and *ensure that any principal adverse impact that they might have on the climate and any other environment-related adverse impact is adequately identified and disclosed by issuers and crypto-asset service providers* [italics added, DB]. When determining whether adverse effects are principal, account should be taken of the principle of proportionality and the size and volume of the crypto-asset issued. ESMA, in cooperation with EBA, should therefore be mandated to develop draft regulatory technical standards to further specify the content, methodologies and presentation of information in relation to sustainability indicators with regard to climate and other environment-related adverse impacts, and to outline key energy indicators. The draft regulatory technical standards should also ensure coherence of disclosures by issuers and crypto-asset service providers. When developing the draft regulatory technical standards, ESMA should take into account the various types of consensus mechanisms used for the validation of transactions in crypto-asset, their characteristics and the differences between them. ESMA should also take into account existing disclosure requirements, ensure complementarity and consistency, and avoid double burden on companies.' See further arts 5(1)(g) and (11a), 17(1)(i) and (6a), 46(2)(g) and (10c), 59(4a) and (4b), 122(2)(n) MiCAR.

115 'TFEU' stands for 'Treaty on the Functioning of the European Union'.

116 See Section 9.

117 Art 14(2) SFDR.

approve certain categories of prospectuses.[118] The Commission also wanted to place providers of so-called Pan-European Personal Pension Products (PEPPs) under the direct supervision of the European Insurance and Occupational Pensions Authority (EIOPA).[119]

None of these plans has come to fruition. Why not? More supervisory powers for ESMA (or EIOPA) would be at the expense of the influence of national supervisors and hence of the member states. France and the Netherlands were in favour of a more centralized form of supervision, but at the time in question Germany was not. If the supervision of financial markets is to be more centralized, Germany will have to give up its opposition. After all, we all know how things work in Europe: if the Franco-German axis agrees on a course of action, there is a real chance it will happen, especially now that the UK has left the EU.

In view of the above, from a practical point of view, a proposal to designate ESMA as the sole supervisor and enforcer of the SFDR is unlikely to reach the finish line.

At the same time, perhaps the Wirecard scandal will serve as a game changer. After all, in future discussions on this subject Germany will find it harder to claim that its national supervision is always beyond reproach, as the German Federal Financial Supervisory Authority (BaFin) and also the German Financial Reporting Enforcement Panel (FREP) were recently confronted with a highly critical report from ESMA about their defective supervision of Wirecard AG.[120] According to Action 16 of the CMU Action Plan 2020, the European Commission will consider proposing measures for stronger supervisory coordination or direct supervision by the European supervisory authorities. The Commission will also carefully assess the implications of the Wirecard case for the regulation and supervision of EU capital markets and act to address any shortcomings that are identified in the EU legal framework.[121]

No harmonization of liability law

The SFDR remains silent on the civil liability of financial market participants and financial advisers for a breach of the sustainability-related disclosure rules and fiduciary duties it features. This is apparently left to the national systems of private law in the Member States. The general EU principle of effectiveness (also known as *effet utile*) may have a harmonizing effect on how national civil courts should assess damages claims for a breach of the sustainability-

118 COM(2017) 536 final (20 September 2017) (certain investment institutions and prospectuses); COM(2018) 113 final (8 March 2018) (crowdfunding service providers).

119 COM(2017) 343 final (29 June 2017). It is noted in this connection that, under the forthcoming MiCAR, if an asset-referenced token has been classified as significant in accordance with arts 39 or 40, its issuer shall carry out its activities under the supervision of the European Banking Authority (EBA), which shall exercise the powers of competent authorities conferred by arts 21 and 37–38 as regards issuers of such tokens (art 98(1)). Furthermore, if an e-money token has been classified as significant pursuant to arts 50 or 51, the EBA shall be responsible of their issuers' compliance with the requirements laid down in art 52 (art 98(4)). Of course, we will need to wait and see whether this proposal will reach the finish line. The (near) final draft of MiCAR dated 5 October 2022 (2020/0265 (COD)) however still features these elements.

120 ESMA, *Fast track peer review report on the application of the guidelines on the enforcement of financial information (ESMA/2014/1293) by BaFin and FREP in the context of Wirecard* (3 November 2020) (ESMA42-111-5349).

121 See further <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan/action-16-supervision_en> accessed on 15 February 2023.

related disclosure rules and fiduciary duties set out in the SFDR, but even if that is the case, there is still room for national, and therefore potentially divergent, approaches.[122]

In addition, it cannot be excluded that some national civil courts will take the liberty of accepting sustainability-related disclosure rules and fiduciary duties that go beyond those included in the SFDR, based on national prospectus liability rules, private law fiduciary duties, private law duties of care and broad private law concepts such as good faith/reasonableness and fairness. This constitutes a real risk, especially since it can be expected that the regulatory sustainability-related disclosure rules and fiduciary duties will become stricter in the years to come (through amendments of the SFDR itself and/or amendments at level 2 and/or 3). It is not at all unusual that it takes ten years before a civil case reaches the competent national supreme court, and this will be no different for damages claims for breaches of sustainability-related disclosure rules and fiduciary duties. It will no doubt be tempting for some national supreme courts to give retroactive effect to the regulatory sustainability-related disclosure rules and fiduciary duties in force at some point in time through the backdoor of broad private law concepts.[123]

Supplementing the SFDR with truly European liability rules for a breach of the sustainability-related disclosure rules and fiduciary duties would beyond any doubt be preferable from the viewpoint of harmonization.

Should the European Commission wish to consider the introduction of truly European liability rules for a breach of the sustainability-related disclosure rules and fiduciary duties included in the SFDR, it is submitted that it should bear in mind that the traditional private law consequences for a breach of a rule or duty may not be entirely adequate in the current context. Suppose that it is clear that a financial adviser rendered an investor the wrong advice in the sense that it advised financial products that are not sustainable, whereas the financial adviser advised him or her that they were, and *also* suppose that the adviser should have known or even knew that the financial products were not sustainable. Sustainability and return on investment are not necessarily correlated. It is therefore conceivable that the investor did not suffer any damages due to the inadequate advice. A traditional tort claim for damages or damages for breach of contract may therefore not always work in this context. If it was clear to the financial adviser that a certain degree of sustainability was crucial to the investor, the latter should perhaps have the power to annul the contract, triggering restitutionary claims in both directions, but that may not necessarily have the desired effect either. After all, what the investor wants is to be put in a position that his or her investments are as sustainable as he or she expected them to be based on the financial adviser's

122 See on the EU principle of effectiveness with regard to various aspects of EU financial law: D Busch, 'The Private Law Effect of MiFID: Genil and Beyond' (2017) 1 *European Review of Contract Law* 70; D Busch, 'The Private Law Effect of the EU Market Abuse Regulation' (2019) 3 *Capital Markets Law Journal* 296; D Busch, 'The Influence of the EU Prospectus Rules on Private Law' (2020) 4 *Capital Markets Law Journal* (all with further references, also to the relevant decisions from the Court of Justice of the European Union).

123 See B Bierens, 'Hoofdstuk 6: De bancaire zorgplicht, klimaatverandering en het Europese 'Actieplan: duurzame groei financieren', in D Busch et al (eds), *Zorgplicht in de financiële Sector* (Kluwer, Deventer 2020) § 2.4. See more generally on the phenomenon of supreme courts giving retroactive effect to regulatory law through the backdoor of broad private law concepts: D Busch, 'The Future of the Special Duty of Care in the Dutch Financial Sector' (2021) 3 *European Business Law Review* 473 (Section 7).

advice. A damages claim *in natura* may therefore perhaps be an option to actually put him or her in that position, at least in certain cases. In a more radical approach, the notion of 'damage' could be redefined as including damage to the environment, etc, and not necessarily to the investor's patrimony, in which case harmonized EU law could perhaps oblige the relevant financial adviser to pay damages to a sustainability fund, either at EU level or at Member State level. Drafting harmonized EU liability rules in this context will in any event require some serious out-of-the-box thinking.[124]

No harmonization of the administrative sanctioning regime

Finally, the SFDR does not offer a harmonized administrative sanctioning regime for a breach of the sustainability-related disclosure rules and fiduciary duties it features. In fact, it does little more than reiterating the general EU principle of effectiveness (*effet utile*):

> Member States shall ensure that the competent authorities ... monitor the compliance of financial market participants and financial advisers with the requirements of [the SFDR]. The competent authorities shall have all the supervisory and investigatory powers that are necessary for the exercise of their functions under [the SFDR].[125]

The introduction of a truly European administrative sanctioning regime for a breach of the sustainability-related disclosure rules and fiduciary duties would of course be preferable from the viewpoint of harmonization.

9. Outlook

Is the SFDR an exercise in vain? Not quite, one would hope, but there is still a long way to go. First of all, the phenomenon of greenwashing, in which organizations pretend to be greener or more socially responsible than they actually are, is widespread among collective investment schemes (investment funds). Almost half of the European investment funds, whose mission is to combat environmental pollution or human rights violations, also invest in companies that are active in, for example, the fossil fuel industry or in Chinese regions where forced labour cannot be ruled out. This emerged from an investigation by The Great Green Investment Investigation, a partnership of 26 journalists from 9 European countries.[126]

Also, the EU is not an island. There are roughly two opposite scenarios. In a pessimistic scenario, the more lenient or even non-existent sustainability agenda of other geopolitical powers gives them a competitive edge that is detrimental to the EU. In a positive scenario,

124 It is noted that the European Commission published on 30 March 2022 a proposal for a directive amending Directives 2005/29/EC (the Unfair Commercial Practices Directive, UCPD) and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and better information (COM(2022) 143 final). The UCPD amendment proposal explicitly targets greenwashing.

125 Art. 14(1) SFDR.

126 See <https://www.ftm.eu/green-investments> accessed on 15 February 2023. See also <https://www.esma.europa.eu/press-news/consultations/esas-call-evidence-greenwashing> accessed on 15 February 2023.

the EU becomes a global standard-setter in the area of sustainability.[127] The USA's re-entry in the Paris Climate Agreement under the Biden Administration and its recent success in delivering a climate bill as part of the Inflation Reduction Act (IRA) may give us some hope.[128] Finally, on 9 December 2022, the UK Government announced a major reform of financial services regulation 'to drive growth and competitiveness in the financial services sector' (the Edinburgh reforms). In this context, the UK Government 'is ensuring that the financial system plays a major role in the delivery of the UK's Net Zero target, and is acting to secure the UK as the best place in the world for responsible and sustainable investment'.[129] Whether these developments will contribute to the EU becoming a global standard-setter in the area of sustainability, only time will tell.

127 Cf Anu Bradford, *The Brussels Effect—How the European Union Rules the World* (OUP 2020).

128 See <https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/paris-climate-agreement/> accessed on 15 February 2023; <https://www.theguardian.com/global-development/2022/nov/06/inflation-reduction-act-climate-crisis-congress> accessed on 15 February 2023. Cf also the Public Statement of John Coates (acting director division of corporation finance, US Securities and Exchange Commission, SEC) dated 11 March 2021 'ESG disclosure—keeping pace with developments affecting investors, public companies and the capital markets' (<https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121> accessed on 15 February 2023).

129 See <https://www.gov.uk/government/collections/financial-services-the-edinburgh-reforms> accessed on 15 February 2023.