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## EC Will Not Introduce Minimum Criteria for Sustainability Funds Under SFDR

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The European Commission has rejected suggestions that it introduce minimum environmental standards for Article 8 or Article 9 funds under the EU Sustainable Finance Disclosure Regulation (SFDR). On April 14, 2023, the Commission confirmed that it will not provide a definition for “sustainable investment,” nor will it introduce **minimum qualifying sustainability criteria**.

The clarifications, published by financial services commissioner Mairead McGuinness, come after European Supervisory Authorities asked the Commission in September last year for further guidance on the interpretation of the SFDR. This was against the backdrop of asset managers downgrading approximately €175 billion (\$193 billion) of assets from Article 9 funds (i.e. those holding the SFDR's highest sustainability classification) to the broader, less demanding Article 8 label (which requires sustainability to be only one of the factors informing investment decisions) due to uncertainty over the rules.

The Commission has:

- reiterated that the SFDR is a disclosure regime and that it will not set minimum requirements for the key parameters of sustainable investment, such as “do no significant harm” and governance indicators; and
- affirmed once again that SFDR is not a labelling regime, leaving it up to the market to assess whether a given investment should be considered as sustainable under SFDR.

The Commission **stated** that: “Financial market participants must carry out their own assessment for each investment and disclose their underlying assumptions.” It **added** that funds subject to Article 9 under the SFDR remain “neutral” in terms of product design, investing styles, investment tools, strategies and methodologies.

Highlighting the ongoing challenges in compliance with the SFDR, on April 12, 2023 the European Supervisory Authorities (ESAs) published a **Consultation Paper** regarding potential amendments to the Delegated Regulation of the SFDR. The consultation will remain open until July 4, 2023.

The ESAs are proposing changes to the disclosure framework to attempt to address issues that have emerged since the introduction of the SFDR. The authorities are seeking feedback on a number of amendments, including:

- extending the list of universal social indicators for the disclosure of the principal adverse impacts of investment decisions on the environment and society;
- refining the content of other indicators for adverse impacts and their respective definitions and sources of information on which the disclosure is based; and
- adding product-level disclosures regarding decarbonization targets, including intermediate targets and how the target will be achieved.

Additionally, the ESAs have proposed a number of further technical revisions to the SFDR Delegated Regulation that seek to:

- improve disclosure regarding how sustainable investments “do not significantly harm” the environment and society;
- simplify pre-contractual and periodic disclosure templates for financial products; and
- clarify the treatment of derivatives and the definition of “equivalent information.”

**Taking the temperature: We have **previously discussed** how climate-related data assessment and disclosure arising in financing transactions remains a work in progress globally, as evidenced by decisions by a large number of asset managers to **downgrade** ESG funds due to a lack of guidance on how to apply the existing regulatory announcements in distinguishing Article 8 from Article 9 funds. What the Commission’s action demonstrates is that, in Europe at least, there is still much work to be done by regulators to resolve this tension. Financial firms will need to continue to be cautious about use of sustainability labels for investment products and must have a documented basis and methodology for supporting any such descriptions.**