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European Commission Launches Consultation on the Sustainable Finance Disclosure Regulation

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On 14 September 2023, the European Commission published "targeted" and "public" consultations on *Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector* (the "**SFDR**"). While the European Commission states that the views reflected in the consultation papers do not indicate its final position on the future shape of the SFDR, the tenor of both consultations provide useful insights into the potential implications of future reform for those financial market participants ("**FMPs**") (which includes alternative investment fund managers ("**AIFMs**")) who fall within the scope of the current regime.

The scope and detail of the questions asked in the consultation papers speak to Brussels' serious concerns about the implementation of the SFDR since its introduction in March 2021, as well as its increasing contemplation of an overhaul of the existing framework. While any proposed changes would not come into force for several years, AIFMs and other FMPs should expect continuing legal uncertainty as it relates to future obligations under the SFDR.

The European Commission has set a deadline of 15 December 2023 for feedback on four distinct areas addressed in the consultations: (a) the current requirements of the SFDR; (b) its interaction with other sustainable finance legislation; (c) potential changes to disclosure requirements for financial market participants; and (d) the potential establishment of a categorisation system for financial products. The Commission aims to publish a finalised report on the SFDR in Q2 2024.

We set out below the future reforms seemingly under consideration by the European Commission and which AIFMs and other FMPs should follow with interest.

Topic 1: Current requirements of the SFDR

The first topic focuses on whether the SFDR has so far met its objective of "*strengthening transparency through sustainability-related disclosures in the financial services sector*" to support the transition to "*a sustainable, climate-neutral economy*". The questions acknowledge recurring criticisms of the SFDR, chiefly relating to the extent to which the disclosures required by the SFDR are "*sufficiently useful*" to investors. The consultation also queries whether the current reporting obligations "*prevent capital from being allocated to sustainable investments as effectively as it could be*".

Addressing potential issues with the implementation of the SFDR, the European Commission asks whether the costs of compliance with the SFDR framework are "*proportionate to the benefits generated*" and requests detailed breakdowns of the internal and external costs AIFMs have resultingly incurred.

In a welcome development, the European Commission also recognises the continuing

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difficulties FMPs face sourcing reliable data. The shortage of comprehensive, quality data has been a criticism levelled frequently against the SFDR. The consultation seeks to offer potential solutions, including allowing the use of estimates to fill data gaps where required.

Topic 2: Interaction with other sustainable finance legislation

Respondents to the consultation are invited to give views on any "*potential inconsistencies or misalignments*" which exist between the SFDR and other sustainable finance legislation, including the Taxonomy Regulation, the Benchmarks Regulation, the Corporate Sustainability Reporting Directive, the Markets in Financial Instruments Directive, the Insurance Distribution Directive and the Regulation on Packaged Retail Investment and Insurance Products.

Topic 3: Potential changes to the disclosure requirements for financial market participants

The European Commission seeks to assess the utility of entity-level disclosures to prospective investors. Given that a number of pieces of European Union legislation require sustainability-related entity-level disclosures, the consultation asks whether such requirements could be streamlined—a potential reform which could result in the removal of such requirements from the SFDR.

The consultation goes on to consider product-level disclosure requirements under the SFDR. Here, the European Commission indicates a preference to expand the scope of SFDR reporting obligations. It seeks feedback on whether uniform disclosure requirements should be imposed on *all* financial products offered within the EU, as opposed to only those making sustainability-related claims. This proposal is made on the basis that the implementation of uniform requirements could aid prospective investors in seeking to understand a product's sustainability performance by enabling useful comparisons against products that are not designed to achieve any sustainability-related outcomes. The list of uniform disclosure requirements for all financial products which the consultation suggests includes taxonomy-related disclosures, engagement strategies, exclusions and information about how ESG-related evidence is used in the investment process.

Topic 4: Potential establishment of a categorisation system for financial products

Although the SFDR was designed as a disclosure regime, the European Commission acknowledges that "*Articles 8 and 9 of the SFDR are being used as de facto product labels*". While this use "*suggests there is a market demand for such tools in order to communicate the sustainability performance of financial products*", the consultation also notes "*a labelling scheme might lead to risks of greenwashing*".

In order to mitigate against these risks, the European Commission seeks views on "*the merits of developing a more precise product categorisation system based on precise criteria*". It outlines two potential strategies for the development of a product categorisation system:

- build on the existing concepts within Articles 8 and 9, with additional (minimum) criteria for products to make clear the scope of each article; or
- focus instead on the types of investment strategies chosen, with the existing concepts within Articles 8 and 9 likely disappearing from the current legal framework.

The target consultation also considers the introduction of specific prohibitions relating to the labelling and communication of financial products, such as banning products that do not fall under the relevant product categories from using such terms as "*sustainable*" and "*green*".

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Given the page space given to this topic in the consultation, it is evident that the Commission is giving genuine consideration to a product categorisation system. The development of a labelling system would have the effect of aligning the SFDR more closely with the UK's (yet to be finalised) sustainable finance regulatory framework. We are also expecting the US Securities and Exchange Commission to publish proposals for its ESG rules for investment advisers which will include a labelling system. Greater alignment is of course to be welcomed, but interoperability is vital for those AIFMs operating globally.

Conclusion

Despite having been introduced less than three years ago, the wide-ranging scope of the European Commission consultation on the SFDR demonstrates that Brussels is increasingly receptive to a substantial, if not complete, overhaul of the existing regime. The potential implications for AIFMs falling within the scope of the current SFDR regime, including non-EU AIFMs marketing funds into the EU, could be highly significant—particularly if the European Commission chooses to expand the current disclosure obligations to all financial products. While the European Commission's final proposals will not be revealed until Q2 2024 at the earliest, AIFMs can contribute to the policymaking process by providing feedback here.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. If you wish to discuss any of the matters set out above, please contact the Gibson Dunn lawyer with whom you usually work, any member of Gibson Dunn's Global Financial Regulatory or Investment Funds teams, or the following authors:

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