Proskauer

Sustainability-related disclosures for all funds proposed by EU Platform on Sustainable Finance

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On 17 December 2024, the EU Platform on Sustainable Finance (the "Platform"), an advisory body to the European Commission (the "Commission"), has published a briefing note to the Commission, outlining their proposals for a new categorization system for sustainable finance products (the "Proposal"). This is intended to be in replacement of the current regime under the Sustainable Finance Disclosure Regulation ((EU) 2019/2088, "SFDR").

We outline below:

- **Fund categories:** the headline points of the proposed fund categories recommended by the Platform;
- **Disclosures for all funds:** the proposed metrics to be reported on by all funds (regardless of any commitment to sustainability); and
- **Private markets:** the key considerations made in relation to private markets' funds.

Fund categories

In summary, the Platform recommends categorizing funds as follows:

- **Sustainable**:
  - The sustainable category is applicable to funds that contribute to a sustainable investment objective through EU Taxonomy-aligned investments or sustainable investments with no significant harmful activities ("DNSH") for a minimum proportion of assets.
  - There is a significant elevation of the use of the EU Taxonomy ((EU) 2020/852) in this proposed category, in line with the European Supervisory Authorities' Opinion which we reported on here. Essentially, the Platform recommends that if an economic activity is listed in the EU Taxonomy, then the requirements, including the technical screening criteria, of the EU

Taxonomy must be met for it to be considered a sustainable investment. The more flexible definition of "sustainable investment" under Art. 2(17) of the SFDR can only be used if the economic activity is not listed in the EU Taxonomy. The Platform sets out "the more the EU Taxonomy is developed, the less need there will be for the use of the SFDR sustainable investments, ultimately leading to the full replacement by the EU Taxonomy". Their rationale is that with multiple definitions of sustainable investment, it creates "confusion, inefficiencies, and ultimately undermines the overarching goal of the Sustainable Finance package".

- For the DNSH test, the principal adverse impacts ("PAIs") must still be assessed, with an emphasis on the PAIs relevant to the sustainability features of the fund.
- The Paris-aligned Benchmark exclusionary criteria must also be complied with for this category.
- Further sustainability-related binding elements could be implemented, for example, on engagement.
- For all binding elements of the sustainable investment strategy pursued, there must be corresponding sustainability indicators reported on, alongside reporting on EU-Taxonomy alignment and all mandatory PAIs.
- There seems to be a drive to report on a more granular basis with regards to PAIs too, where managers will be required to "explain deficient or poor PAI indicator performance and how this is in line with the principle that the remainder should not undermine the sustainability objective".

- **Transition**:
    - This category is intended where there are investments or portfolios supporting the transition to net zero and a sustainable economy, avoiding carbon lock-ins, per the Commission's recommendations on facilitating financing for the transition to a sustainable economy.
    - There are various options to commit to a transition, including by complying with decarbonisation according to the Benchmark Regulation ((EU) 2016/2011), tracking the Climate Transition Benchmarks or Paris-aligned Benchmarks, or committing to EU Taxonomy-aligned CapEx or transitional activities. Further options include committing to investments with transition plans or science-based targets, engaging with companies with an escalation (and ultimately divestment) plan to commit to a transition plan, and transitioning real estate and infrastructure investments with portfolio-level

commitments. The option(s) committed to must be made binding elements of the investment strategy.

  - The difference in the exclusion criteria compared to the sustainability category is that the criteria set out in the Climate Transition Benchmarks must be met.
  - Sustainability indicators must be reported on with regards to whichever option is committed to, alongside EU-Taxonomy alignment and reporting on all mandatory environmental PAIs if the focus is on environmental transition, or all mandatory social PAIs if the focus is social transition (or both).

- **ESG collection**:
  - Investments must be committed to one or more “material sustainability features” with flexibility of what this might be, including:
    - Effective reduction of the investment universe, e.g., by 20% in line with the French regulator’s, the AMF’s, expectations
    - Investing in funds that themselves are sustainable, transition or ESG collection
    - Investing in companies without transition plans with a credible engagement strategy, including an escalation (and ultimately divestment) plan to commit to a transition plan
    - Percentage of assets committed to year-on-year improvements or to be better than a reference benchmark
  - Other assets must not undermine the sustainability features committed to in the binding elements.
  - Adherence to minimum exclusions under the Climate Transition Benchmark criteria (although this is adjusted).
- As with the other proposed categories, the commitments must be binding on the investment strategy and have respective sustainability indicators.
- EU Taxonomy alignment must be reported on, and all mandatory environmental PAIs must be reported if the focus is on environmental characteristics, and all mandatory social PAIs must be reported if the focus is on social characteristics (or both). Notwithstanding this, there are certain core PAI indicators that must be reported on, as set out below under ‘Minimum disclosure for all funds’.

All other funds should be identified as **unclassified products**, the Platform recommends — nevertheless with a set of mandatory sustainability disclosures, as set out below. Further, a disclaimer should state that (i) the fund is unclassified; (ii) it does not fulfil the standards required for a categorised financial product; and (iii) any ESG characteristics or sustainable or transition features must only be described in the legal documentation.

There is no separate impact investing category, however, the Platform sees merit in the European Commission analysing how impact investing funds could be considered in the categorisation. This is in contrast to the UK's labelling regime under the Sustainability Disclosure Requirements, which does have a specific impact label.

Minimum disclosures for all funds

In a marked departure from the light-touch current Article 6 fund disclosure requirements, the Platform proposes that all funds are required to report on:

- EU Taxonomy alignment (revenue and CapEx); and
- PAIs on GHG emissions, carbon footprint, GHG intensity of investee companies and UN Guiding Principles or OECD Multinational Enterprises Guidelines.

There seem limited options in the Proposal for not providing such disclosures, with the Platform instead noting that estimates could be used.

Private markets

There is an acknowledgement at the front of the Proposal that it "puts retail investors and their needs at its core". There are also scattered references to private markets, however, including:

- **PAIs:** the Platform notes that PAIs are often not tailored for private market investments like infrastructure debt and equity, private equity and debt, venture capital, real assets and indirect investments. The Platform sets out it would welcome guidance from the Commission on how these investments can be assessed via the PAIs, for example, by providing examples of indicators that can be used as a proxy for indicators commonly used for listed asset classes. Similarly, the Platform recommends further analysis on setting thresholds for PAIs in private market funds.

- **Sustainability indicators:** as set out in the summary of the proposed categories, there are many suggested indicators; however, the Platform acknowledges that particularly for non-listed assets such as real estate and private market investments there could be a need for the use of tailored indicators.
- **Ramp up/wind down:** whilst there is the concept of mandatory commitments which need to be maintained throughout a fund's lifecycle, there is the awareness from the Platform that the mandatory commitment could be applicable in a timeframe specified with reference to private market funds' ramp up and wind-down phases.

Application to Overseas Funds marketed in the EEA by non-EEA Managers

We note there is no direct coverage of the applicability of the Proposals to overseas funds marketed into the EEA and therefore presume that a marketing notification in one or more EEA Member States under a national private placement regime will bring funds managed by non-EEA managers into the scope.

Next steps

There is no committed timeline for the European Commission to consider the Platform's Proposal or for SFDR 2.0 to be implemented. However, the influential Platform's Proposal will certainly trigger momentum on developments.

Proskauer will continue to monitor developments — for more information or a briefing session on the Proposal, please reach out to ukreg@proskauer.com.

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