FACULTY OF LAW

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A Comprehensive Analysis of Sustainable Finance Disclosures

JAEM01 Master Thesis

European Business Law

15 higher education credits

Supervisor: Radu Mares

Term of graduation: Spring 2024

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Summary

This thesis delves into a comprehensive analysis of the current European framework on disclosure of sustainable investments. This framework is composed by the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation (TR). Both regulations set disclosure rules and define what can be regarded as sustainable investments. Harmonised disclosure rules are important to prevent greenwashing and ensure that investors are well-informed about genuine sustainable investments.

However, the interplay of the regulations may lead to lack of clarity. The main research question of this thesis is to what extent the SFDR and the TR are aligned with each other in terms of their definitions and objectives. Sub-questions that arise are as follows: What risks are associated with misalignments? Are the regulations effectively preventing greenwashing and contributing to disclosure standards? Do they need to be realigned?

To answer the research question(s), the thesis delves into the analysis of the objectives of the regulations, their scopes (personal and material) including the definitions and requirements entailed in the regulations.

This thesis reveals that some parts of the regulations overlap even if different approaches are used, as for example the exclusion of adverse investments. Other aspects require realignment such as the scopes of application. The personal scopes overlap but the TR's personal scope is broader since it includes undertakings subject to non-financial disclosures. While an alignment of the personal scopes may minimise confusion, significant discrepancies arise in the material scope, notably in the definition of 'sustainable investment'. The SFDR-definition is unclear and creates insecurity among investors and financial market participants. The definition creates risks of greenwashing as only a small contribution to the environment or social rights is sufficient to be considered as sustainable. The SFDR should consider minimum requirements and aligning itself more to the TR.

Sammanfattning

Denna avhandling innehåller en omfattande analys av det nuvarande europeiska ramverket för redovisning av hållbara investeringar. Detta ramverk består av förordningen om redovisning av hållbar finansiering (SFDR) och taxonomiförordningen (TR). Båda förordningarna fastställer regler för offentliggörande och definierar vad som kan betraktas som hållbara investeringar. Harmoniserade informationsregler är viktiga för att förhindra ”greenwashing” och säkerställa att investerare är välinformerade.

Samspelet mellan regelverken kan dock leda till oklarheter. Den huvudsakliga forskningsfrågan i denna avhandling är i vilken utsträckning SFDR och TR är anpassade till varandra när det gäller deras definitioner och mål. De underfrågor som uppkommer är följande: Vilka risker är förknippade med felaktiga anpassningar? Förebygger regelverken effektivt greenwashing och bidrar de till upplysningsstandarder? Behöver de justeras? För att besvara forskningsfrågan/frågorna fördjupar sig avhandlingen i analysen av föreskrifternas syften, deras räckvidd (personlig och materiell) inklusive de definitioner och krav som föreskrifterna medför.

Denna avhandling visar att vissa delar av reglerna överlappar varandra även om olika tillvägagångssätt används, som till exempel uteslutning av negativa effekter. Andra aspekter kräver en ny inriktning, t.ex. tillämpningsområdet (TO). De personliga TO är överlappande, men TR:s personliga TO är bredare eftersom det omfattar företag som omfattas av icke-finansiella upplysningar. Även om en anpassning av de personliga TO kan minimera förvirringen, uppstår betydande skillnader i det materiella TO, särskilt i definitionen av ”hållbara investeringar”. SFDR-definitionen är otydlig och skapar osäkerhet bland investerare och finansmarknadsaktörer. Definitionen skapar risker för greenwashing eftersom endast ett litet bidrag till miljön eller sociala rättigheter är tillräckligt för att anses vara hållbart. SFDR bör överväga minimikrav och att anpassa sig mer till TR.

Translated with DeepL.com (free version), Luxembourg, 13 May 2024

Preface

I would like to express my sincere gratitude to Radu Mares, my supervisor, whose guidance and support have been invaluable throughout the process of writing this thesis.

I would also like to extend my appreciation to Julian Nowag and Kristina Ackermann for their constructive comments and assistance during the 'work in progress seminar'.

Finally, I am grateful to the staff at Lund University's Library and at the National Library in Luxembourg for guiding me in my research.

Lund, 18th of May 2024

Abbreviations

AIFM	Alternative Investment Fund Manager
CapEx	Capital Expenditure
CDR	Commission Delegated Regulation
CSDDD	Corporate Sustainability Due Diligence Directive
CSRD	Corporate Sustainability Reporting Directive
DNSH	Do No Significant Harm
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standard Regulation
ETF	Exchange Traded Funds
FMP	Financial Market Participant
ILO	International Labour Organisation
MNEs	Multinational Entreprise
NGO	Non-governmental Organisation
OECD	Organisation for Economic Cooperation and Development
OpEx	Operating Expenditure
PAI	Principal Adverse Impacts
RTS	Regulatory Technical Standards
SDG	Sustainable Development Goals
SFDR	Sustainable Finance Disclosure Regulation
SICAR	Investment Company in Risk Capital (French acronym)
SIF	Specialised Investment Funds
SoC	Substances of Concern
TR	Taxonomy Regulation
TSC	Technical Screening Criteria
UCI	Undertakings for Collective Investment
UCITS	UCI in Transferable Securities
UN	United Nations
UNGP	United Nations Guiding Principles

1 Introduction

1.1 Background

On the 25 September 2015, the United Nations' General Assembly adopted the 2030 Agenda for Sustainable Development[1], a landmark moment for the prioritisation of environmental, social and governance (ESG) objectives.

The European Union committed to adhere to the sustainable policy framework of the 2030 Agenda[2] by focusing on 17 sustainable development goals (SDG) and by encouraging the Member States to commit to that framework.[3] That same year, the UN adopted the Paris Agreement, which is strengthening this policy framework, foreseeing reduction of greenhouse gas emissions and limiting temperature increase to 1,5°C.[4] Those goals include *inter alia* sustainable cities, sustainable economic growth, clean energy, poverty reduction and climate actions.[5]

Sustainability refers not only to environmental aspects but also to social and governance practices. Thus, the protection of human rights, ethical supply chains, internal governance in business strategies and responsibilities are also part of the ESG. Before the European Union introduced the binding legal framework, ESG was 'soft law' without mandatory requirements. However, the European institutions and the stakeholders recognised the need for legally binding acts.[6] Such 'hard law' ensures that economic actors are obliged to

[1] United Nations, 'Resolution adopted by the General Assembly on 25 September 2015' A/RES/70/1, <www.un.org/en/development/desa/population/migration/generalassembly/docs/globalcompact/A_RES_70_1_E.pdf> accessed 9 May 2024

[2] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector OJ L 317/1, recital 1

[3] European Commission, Sustainable Development Goals <https://international-partnerships.ec.europa.eu/policies/sustainable-development-goals_en> accessed 9 May 2024

[4] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 (2020) OJ L 198/13, recitals 2 and 3

[5] United Nations, The 17 Goals <https://sdgs.un.org/goals> accessed 9 May 2024

[6] European Commission, Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, COM(2018) 353 final 2018/0178 (COD), 6

change their business and investment strategies. The European Union is still actively implementing legal measures that are in line with the Paris Agreement because sustainability goals are an ongoing project.

Among these legal measures, the European institutions are for example adopting disclosure rules. They are part of the EU Action Plan[7], which sets out 10 actions in the field of sustainable finance. Disclosures have a significant impact in enhancing sustainability efforts and was thus a key action in that regard. They ensure the transparency required to determine the sustainability degree of an entity or of a product offered on a market.

Sustainable financial investments are important because they enable financial returns while promoting environmental sustainability at the same time, for example through Green Bonds, sustainable ETFs or renewable infrastructure investments.[8] The demand for sustainable investments is increasing constantly and such is its reporting.[9] BlackRock, the largest asset manager in the world[10], recently made sustainability a key element in its strategy.[11] Because of the growing demand, but also the growing necessity to invest sustainable, '[f]inancial market participants and financial advisers should be required to disclose specific information regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts'.[12]

The *rationale* behind the regulations is that disclosures of such information enable investors to compare different products regarding their sustainability

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[7] European Commission, 'Renewed sustainable finance strategy and implementation of the action plan on financing sustainable growth' (2018) <https://finance.ec.europa.eu/publications/renewed-sustainable-finance-strategy-and-implementation-action-plan-financing-sustainable-growth_en> accessed 9 May 2024

[8] John Hill, *Environmental, Social, and Governance (ESG) Investing, A Balanced Analysis of the Theory and Practice of a Sustainable Portfolio* (Academic Press 2020) 188

[9] Christof Falkenberg, Carina Schneeberger and Siegfried Pöchtrager, 'Is Sustainability Reporting Promoting a Circular Economy? Analysis of Companies' Sustainability Reports in the Agri-Food Sector in the Scope of CSRD and EU TR' (2023) 15 Sustainability MDPI; Katelin Opferkuch and others, 'Circular Economy in Corporate Sustainability Reporting' (2021) 30 Business Strategy and the Environment 4015

[10] John Hill (n 8)

[11] Michael Vuong, 'The European Union's Sustainable Finance Disclosure Regulation: Compliance and amp; policy implications' (2022) 55 International Lawyer 395

[12] TR (n 4), recital 8

aspects. The transparency also helps to promote investors' choices towards more sustainable investments. Moreover, it encourages investment issuers to integrate sustainable elements into their products, and to deal with the assessment of sustainability risks in financial products.

The SFDR, adopted on 27 November 2019, is applicable since the 10th of March 2021 and has been amended twice, the first time by Regulation 2020/852 on the 18th of June 2020 (the 'Taxonomy Regulation), and the second time by Regulation 2023/2869 on the 13th of December 2023. The first amendment introduced the principle of 'do no significant harm'. The second amendment added Article 18a to the SFDR, which focuses on the European single access point to which the financial market participants (FMPs) and advisers shall send all the relevant information.[13] The SFDR introduced disclosure requirements at entity, service and product level.[14] Its purpose is to provide transparency and prevent greenwashing in the financial market.[15] The Commission supplemented the SFDR with a Delegated Regulation 2022/1288[16] which is often referred to as 'level 2 SFDR' because it entails technical standards specifying the content, methodologies and presentation of the information.

For individuals and companies obliged to comply with the SFRD, it is important to understand what can be qualified as a sustainable investment. National labelling schemes are unsatisfying as economic operators active in different Member States would have to adhere to different national criteria. It has been proved that 'such practices discourage investors from investing in

[13] European Commission, Sustainability-related disclosure in the financial services sector <https://finance.ec.europa.eu/sustainable-finance/disclosures/sustainability-related-disclosure-financial-services-sector_en> accessed 9 May 2024

[14] Deborah Cloutier, 'From Materiality to Risk Mitigation: ESG at A Tipping Point for Real Estate' (2022) 45 CRE 1

[15] ibid

[16] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports (2022) OJ L 196/1

environmentally sustainable financial products'.[17] The absence of harmonised rules makes it impossible to compare different financial products in regards the ESG aspects.[18] Therefore a unified classification system throughout the European Union was necessary. The Taxonomy Regulation (TR)[19], adopted by the European Parliament and the Council on 18 June 2020, applicable since 12 July 2020, classifies environmentally sustainable economic activities. It has been amended four times and different expert groups and stakeholder request mechanisms have been necessary to implement the Regulation as it stands today.

Those regulations and directives in the area of sustainability are all intertwined. The Corporate Sustainability Reporting Directive (CSRD) requires the company in which the FMPs is investing to disclose its business strategies in relation to sustainability risks. The CSRD is applicable to companies and such rules are not always suitable for FMPs which is the reason why financial investments needed their own disclosure regulation.[20] FMPs are impacted by the CSRD since it enables them to assess whether their investments in entities, such as equity investments, can be deemed sustainable.

The European Sustainability Reporting Standard Regulation (ESRS)[21] amends the CSRD by harmonising the common standards for reporting 'comparable and reliable sustainability information'.[22] The ESRS allows FMPs to have access to more harmonised data required for the SFDR compliance.

Moreover, the Corporate Due Diligence directive (CSDDD) requires big companies to respect due diligence standards. This adds an obligation which

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[17] TR (n 4), recital 13
[18] TR (n 4), recital 9
[19] TR (n 4)
[20] TR (n 4), recital 25
[21] Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards
[22] European Commission, Questions and Answers on the Adoption of European Sustainability Reporting Standards, 31 July 2023, <https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_4043> accessed 9 May 2024

is not disclosure related but aims more to redirect business strategies of companies to sustainability.

The TR comes into play by enabling FMPs and financial advisers to know what kind of investments can be qualified as environmentally sustainable. In addition, FMPs sometimes use ESG rating providers to evaluate the sustainability degree of financial products for them. The current proposal on an ESG rating regulation[23] would ensure that the financial undertakings disclose the same information as ESG rating providers.[24] Finally, the EU Benchmark regulation[25] assists FMPs in a technical way by providing a framework for indexes that are measuring the performance of financial instruments, including EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.[26]

Having this interconnection in mind, the sustainable legal framework is broad and is sometimes referred to as an 'alphabet soup'.[27] However, three different stages of the legal sustainability framework can be identified.

The first stage is the CSDDD which, as prementioned, requires companies to adopt sustainable business strategies and integrating risks. The personal scope of application of the CSDDD excludes the financial sector.

The second stage is the CSRD foreseeing mandatory disclosures for companies fulfilling the threshold set in the directive. The ESRS also falls

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[23] Proposal for a Regulation of the European Regulation and the Council on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities, and amending Regulation (EU) 2019/2088, 6255/24, 9 February 2024

[24] European Commission, ESG rating activities, <https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/esg-rating-activities_en?> accessed 9 May 2024

[25] 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 171/1

[26] Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks

[27] Simon Watkins, 'The ISSB's battle to sort the alphabet soup of ESG reporting', Financial Times <https://professional.ft.com/en-gb/blog/the-issbs-battle-to-sort-the-alphabet-soup-of-esg-reporting/> accessed 9 May 2024

into this second stage as it is aimed to the undertakings falling under the CSRD in order to ensure harmonised standard reporting.

The third stage is the financial investments one, where financial undertakings take into account the CSRD data in order for them to identify the principal adverse impacts and sustainability risks of their investments. This stage can be subdivided into two objectives: the disclosure (SFDR and TR) and the classification (TR). This thesis will focus solely on the third stage.

The EU Benchmark regulation can also be categorised under the third stage, but as it entails technical requirements, into which this thesis will not delve into, it can be excluded from the research. Finally, the ESG rating Regulation is still a proposal which means that the final legal outcome is still unsure, but it could lead to an amendment of the SFDR. However, because of the legal insecurity this proposal entails, this thesis will not focus on the external provisions of ESG ratings from such service providers, but rather on the consequences of the current legal sustainable investment framework: disclosure and categorisation of the sustainability degree of financial products.

1.2 Purpose and research question

The European AIF market is constantly growing, especially in Luxembourg. The Luxembourg collective investment undertaking (UCI) industry registered a positive variation amounting to 132.781 billion euros in December 2023.[28] This increase is perceivable particularly since the creation of the European passport allowing to promote a financial product within the entire European union through the notification of only one single Member State.[29] Among

[28] CSSF Luxembourg, Global situation of undertakings for collective investment at the end of December 2023, Press release 24/02, <www.cssf.lu/en/2024/02/global-situation-of-undertakings-for-collective-investment-at-the-end-of-january-2024/#:~:text=As%20at%2031%20January%202024,of%200.78%25%20over%20one%20month.> accessed 9 May 2024

[29] Olivier Malherbe, 'I Disclose Therefore I Am: Disclosures and European Investment Funds Classification under the SFDR and the Taxonomy Regulation' (2023) 30 The Investment Lawyer 20

growing assets, ESG assets are also increasing rapidly, reaching 41 trillion dollars globally in 2022, compared with 22.8 trillion dollars in 2016.[30] Europe remains the forerunner in ESG investments with a market share of 83%, ahead of the US and Asia.[31]

In order to ensure a sustainable economic growth in Europe, the European Union had to adopt several sustainable finance regulations, especially regarding classification and disclosure. However, stakeholders, asset managers and FMPs in general are confronted with different challenges relating to disclosures, such as the lack of data availability and time management with the new compliances of the SFDR regulatory technical standards (RTS).[32] Despite these challenges, FMPs are also faced with unclear interconnections between the SFDR and the TR which creates regulatory insecurity and increases complexity of the compliance for both regulations.

The SFDR and TR are linked together as the SFDR requires FMPs and financial advisers to disclose the sustainability degree of their financial products and this disclosure is supplemented by the TR. The TR 'provides for supplementary disclosure obligations for environmentally driven Article 8 and 9 [financial products] and minimal disclosure obligations for Article 6'.[33]

The TR also classifies what can be considered as environmentally sustainable. The TR is therefore the cornerstone of the E(SG) framework[34] as it helps all the stakeholder, regardless of the legal instrument (CSRD, SFDR), to qualify environmental sustainability. Regarding sustainability disclosure applying to

[30] ibid; Bloomberg Press 'ESG May Surpass $41 Trillion Assets in 2022, But Not Without Challenges' <www.bloomberg.com/company/press/esg-may-surpass-41-trillion-assets-in-2022-but-not-without-challenges-finds-bloomberg-intelligence/> accessed 9 May 2024
[31] ALFI, ZEB and Morningstar, 'European Sustainable Investment Funds Study' (2022), 3
[32] Ian Conlon and Niamh O'Shea, 'Challenges for asset managers complying with SFDR and EU Taxonomy regulations' (2021) IFLR
[33] Olivier Malherbe (n 29), 23
[34] Irene Bengo, Leonardo Boni and Alessandro Sancino, 'EU financial regulations and social impact measurement practices: A comprehensive framework on finance for sustainable development' (2022) 29 Corporate Social Responsibility and Environmental Management 809, 813

FMPs, the SFDR is the major European regulation. However, the TR adds additional disclosures in order to 'back up claims on environmental characteristics'.[35] The TR amended the SFDR by a Commission Delegated Regulation on 6 April 2022, just one year after the application of the SFDR and one might think that the two regulations are well aligned with each other. However, several insecurities persist, for example on different scopes of application, making it difficult for stakeholders to comply with both regulations at the same time.[36]

The definition of sustainable investment can be complex and thus, the TR is an instrument intended to help the FMPs with their sustainability disclosure. However, NGOs and stakeholders regret that the SFDR is not sufficiently aligned to the TR.[37] The interconnection of two different regulations would therefore rather hamper the sustainability disclosure instead of supporting it. Article 8 and 9 SFDR entail greenwashing risks as FMPs could qualify an investment as light green or dark green without respecting Taxonomy's requirements. Greenwashing refers to 'the use of terminology that sounds more "green" or environmentally sustainable than the products are in substance'.[38] Hence, greenwashing consists of making false or misleading claims about the sustainability degree of the investment without making a genuine contribution to ESG factors.

Thus, this thesis aims to analyse the misalignment between the SFDR and the TR, explaining how this could lead to greenwashing. The regulations have different scopes of application, which could constitute gaps in the law. Moreover, it is not clear whether the requirements outlined in the TR apply

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[35] Deborah Cloutier, 'ESG Requirements Forcing Change' (2022) 46 CRE 1
[36] Diana Ribeiro Duarte, Pedro Capitão Barbosa and Sofia Araújo Matias, 'Shedding light on the Taxonomy's minimum safeguards and its interconnection with the SFDR' (2023) IFLR
[37] Eurosif, 'Eurosif's response to the European Commission targeted consultation on the implementation of the SFDR' (2023) <www.eurosif.org/news/eurosif-response-to-consultation-implementation-sustainable-finance-disclosure-regulation-sfdr/> accessed 9 May 2024
[38] Marieke Driessen, 'Sustainable Finance: An Overview of ESG in the Financial Markets' in Danny Busch, *Sustainable Finance in Europe, Corporate Governance, Financial Stability and Financial Markets* (Palgrave MacMillen 2021), 331

to all the different financial products encompassed in the SFDR. Therefore, it is important to examine this regulatory incoherence.

This leads to the examination of the following research question(s):

To what extent are the Sustainability Finance Disclosure Regulation and the Taxonomy Regulation aligned with each other in terms of their definitions and objectives?

Do the TR and SFDR overlap or misalign? What are the potential risks associated with misalignments?

What are the key challenges of greenwashing prevention in the context of the SFDR and TR regulatory framework? How are the regulations ensuring genuine ESG financial products?

Are the TR and SFDR effective? Do the TR and/or the SFDR need revisions in order to enhance a clear disclosure framework of sustainable investments? What solutions could be envisaged by the EU legislators?

Are both regulations contributing to a harmonised standardisation of reporting?

In order to examine these research questions, it is important to analyse the role of both regulations (chapter 2), their scope of application (chapter 3), and the exclusion of adverse investments (chapter 4).

Understanding the role of the regulations will determine the objectives and their effectiveness.

Examining the scopes of application is essential for identifying misalignments or overlaps.

Investigating how the regulations are addressing the exclusion of adverse investments is important for knowing whether the regulations are preventing greenwashing or promoting genuine ESG investments.

1.3 Methodology

This thesis employs a comparative analysis methodology and a legal doctrine methodology[39] relying on the legal definitions and provisions enshrined within the texts of the respective regulations. This method gives a 'systematic exposition of the principles, rules and concepts'[40] of the regulations studied and 'analyses the relationship between these principles, rules and concepts with a view to solving unclarities and gaps in the existing law.'[41]

As the focus is primarily on legal aspects and technical definitions, this thesis does not incorporate mathematical aspects. Moreover, the research question and the regulations do not require any case law analysis since such case law is inexistent.

Legal definitions and key terms such as 'sustainable investments' have to be identified, which will be done by analysing the regulations and by adding comments and insights from literature review. It is important to include European Commission's guidelines set out in its Q&A-document and in its notices on the subject. Additionally, documents from ESMA or from the Platform for Sustainable Finance can provide information that enables comparison between both regulations. Hence, such documents will be further explored and cited in this thesis, because they are reliable and relevant sources.

Moreover, literature review is conducted to gather relevant stakeholder perspectives, critiques and analysis of the regulations. This includes mainly position papers, articles and other publications from professionals in the finance sector. Those professionals can provide valuable insights and challenges within the regulations.

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[39] Jan M. Smits, *Rethinking legal scholarship, A transatlantic dialogue* (2017) Cambridge Books, 210
[40] ibid
[41] ibid

Practical insights regarding the compliance with the regulations can be obtained from financial institutions such as banks and investment funds based in Luxembourg because it is the most active Member State in the European Union regarding investment funds. Such compliance with EU law can be provided through website disclosures publicly accessible. It is important to note that this practical angle will be separated from the objective European law analysis to avoid confusing the alignment-analysis of the two regulations with practical implementation issues.

Special attention within the comparison and analysis is paid to any ambiguities that may contribute to regulatory incoherence or greenwashing. Conclusions drawn from the legal comparison of the regulations can provide advice on realigning the regulations and making revisions or amendments to the existing regulations.

1.4 Delimitations

This thesis focuses solely on European Union Law. However, in order to provide a comprehensive practical perspective, examples from Luxembourg, a Member State highly impacted by investment funds and financial services, will be included within a sub-section of this thesis. These examples will serve to illustrate challenges within the context of the EU regulation. However, Luxembourg is not representative of the entire European Union. While it could be advantageous to delve into practical implications from other Member States as well, this thesis will be limited to Luxembourgish examples for the sake of simplicity.

As this thesis focuses on European law and the regulations are directly applicable in all the Member States without any implementation requirement, there is no need for an analysis of national disclosure rules.

Moreover, the practical angle in this thesis is limited to website disclosures primarily aimed at private investors. Disclosures for institutional investors

and pre-contractual documents could not be considered within the scope of the research.

Furthermore, while qualitative interviews with stakeholders and professionals in this industry would have provided valuable insights, logistical constraints prevented their inclusion in this thesis.

In terms of temporal delimitations, it should be noted that the regulations being analysed are recent. Therefore, the majority of the sources used are recent as well (mainly from 2019 onwards). This thesis is submitted in May 2024, meaning that any sources published after this date could not be considered in the analysis.

In general, this thesis compares the overall framework of the regulations without going into mathematical or economic details. Its aim is to provide a comprehensive overview of the interplay between the regulations and examine how they may either create or alleviate confusion for investors. By focusing on the key provisions, this thesis seeks to illustrate the potential implications for investor understanding.

2 The Role of the SFDR and TR

The TR aims to establish a common framework for classifying sustainable investments but also operates as a disclosure tool. Conversely, the SFDR initially plays a disclosure role, but also integrates a so-called labelling role. Hence, the two following sections will be dedicated first to the TR and its roles, and the two sections thereafter will concentrate on the role of the SFDR.

2.1 TR as a classification tool

The TR is a classification tool at Union level in order to 'establish clarity on which activities qualify as 'green' or sustainable'.[42] It was the most 'important and urgent action envisaged by the action plan'.[43] Unlike disclosure which focuses on transparency and publication of information, classification means the definition or qualification of sustainability under the regulation.

The criteria that an economic activity must fulfil in order for it to be qualified as environmentally sustainable are enshrined in Article 3 TR. These criteria are used by FMPs and issuers according to Article 4 TR and are examined in detail in section 3.2 of this thesis on the material definitions of the Regulation.

The classification is related to six environmental objectives laid down in Article 9 TR: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and finally the protection and restoration of biodiversity and ecosystems. Articles 10 to 15 explain those six objectives in more detail, for example when and how an economic activity shall qualify as contributing substantially to the protection and restoration of biodiversity and ecosystems. According to Article 19, technical screening criteria (TSC) should identify the contributions to the environmental

[42] TR (n 4), recital 5
[43] TR (n 4), recital 6

objectives and the minimum requirements. Those TSC should ensure for example that 'power generation activities that use solid fossil fuels do not qualify as environmentally sustainable economic activities'.[44]

The TSC identify sector specific and science-based criteria that defines the substantial contribution to one of the six environmental objectives and also determines when it does not significantly harm (DNSH) other environmental objectives.[45] This will be further examined in chapter four of this thesis.

In addition to those TSC, the Delegated Regulation (EU) 2021/2139 sets criteria in Annex I and II that have to be respected in order to be qualified as sustainable under the TR.[46] Its focus lays on the substantial contribution to climate mitigation, one of the six objectives under the TR.

More general, to assess the sustainability, the concerned entities can use the 'best-in-class' or 'best performance in sector' test. This test is for example used when no low-carbon alternative is accessible for the economic activity in question. An economic activity can then still be qualified as TR-eligible if the greenhouse gas emission levels correspond to the industry's best performance, does not hamper low-carbon alternatives, and does not lead to a lock-in of carbon-intensive assets.[47]

However, classification is not the only purpose of the TR as it also constitutes a disclosure tool, which will be explained in the next section.

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[44] TR (n 4), Article 19 (3)
[45] ESMA, 'Do No Significant Harm' definitions and criteria across the EU Sustainable Finance framework' (2023), ESMA30-379-2281, 2
[46] ESMA, 'Consolidated questions and answers (Q&A) on the SFDR (Regulation (EU) 2019/2088) and the SFDR Delegated Regulation (Commission Delegated Regulation (EU) 2022/1288)' JC 2023 18, question 18
[47] TR (n 4), Article 10 (2)

2.2 TR as a disclosure tool

Recital 19 TR explicitly states that the TR is not only a classification tool but also a disclosure tool supplementing the SFDR. Article 5 TR refers to Article 9 dark green financial products and explains that 'information on the environmental objective'[48] should be added to the disclosure required under the SFDR. Likewise, a description of how and to what extent the investments are environmentally sustainable under the definition of the TR has to be disclosed.[49] This disclosure requirement laid down in the TR is also required for Article 8 light green products as stated in Article 6 TR.

More precisely, according to Articles 5 and 6 TR, undertakings are obliged to insert in pre-contractual documents and periodic reports to what extent their investments align with the taxonomy by 'specifying the percentage of investments made in these green activities'.[50] The TR distinguishes between Taxonomy-eligible and Taxonomy-aligned economic activities.[51] Taxonomy eligible means that the activity only has to fulfil the TSC, opposed to Taxonomy-aligned where those activities comply with additional minimum safeguards which refer to international social standards and human rights.

Moreover, undertakings that must disclose non-financial information under the Directive 2013/34/EU have to add the proportion of turnover[52] derived from environmentally sustainable economic activities. Likewise, the proportion of the capital expenditure (CapEx) and operating expenditure (OpEx) related to environmentally sustainable economic activities must be

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[48] TR (n 4), Article 5 (a)
[49] TR (n 4), Article 5 (b)
[50] Grégoire Lunven, 'The EU Sustainable Finance Taxonomy Regulation: implications for ESG Information and Hong Kong Financial Industry' (2021) 15 Hein Online 76, 82-83
[51] Katrin Hummel, Karina Bauernhofer, 'Consequences of sustainability reporting mandates: evidence from the EU taxonomy regulation' (2022), 4 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4175157> accessed 9 May 2024
[52] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (2013) OJ L 182/19, Article 8 II (a)

disclosed in the non-financial statements according to Article 8 (2b). Finally, if the investments underlaying the financial product do not take into account any of the environmental objectives, it has to state so according to Article 7 TR.

The disclosure requirement has to be operated on economic activity level, as opposed to the SFDR where the disclosure has to be operated on entity and product level.[53] This constitutes a fundamental difference because the broader disclosure scope of the TR requires entities to gather a wider range of sustainability related data.

It is now important to examine to what extent the TR complements the disclosure obligations outlined in the SFDR. Thus, this thesis will explore the disclosure obligations of the SFDR in the following section.

2.3 Disclosure as an initial aim of the SFDR

The SFDR has been adopted in order to require FMPs to disclose information on the sustainability degree of the financial product and of the concerned entity.

As stated in section 2.1 of this thesis, the SFDR operates at entity and investment level, whereas the TR operates at economic activity level. Level 1 of the SFDR pertains the disclosure obligations at entity-level (the FMP). In contrast, level 2 contains the RTS and detailed rules on how to disclose at product-level.[54]

Level 1 obligations relate to the publication on websites of information on how sustainability risks are integrated in the investment strategy policies and how they are integrated into remuneration policy. They also require statements 'on due diligence policies with respect to [principal adverse

[53] Platform for Sustainable Finance, 'Recommendations on Data and Usability' (2022)
[54] Maria Gebhardt and others, 'Institutional investors' information needs in the context of the sustainable finance disclosure regulation (EU/2019/2088): the implications for companies' sustainability reporting' (2023) 24 Journal of Applied Accounting Research, 4

impacts]'.[55] These obligations are referred to as 'firm level disclosures'[56] or entity-level disclosures.

Level 2 requires FMPs to assess if the financial product is categorised under Articles 6, 8 or 9 SFDR, which refers to the labelling mission that the SFDR has become, and which will be explored in the section 2.4. of this thesis.

The SFDR foresees four different disclosure requirements which can be divided into two categories.[57] On the one hand ESG risks disclosure that obliges any FMP and financial adviser regardless of the classification in the SFDR, and on the other hand disclosures obligation tied to the classification as Article 6, 8 or 9 financial products.[58] The following development concentrates on Level 1 requirements.

The ESG risks can be subdivided again into two obligations: on the one hand the disclosure of the sustainability risks that an investment may entail, and on the other hand the principal adverse impacts (PAI) directly attributable to the actions or operations of the financial entity itself, for example the investment fund or the financial adviser of the fund. The PAI indicators identify 'impacts of investment decisions and advice that result in negative effects on sustainability factors'[59] whereas the sustainability risks are of an economic nature because they explain how sustainability factors are impacting decision-making.[60] Sustainability risks have to be considered by every FMP, even those subject to Article 6 category, meaning those that do not take into account any sustainable factors. In contrast, the PAI indicators enable the FMPs to assess the negative effects of only sustainable investments (Article 8 and 9 financial products) towards social and environmental elements.

Hence, PAI indicators and sustainability risks are encompassing a double materiality: the risks created by investments on sustainability elements such

[55] SFDR (n 2), Article 4 (1a)
[56] Owen Lysak, Carolyn Housten and Ramya Juwadi, 'The EU SFDR—What's Happening in the Market' (2021) 28 The Investment Lawyer 17
[57] Olivier Malherbe (n 29), 23
[58] ibid
[59] Regulation (EU) 2016/1011 (n 25), recital 20
[60] Olivier Malherbe (n 29), 23

as the environment or human rights (PAI), and *vice versa* the impact of sustainability factors on investment-decisions (sustainability risks). Double materiality means the fact that disclosure works both ways: how investment strategies affect sustainability factors, as well as how sustainability factors affect investment strategies.

PAI indicators are required at entity level according to Article 4 SFDR and at product level according to Article 7 SFDR. Further assessment on these articles is provided in chapter four of this thesis.

Article 6 SFDR relates to the descriptions entailed in pre-contractual disclosures. Those have to reveal the manner in which sustainability risks are integrated into the investment decisions. Article 6 disclosure also must contain the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products available. Wherever the FMPs and financial advisers deem the ESG risks not to be relevant, a clear and concise explanation of the reasons therefor is required. FMPs have to state that their product is non-sustainable. This enables investors to have a pre-established clear framework of the impacts the sustainability risks could have on the return of the financial product they are investing in. This transparency is an added value for investors.

The conducted examination of the entity-level disclosure obligations shows that the requirements are more explanatory than detailed regarding the content of the disclosures. Disclosures are lawful as long as ESG risks have been taken into account. However, the PAI indicators enshrined in Article 4 of the SFDR can guide FMPs in their disclosure obligations. This guidance will be further explored in chapter four of this thesis.

In addition to the ESG risks disclosures that are independent on the classification, FMPs also must disclose category-relevant information depending on Articles 8 or 9 label. This will be analysed in the following section.

2.4 SFDR as a 'labelling' tool

The SFDR was initially designed as a disclosure tool but has faced criticism for its transformation into a so called 'labelling' tool. The intention behind the SFDR was 'to encompass as wide a range of products as possible, so that any sustainability claims had to be substantiated'.[61] Thus, the SFDR has led to a three-tier classification. The differentiation between the Article 6, 8 and 9 products disclosures has automatically led to such a labelling because FMPs advertise their products as Article 8 or 9 products. The European Commission admits that 'the SFDR was designed as a disclosure regime, but is being used as a labelling scheme'.[62] Some stakeholders criticise that Articles 8 and 9 SFDR are being misused by the FMPs as a labelling tool.[63] The misuse arises because 'the market has been using the distinction between these categories as de facto labels for a certain degree of sustainability'.[64] The criticism is due to the fact that 'the categories are not meant to be used as product labels and are not suitable for this purpose'.[65]

However, labelling has not necessarily a negative connotation. The categorisation as Article 8 or 9 financial product creates a 'powerful incentive to attract certain investors'.[66] Certain stakeholders also admit that the labelling is useful and 'shows that there is a strong desire amongst FMPs, distributors and investors alike to use relatively simple classifications for sustainable products'.[67] Nevertheless, other stakeholders suggest that the

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[61] Eurosif (n 37), 70
[62] European Commission, Targeted consultation document on the Implementation of the sustainable finance disclosures regulation (SFDR), 20 <https://finance.ec.europa.eu/document/download/99bc25fe-4dd8-4b57-ab37-212b5ab05c41_en?filename=2023-sfdr-implementation-targeted-consultation-document_en.pdf> accessed 9 May 2024
[63] AFM, 'Position paper on improving the SFDR' (2023), 2 <www.afm.nl/en/sector/actueel/2023/november/position-paper-SFDR> accessed 9 May 2024
[64] ibid
[65] ibid
[66] Olivier Malherbe (n 29), 23
[67] AFM (n 63), 3

SFDR should be transformed into a marketing tool, instead of a disclosure tool.[68]

In the ESG context, labels are usually icons sold by associations or undertakings that attest to a commitment to certain sustainable criteria. The EU Ecolabel is for example a logo that should help consumers to make responsible choices, and which should guarantee that products are sustainable.[69] Other private organisations offer their labels, also for the finance sector, for example ISR, Febelfin and LuxFlag.[70] However, in the context of Articles 6, 8 and 9 SFDR, the use of the term 'label' is eventually inappropriate, as it is more of a legal classification. The 'label' is reminiscent of the classification-role of the TR, as the Articles define three different categories, from non-sustainable products to products encompassing a sustainable objective. Thus, the labelling refers to the three-tiered classification[71], classification reminding of the TR's role (see section 2.1).

Yet, the TR and SFDR classifications are different. The TR classifies, or more generally defines, the environmental sustainability of an activity by meeting three different conditions: contributing substantially to at least one of the six environmental objectives, doing no significant harm to any of those six objectives and complying with the minimum safeguards. In contrast, the SFDR classifies financial products differently. The following sections will focus on this classification entailed in SFDR, namely Articles 6, 8 and 9 SFDR.

[68] Groupe BPCE Consultation Paper, 2 <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13961-Sustainable-Finance-Disclosure-Regulation-assessment/F_en> accessed 9 May 2024
[69] European Commission, EU Ecolabel Guiding your sustainable choices, <https://environment.ec.europa.eu/topics/circular-economy/eu-ecolabel_en> accessed 9 May 2024
[70] Groupe BPCE (n 68)
[71] Olivier Malherbe (n 29), 23

2.4.1 SFDR obligations based on product classification

When an investment is labelled as Article 6 SFDR, this means that the investment does not consider any ESG elements. However, FMPs and financial advisers still have to consider sustainability risks in accordance with Article 6, and where such risks are not considered relevant, FMPs and financial advisers have to disclose the reasons therefor.

This is the legal principle of 'comply or explain', which exists in several European disclosure regulations. It should prevent greenwashing by enhancing transparency and obliging the actors to comply. Article 7 TR adds a disclosure obligation for Article 6 products as it requires to include in the statement that the 'investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities.'[72] Thus, understanding the classification under the SFDR is crucial to determine which obligations under the TR apply.

Articles 8 and 9 SFDR refer to light and dark green financial products. Light green financial products (Article 8) should promote environmental, social or good governance characteristics, whereas dark green products (Article 9) have a stronger sustainable impact. The latter are called 'sustainable investments' because their own objective is a sustainable one. In order to prove the sustainable objective, an index as a reference benchmark should be designated.[73]

More precisely, for pre-contractual disclosures at product level, the SFDR foresees different disclosures for Article 8 and 9 categories which will be examined in the next sections.

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[72] TR (n 4), Article 7 (2)
[73] Danny Busch, 'EU Sustainable Finance Disclosure Regulation' (2023), 18 CMLJ 303, 319-320

2.4.1.1 Article 8 financial products and the link to the TR

For Article 8 SFDR disclosures, FMPs have to publish information on how the environmental characteristics are met and how the index is consistent with those characteristics, if such an index has been designated.[74] The TR comes into play because Article 8 (2a) SFDR refers to Article 6 TR. The latter states that Article 5 TR applies to Article 8 SFDR categories and concerns the publication in pre-contractual disclosures of economic activities contributing to an environmental objective (see section 2.2). Hence, this creates a link from the SFDR to the TR.

More precisely, Article 6 TR requires FMPs to include for Article 8 SFDR products the statement that 'the 'do no significant harm' principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities'[75] and that the remaining investments do not have to take into account those criteria. Hence, Article 6 TR creates an interconnection to the SFDR-categories and their specific disclosures.

Some sub-funds do not designate a reference benchmark for Article 8 funds.[76] Where a finance product has no index, FMPs have to disclose in their pre-contractual information how the sustainable objective of the product can be attained.[77]

Having examined the categorisation of Article 8 and its interconnection with the TR, the next section will look at the categorisation of Article 9 and its link with the TR.

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[74] SFDR (n 2), Article 8 (1) (a) and (b)
[75] SFDR (n 2), Article 6 (2), (3) and (4)
[76] DWS, Publication pursuant to SFDR – Details, DWS Invest European Equity High Conviction, 4 ISIN: LU0145634076, <file:///C:/Users/lisaw/Downloads/SFDR%20Summary_LU0145634076_EN_21-11-2023%20(1).pdf> accessed 9 May 2024
[77] SFDR (n 2), Article 9 (2)

2.4.1.2 Article 9 financial products and the link to the TR

Article 9 SFDR requires the publication of how the designated index is aligned with the sustainability objective and why and how it differs from a broad market index.[78]

Indexes include other companies or/and assets dependent on different factors. The reference benchmark is used to assess investment performance compared to the group of assets in the market. Service providers such as MSCI offer indexes and data that reflect ESG factors to asset owners. For example 'MSCI Global Sustainability Indexes' consists of benchmarks targeting high ESG-rated companies.[79] There are other service providers offering similar indexes, such as FTSE Russell[80], or Morningstar[81]. A fundamental issue is that one ESG factor may be crucial to one investor, but unimportant to another. Many ESG indicators are possible, and the investor must decide the merits of each.[82]

In addition, Article 9 foresees a specific example of the reduction in carbon emissions and requires the disclosure of long-term achievements regarding global warming objectives of the Paris Agreement.[83] Like the prementioned link from Article 8 SFDR to Articles 6 and 5 TR, paragraph 4a of Article 9 SFDR also creates a link to Article 5 TR, requiring additional disclosure information. These links between the two regulations are clear and should not lead to confusion. Only the content of the various information may be confusing and will be examined in chapter 3 of this thesis.

An important issue regarding the classification is its subjective or objective nature which will be examined in the following section.

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[78] SFDR (n 2), Article 9 (1) (a) and (b)
[79] John Hill (n 8), 109-110
[80] ibid, 111
[81] ibid, 113
[82] ibid, 168
[83] SFDR (n 2), Article 9 (3)

2.4.2 The subjective or objective nature of financial product classification

It is important to understand whether FMPs have discretionary power to subjectively classify products as sustainable, or if that classification is based on objective criteria. Subjective characterisation poses higher greenwashing risks.

The label of Article 8 SFDR products results from the promotion of the investment which is perceived in a broad way by the Commission. The Q&A on the SFDR from the European Commission lists different communications that qualify as promotion, such as direct and indirect claims, information, marketing communication, factsheets, even the name of the investment.[84] If any part of the marketing or communication suggests a focus on sustainability, then it will be treated under Article 8 SFDR.

In principle, the FMP can decide voluntarily whether he promotes the environmental elements of the product or not. A product can have sustainable elements and still fall under Article 6 because the FMP has decided not to promote such elements. However, since the definition of 'promoting' is very broad, it is possible that already the consideration of ESG risks falls under Article 8 SFDR.[85] Likewise, some authors argue that Articles 8 and 9 labels are not a subjective decision (matter of choice) but are a matter of fact[86] and therefore, as soon as an investment has a sustainable consideration, FMPs must comply with Articles 8 or 9 SFDR. But since the FMP still can decide to promote them and to consider ESG risks or not, it still has a subjective connotation.

Investors, when qualifying a product as Article 8, must analyse the underlying detail to understand what kind of ESG impacts it may have.[87] FMPs cannot

[84] ESMA, Q&A (n 46), 30-31
[85] Milena Prisco, 'The Impact of ESG Considerations on Private Equity and Venture Capital Transactions: the Western Scenario' (2024) 25 Business Law International 5, 10
[86] Olivier Malherbe (n 29), 24
[87] Owen Lysak (n 56), 17

simply claim to consider ESG factors without substantiating these claims. Once an FMP advertises an investment as entailing ESG factors, it has to comply with Article 8 requirements. This prevents greenwashing because it forces funds to either commit genuinely to ESG integration and comply with the SFDR or refrain from making unsubstantiated sustainability claims.

In contrast, the TR classification is objective (matter of fact) without a subjective connotation, as the different steps of the definition enshrined in Article 3 TR have to be respected. Those definitions, for example the contribution to one of the environmentally sustainable objectives, are defined in Articles 10 to 16 TR. The undertakings therefore do not have subjective discretion when explaining why their economic activity is TR-eligible.

In conclusion, Article 8 SFDR products entail more greenwashing risks than the TR classification as the definition of 'promoting' has a subjective connotation.

After having explored the subjective and objective nature of the financial product classification, the next section will critically examine the three-tiered classification system.

2.4.3 Critiques of SFDR's three-tiered classification

The SFDR categorisation was criticised by stakeholders because of the lack of clarity of the definition. According to them, 'the SFDR categorization is not completely clear as a labelling system'.[88] They argue that Articles 8 and 9 are 'market constructs and are accompanied with specific assumptions as to the sustainability features of products (and that) [t]hey are not meaningful for retail investors and lack clarity for professional investors'.[89] In addition,

[88] ibid
[89] Eurosif's response (n 37), 74

practitioners regret that labelling has become the end in itself, which 'was [not] the original aim of the regulation'.[90]

Most financial products are Article 8 products. According to Morningstar, 'around 39% of corresponding net assets are classified as Article 8 and (only) 5% as Article 9'.[91] This may be the result of the high standards of Article 9 such as the criterion that all underlying investments must be sustainable. Moreover, the lack of clarity of what exactly qualifies as a sustainable objective also constitutes an issue. As some undertakings struggle with the definition of Article 9, they downgrade their products to Article 8, such as the asset manager Robeco International.[92]

Moreover, insecurities persist whether products are appropriately categorised under the SFDR. The Dutch regulator noticed that 'half of the funds categorized as Article 9 products do not exclusively focus on sustainable investments and can send the wrong message to investors'.[93]

However, as prementioned in section 2.4., some stakeholders support the SFDR categories as they attract investors. Those stakeholders welcome the simplicity of the SFDR categories, but others criticise this simplicity. A solution could be to maintain a three-tiered category within the SFDR but defining the categories appropriately. If the Commission were to provide clearer definitions, companies would not be discouraged from categorising their product as Article 9.

It is apparent that the categorisation in the TR and the categorisation (or labelling) in the SFDR are different as the SFDR concentrates on products without ESG element (Article 6), products that are promoting ESG (Article 8 – light green) and products with an ESG objective (Article 9 – dark green), whereas the TR focuses on one single definition of sustainable investment.

[90] Thomas Helm, Interview with Arthur Krebbers, 'SFDR: views differ on article 8 net outflows' (2022), IFLR, 1
[91] ALFI (n 31), 6
[92] Paulina Pielichata, 'New EU rules pose problems for institutions: Challenges expected when it comes to aligning investments with sustainability regulations' (2021) 49 Pensions & Investments 2,
[93] Owen Lysak (n 56), 17

Moreover, it is also apparent that TR-disclosures and SFDR-disclosures are intrinsically linked because some disclosures enshrined in the TR refer to Article 8 or 9 SFDR products. This means that one of the consequences of being an Article 8 SFDR product is an increased reporting obligation under the TR.[94]

The next chapter will focus on personal and material scope of the regulations, essential to identify misalignments, overlaps and ambiguities.

[94] ibid

3 Scope of application of the SFDR and TR

When comparing the TR to the SFDR, the analysis of the scope of application is a crucial part. It is not only background information on the individual regulations, but it allows a comprehensive understanding how those regulations are connected, to whom they apply and what kind of investments fall under each of the regulation. This enables to discover misalignments or similarities, meaning elements where the regulations might overlap. Hence, the following section will analyse the personal scope of the regulations (section 3.1.) and the section thereafter will examine the material scope of the regulations (section 3.2.).

3.1 Personal scope

The personal scope of the TR and SFDR are different but overlap. Both regulations apply to FMPs but the TR applies additionally to undertakings and the SFDR to financial advisers.

To clarify the personal scope of the regulations, the following section will delve into the definitions of FMPs, financial advisers and undertakings.

3.1.1 FMPs, financial advisers and undertakings

The TR applies to FMPs that make available financial products[95] and undertakings subject to the obligations pursuant to Article 19a or Article 29a of Directive 2013/34/EU[96], modified by the CSRD.[97] Those Articles refer to '[l]arge undertakings, and small and medium-sized undertakings, except

[95] TR (n 4), Article 1 (2) (b)
[96] Directive 2013/34/EU (n 52)
[97] TR (n 4), Article 1 (2) (c)

micro undertakings, which are public-interest entities'[98] and '[p]arent undertakings of a large group'.[99] Large undertakings are defined as having more than 500 employees.[100]

Usually, the European institutions exclude micro-undertakings from disclosure regulations because of the large burden they entail. Small-sized companies are defined as having up to 50 employees and a balance sheet total of maximum 10 million euros.[101] Small and medium-sized undertakings face difficulties because they have limited resources disponible to comply with the disclosures. Disclosures require pre-analytical research for example on risk management and sustainable policies, which constitutes an enormous effort for small and medium-sized undertakings.[102] However, those companies are subject to the SFDR. Yet, they do not have to disclose PAI under Article 4 SFDR in order to minimise their disclosure-burden.[103]

Article 1 TR explains that the Regulation applies to measures adopted by the Member States or by the Union that set out requirements for FMPs (such as the SFDR). Thus, the personal scope of the TR and SFDR overlap. The definition of FMP, laid down in the TR, refers to the definition of FMP set out in the SFDR. Consequently, the definitions of FMP in the TR and SFDR are identical.[104]

In contrast to the TR, the SFDR does not encompass an article on the scope. Article 1 is about the subject matter and Article 2 already entails the definitions. However, as its articles refer to FMPs and financial advisers, their definitions in Article 2 SFDR constitute the personal scope. According to Article 2 SFDR, FMPs are insurance undertakings which make available an investment product (IBIP), investment firms that are providing portfolio

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[98] Directive 2013/34/EU (n 52), Article 19a of
[99] ibid Article 29a
[100] SFDR (n 2), Article 4 (3) and (4)
[101] European Union, Small and medium-sized enterprises <https://eur-lex.europa.eu/EN/legal-content/glossary/small-and-medium-sized-enterprises.html> accessed 9 May 2024
[102] Christof Falkenberg (n 9), 15
[103] Milena Prisco (n 85), 15
[104] Recommendations on Data and Usability (n 53), 27

management, institutions for occupational retirement provision (IORP), pension product providers, alternative investment fund managers (AIFMs), managers of funds and of undertakings for collective investment in transferable securities (UCITS management companies) and credit institutions providing portfolio management.[105]

Those terminologies can be complex and are for clarification matters linked to European Directives such as the Directive on markets in financial instruments[106] and the Directive on alternative investment fund managers[107], to which the definitions in the SFDR refer to.

Consequently, the TR has an expanded scope compared to the SFDR, since 'its scope include[s] not only financial market participants but also large companies'.[108] FinTech entities providing crypto-assets services operate through an undertaking fall under the TR but do not fall under the SFDR.[109]

According to the definition set out in the SFDR, a financial adviser is an insurance intermediary or undertaking providing insurance advice such as credit institutions, investment firms, AIFM and UCITS management companies.[110] To put it simply, banks and insurance agencies that can sell investments have to advice their clients on those investments. They are financial advisers within the meaning of the SFDR. The definition of financial advisers overlaps with the definition of FMPs because they refer to the same kind of entities. Hence, the personal scope of the TR also includes such financial advisers.

In conclusion, the personal scopes largely overlap, with the TR being slightly broader as it encompasses undertakings not covered under the SFDR. While

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[105] SFDR (n 2), Article 2 (1)
[106] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (2014) OJ L 173/349
[107] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (2011) OJ L 174/1
[108] Grégoire Lunven (n 50), 84-85
[109] Danny Busch (n 73), 323
[110] SFDR (n 2), Article 2 (11)

the broader scope might lead to confusion for such undertakings, clarity can be achieved by examining the legislations referenced by the TR.

The next section will analyse some practical applications for the personal scope of the SFDR.

3.1.2 ESG analysis in the investment fund industry and credit institutions: practical applications

Both regulations address the investment fund industry which is predominantly affected as the '[n]et assets in sustainable funds domiciled in Europe have reached almost EUR 2 trillion in 2021'.[111] Especially the Member State Luxembourg attracts investment funds offerings its financial products all over the world because of its low tax regime. In December 2023, the total net assets of Luxembourgish UCITS (including SIF, SICAR, UCI) amounted to 5.285.010 billion euros within this single month.[112]

Investment funds and ESG analysis can be complex as the returns result from an investment chain with sub-funds. Every sub-fund has an identification number and should entail personal information on ESG which have to be disclosed under Article 10 SFDR. The following practical applications concern the SFDR, which requires website disclosures independent of the TR.

It can be adjuvant to investigate some European funds website disclosures on Article 8 and 9 sub-funds in order to understand to what extent the information is limited. For example, Amundi Luxembourg promulgates that one of its Article 8 sub-funds is investing 75% in environmental or social investments and the sub-fund commits to have a minimum of 5% of sustainable investments.[113] It is not apparent what exactly is the difference between 'environmental and social investments' and 'sustainable

[111] ALFI (n 31)
[112] CSSF (n 28)
[113] Amundi Funds Absolute Return Global Opportunities Bond, Website Product Disclosures further to art. 10(1) of the SFDR for art. 8 sub-funds, <www.amundi.pt/dl/doc/website-sfdr-disclosure-summary/LU1894677613/ENG?inline> accessed on 9 May 2024

investments' as the Amundi explicitly states that this sub-fund has no sustainable objective (Article 9 investments).

This Amundi publication shows that there is a lack of clarity in terminology and the ambiguity could be problematic when investors rely on such disclosures. There is also a greenwashing concern since the fund may overstate its ESG credentials to attract investors. The website disclosure is not sufficiently informative, and a minimum of ESG investment of only 5% appears to be rather minimal. This Amundi fund is just one example of hundreds of financial products with similar issues.

In general, it depends if the sub-fund invests in securities or other investments. Securities, such as bonds and stocks, represent ownership or debt in a company and it might be more complicated to allocate the investment to a particular ESG project. For another sub-fund, Amundi guarantees that all securities 'are subject to the ESG Criteria'. This is a very vague formulation that does not enlighten the investors. For this sub-fund, no reference index has been set and Amundi operates by the best-in-class screening, ensuring its investments have a 'higher ESG score'[114] than others on the market.

DWS, a German asset manager active in Luxembourg, assesses ESG using a scale from 'A' to 'F' with 'F' consisting of the lowest ESG score which is excluded from the portfolio of the financial product in question (for example 'DWS Invest European Equite High Conviction' product). On the one hand, such a simple grading scale could provide clarity to investors about the ESG factors of the financial product. On the other hand, a subjective grading scale may lack standardisation which hinders comparability to other financial products.

This DWS subjective grading scale calls for greater transparency on the specific ESG criteria in order to enable enlightened ESG decisions because even when excluding 'F'-rated products, the investors still struggle to assess

[114] ibid

the detailed ESG integration. This also raises concerns about greenwashing because investments can be rated as sustainable without genuine ESG integration, since investments rated as 'C' or 'D' might not necessary include such genuine ESG elements.

Regarding credit institutions, BNP Paribas, a French Bank operating in Luxembourg, provides transparency about its investments in JP Morgan, one of the leading investment funds. The bank discloses on its website that the investment is a bottom-up investment, taking into account individual analysis of the investments and the best-in-class approach selecting superior investments compared to those on the market. This transparency can help investors understand the risk management.

On the Luxembourgish retail website of BNP Paribas fund explorer, it is possible to select only Article 8 financial products through a filter. The filter on Article 8 funds[115] will show that 223 out of 276 funds promote ESG characteristics. Article 9 funds are remarkably less offered, exactly 17 funds out of 276[116]. The data indicates that there is a high preference for ESG investments, as only 36 funds do not provide any green investments. However, it also raises suspicions of greenwashing, as it is unlikely that all 223 funds make a remarkable ESG contribution. It could indicate that even minor ESG considerations may be sufficient to be characterised as Article 8 funds, blurring the distinction between truly sustainable investments and those with only minimal ESG impact.

One of the national Luxembourgish Banks, *Banque Internationale à Luxembourg* (BIL), is less transparent on its website regarding Article 8 and 9 funds. It is not using the Articles as a label and promotes the ESG characteristics of its 'six BIL Invest funds' with a national ESG label: LuxFLAG, engaging an exclusion of certain non-responsible activities. This hinders comparability because the disclosure lacks standardisation.

[115] BNP Parisbas, 'Fund explorer', <www.bnpparibas-am.com/en-lu/private-investor/fundexplorer/?sfdr_article=8> accessed 9 May 2024
[116] ibid

In contrast to the previously mentioned disclosures, ING Solutions Investment Management S.A. (ING-ISIM), the asset management vehicle of ING Group in Luxembourg, demonstrates commendable transparency in its ESG disclosures. The bank provides comprehensive documentation on sustainability risk integration[117], fund range mapping[118], a detailed statement on the principal adverse impacts of its investment decisions[119] and on website product disclosures[120].

Within these disclosures, ING-ISIM explains in detail the distinctions between Article 8 and 9 funds. Article 8 funds are further categorized by ING-ISIM into responsible investing approaches and sustainable investing approaches, with specific percentages allocated to responsibility and sustainability. The responsible investing approach promotes environmental and social characteristics but without making any sustainable investments, whereas the sustainable investing approach ensures sustainable investments with a minimum threshold.[121] This clear delineation helps investors understand the varying degrees of ESG funds. Likewise, Article 9 funds are designated by ING-ISIM as impact investments, indicating a higher commitment to ESG. Additionally, ING's fund mapping provides a visual representation of which funds correspond to each SFDR label, making it easy for investors to identify the ESG characteristics of each fund. Overall, its transparency sets it apart from others, demonstrating a commitment to providing clear and meaningful information to investors.

[117] ING ISIM, Sustainability Risk Integration <www.ing-isim.lu/webisim/content/dam/isim/pdf/communication/governance-policies/sustainability/Disclosure_document_sustainable_risk_integration_EN.pdf> accessed 9 May 2024
[118] ING ISIM, Fund range Mapping < www.ing-isim.lu/webisim/content/dam/isim/pdf/communication/governance-policies/sustainability/sfdr-fundrange-mapping.pdf > accessed 9 May 2024
[119] ING ISIM, Investment decisions <www.ing-isim.lu/webisim/content/dam/isim/pdf/communication/governance-policies/sustainability/Adverse_impact_statement_EN.pdf> accessed 9 May 2024
[120] ING ISIM, Website product disclosures <www.ing-isim.lu/webisim/content/dam/isim/pdf/communication/governance-policies/sustainability/Web_Disclosure_Policy.pdf> accessed 9 May 2024
[121] ibid

Despite some website disclosures lacking clarity and being confusing, it is important to note that pre-contractual disclosures are usually not public and are provided to investors once they express interest in particular investments. It is possible that such pre-contractual disclosures may be clearer and less confusing than the pre-analysed website disclosures.

After having examined the practical considerations of the entities concerned by the SFDR, it is important to envisage the material scope and to what extent the definitions enshrined in the regulations are aligned.

3.2 Material scope

The SFDR and the TR focus on different definitions on what can be considered sustainable. It is worth analysing first the different wordings and elements of the definitions, then the missing minimum threshold in the SFDR and finally the possibility of an automatic alignment between the definitions set out in the SFDR and TR.

3.2.1 Different elements of the 'sustainable investment' definition

The SFDR integrates not only environmental sustainability but also social sustainability, and good governance, therefore tackling "E", "S" and "G". In contrast, the TR focuses solely on environmental sustainability. A solution to solve the issue could be to integrate social matters into the TR in a next amendment. The Platform on Sustainable Finance published a report on the necessity to adopt a so-called 'Social Taxonomy'.[122] The report is not legally binding on the Commission, but it would provide guidance and an incentive to create transparency for social matters. *Euractiv* nevertheless reports that

[122] Platform on Sustainable Finance, 'Final Report on Social Taxonomy' (2022) < https://finance.ec.europa.eu/system/files/2022-08/220228-sustainable-finance-platform-finance-report-social-taxonomy_en.pdf> accessed 18 May 2024

the ‘Commission is holding back’ and that the Social Taxonomy will not progress, at least until the end of the mandate 2024.[123] However, the recent ESRS[124] (see section 1.1) sets robust standards in reporting including SFDR requirements in relation to social rights, especially workforce related[125] and could thus fulfil the gap left by the inexistent Social Taxonomy. However, a detailed analysis of the ESRS is beyond the scope of this thesis.

As regards the content of the definitions, Article 2 (17) SFDR defines what is a sustainable investment within the meaning of the SFDR. The sustainable investment definition under the TR is enshrined in Articles 3 and 2 (1).

Article 2 (1) TR defines an environmentally sustainable investment as an investment in at least one economic activity that qualifies as environmentally sustainable under the TR. Article 3 TR explains that an economic activity is environmentally sustainable if it fulfils four conditions: the economic activity contributes substantially to at least one of the objectives set out in Article 9 TR, does not significantly harm any of those objectives, is carried out in compliance with the minimum safeguards and complies with TSCs.

Article 2 (17) SFDR defines a sustainable investment as one contributing to an environmental or social objective, ‘provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices’.

Going into detail, the definition in Article 2 (17) SFDR refers to an investment in an economic activity that qualifies as sustainable under the SFDR. This economic activity has to contribute to an environmental objective or social objective. Article 2 (17) SFDR is listing some examples, stating that a social objective is ‘in particular an investment that contributes to tackling inequality

[123] János Allenbach-Ammann, ‘Social Taxonomy risks death by Commission neglect’ (2022) <www.euractiv.com/section/economy-jobs/news/social-taxonomy-risks-death-by-commission-neglect/> accessed 9 May 2024
[124] CDR (EU) 2023/2772 (n 21)
[125] European Commission, ‘Questions and Answers on the Adoption of European Sustainability Reporting Standards’ (2023) <https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_4043> accessed 18 May 2024

or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities'.

In contrast, for environmental objectives, Article 2 (17) SFDR mentions a measuring tool, namely the key resource efficiency indicator which can be used on energy, 'raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy'.[126] Such metrics or indicators are missing for the definition of social objectives.

Moreover, the next element is the 'do no significant harm' (DNSH) principle which is entailed in both definitions. The difference is that the TR lists in Article 9 six precise objectives to which the economic activity must not harm, whereas the SFDR lists the examples mentioned above which are not exhaustive since the wording entails 'for example' and 'in particular'.

The six objectives enshrined in Article 9 TR are climate change mitigation (a), climate change adaptation (b), sustainable use and protection of water and marine resources (c), transition to a circular economy (d), pollution prevention and control (e), and protection and restoration of biodiversity and ecosystems (f). The wording of the objectives in the SFDR such as measuring the use of water and land (SFDR) cannot be equated with the sustainable use and protection of water and marine resources (TR). However, both definitions mention the biodiversity and circular economy. In general, it can be said that even if the wording differs, the environmental part of the sustainable investment definitions is similar, with the difference that the TR has an exhaustive list.

In addition, according to the definition entailed in the SFDR, as a final condition, the investee company must follow good governance practices in order to be qualified as sustainable. There is no internationally agreed

[126] SFDR (n 2), Article 2 (17)

definition on good governance.[127] However, governance typically refers to the 'transparency in decision-making and mechanisms ensuring it, ethical processes and lack of bribery, diverse leadership teams and equality in pay'.[128] The United Nations are defining governance as a 'process whereby public institutions conduct public affairs, manage public resources and guarantee the realisation of human rights'.[129] In the ESRS[130], governance is defined as the role and responsibilities of 'administrative, management and supervisory bodies'.[131] The definition in Article 2 (17) SFDR refers in particular to sound management structures, employee relations, remuneration of staff and tax compliance.

It is adjuvant to analyse the examples of good governance enshrined in Article 2 (17) SFDR. According to the Council of Europe, sound management entails for example appropriate charges for services provided and a prudent financial management where risks are appropriately estimated and where the local authorities are involved ensuring reduction of risks.[132]

Employee relations and remuneration of staff reminds of Article 31 of the EU Charter of Fundamental Rights, which states in paragraph 1 that '[e]very worker has the right to working conditions which respect his or her health, safety and dignity'. Paragraph 2 says that '[e]very worker has the right to limitation of maximum working hours, to daily and weekly rest periods and to an annual period of paid leave'. The formulation 'employee relations' in the SFDR is broader in order to include as much fair working conditions as possible.

Regarding the reference to tax compliance, this compliance benefits the whole society. According to the Commission, '[f]air taxation is central to the

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[127] Office of the United Nations High Commissioner for Human Rights, 'About good governance', <https://www.ohchr.org/en/good-governance/about-good-governance> accessed 9 May 2024
[128] Chrysovalantis Gaganis and others, *Sustainable Finance and ESG*, (Palgrave Macmillan 2023), 126
[129] UN (n 127)
[130] CDR (EU) 2023/2772 (n 21)
[131] ibid, Appendix A
[132] Council of Europe, <https://www.coe.int/en/web/good-governance/12-principles#{%2225565951%22:[9]}> accessed 9 May 2024

EU's social and economic model and its sustainability [and it is] essential for sustainable revenues [and] a competitive business environment.'[133]

The TR does not entail a good governance criterion per se but instead refers to the minimum safeguards which compensate the absence of social factors in the sustainable investment definition. Those minimum safeguards cover the good governance criterion such as for example the tax compliance.[134] The minimum safeguards are examined in greater detail in the next chapter (see chapter 4).

Finally, the last condition in the definition of sustainable investment in the TR is the TSC. The TSC prevents greenwashing because a proof is required by the SFDR through indexes as reference benchmarks that should compute with a formula the sustainability degree. However, the indexes are not part of the sustainable investment definition under the SFDR, whereas the TSC are the last condition that an investment has to fulfil in order to be qualified as sustainable under the TR.

In summary, while the definitions in the TR and the SFDR share certain similarities in their wording, they take a different approach and contain different elements. The TR provides clarity by delineating six objectives elaborated on various articles in the TR, whereas the definition in the SFDR, found solely in Article 2 (17), is comparatively vague with a non-exhaustive list of objectives. However, the SFDR requirements can be clarified with the help of the recent ESRS by setting standard reporting, as prementioned in this section.

The following section will explain that the SFDR misses a minimum threshold compared to the TR.

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[133] European Commission, 'Communication from the Commission to the European Parliament and the Council on Tax Good Governance in the EU and beyond' (2020), 1 COM/2020/313 final <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0313> accessed 9 May 2024

[134] European Commission, Commission notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation (2023/C 211/01), 5

3.2.2 Missing minimum threshold in the SFDR

In the TR, the wording ‘substantially’ functions as a minimum threshold, showing that a small contribution is not sufficient. This is missing in the SFDR. The SFDR’s definition ‘only requires that it contributes to an environmental objective without needing to meet the substantial contribution criteria of the Taxonomy’.[135] Not only the ‘substantial’ element creates a minimum threshold in the TR, but also the detailed explanations of what exactly can be considered as contributing to the six objectives. Those explanations are entailed in Articles 10 to 16 TR. Such detailed explanations are also absent in the SFDR, as the elaboration of ‘sustainable investment’ is minimal without targets. ‘Even the most basic screening process can be enough to qualify a fund as light green’.[136]

Even if the percentage of sustainable impact plays an important role in the SFDR, this is not sufficient to guarantee a minimum threshold because it is possible to indicate a percentage that is close to zero. For Article 8 investments, it is sufficient to have one single underlying investment that promotes environmental or social characteristics.[137] The template for Article 9 products set out in the Delegated Regulation 2022/1288 ensures transparency (for example the requirement to disclose whether the sustainable objective has been met) but does not guarantee ambitious sustainable thresholds. The percentage indication also does not guarantee that categorisation of Articles 8 or 9 are not dependent on interpretations.[138] ‘Sustainable investment means different things to different people’.[139]

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[135] Recommendations on Data and Usability (n 53), 136

[136] Elizabeth Meager, ‘Is SFDR failing? Eight in ten ‘sustainable’ funds in Europe hold fossil fuel stocks’ (2021), Capital Monitor <https://capitalmonitor.ai/institution/government/is-sfdr-failing-eight-in-ten-sustainable-funds-in-europe-hold-fossil-fuel-stocks/> accessed 9 May 2024

[137] CDR 2022/1288 (n 16), Article 20

[138] AMF Consultation Paper, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13961-Sustainable-Finance-Disclosure-Regulation-assessment/F_en> accessed 9 May 2024

[139] Elizabeth Meager (n 136)

A missing threshold signifies that a financial product can fall under Article 9 even if it invests in fossil fuel, oil and gas stocks only because it has a social objective.[140] In contrast, the TSC in the TR are intended to prevent that such investments can be qualified as environmentally sustainable (see section 2.1).

The European Commission admits in its Q&A on the SFDR that '[t]he SFDR does not set out minimum requirements that qualify concepts such as contribution, do no significant harm, or good governance, i.e. the key parameters of a 'sustainable investment'.'[141] The European Commission also explains that the consequence following from this absence of threshold is that FMPs have to carry out their own subjective assessment which gives them an increased responsibility, and that they have to be careful when measuring the sustainable performance.[142]

The absence of a minimum threshold increases the risk of greenwashing because 'even financial products with no substantial exposure to sustainability related and/or green activities might fall under the scope of application of (…) Article 8 SFDR'.[143] 'ESG is sometimes used as a catchall label to describe any investing style which has an element of social purpose.'[144] It is clear that a more sophisticated approach would be preferable and therefore, the European regulators should work on a minimum threshold in the SFDR.

Different thresholds also lead to 'yield results that are not comparable'.[145] Investors will have a hard time comparing different sustainable investments although this was one the *rationales* of the SFDR.

[140] ibid
[141] ESMA, Q&A (n 46), 7
[142] ibid
[143] Marco Bodellini, 'Greenwashing and the misapplication of articles 8 and 9 of the Sustainable Finance Disclosure Regulation' (2023) 24 Journal of the Academy of European Law Springer 27, 34
[144] John Hill (n 8), 13
[145] Carbon Disclosure Project (CDP) Consultation Paper, <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13961-Sustainable-Finance-Disclosure-Regulation-assessment/F_en> accessed 9 May 2024

However, the European Commission seems open to find a solution to solve the issue. In responses to the consultations launched by the Commission on the SFDR, many stakeholders expressed regret over the discrepancy between the TR and the SFDR concerning the definition of 'sustainable investment'. For example, the French Financial Markets Authority highlights that the SFDR 'creates no minimum standard for market participants and imposes no limitation or formal exclusion on investments'[146], which the TR does.

Meanwhile, 'European regulators are likely to reject very low percentages and market practice recommends a minimum of 50 percent (or even higher, depending on the way [environmental and social] characteristics are being promoted)'.[147] Nevertheless, in order to be able to reject low percentages, national control and supervision must be effectively operated on sustainability disclosures and it is not clear to what extent such supervision is currently effective.

Continuing the misalignment of the definitions, it is important to mention that under the current SFDR, a product can be marketed as pursuing a social and/or environmental objective under the SFDR although being 0% taxonomy-aligned.[148] According to Article 5 TR, FMPs and financial advisers offering Article 9 financial products should disclose the percentage of the taxonomy-alignment of their products. However, a minimum threshold in the SFDR may not address this, as a product could focus solely on a social objective without considering environmental objectives. Therefore, it is not only necessary to set a minimum threshold, but also to include a social definition in the TR in order to better align both regulations.

Consequently, the following section will focus on the question of how it is possible for a financial product falling under Article 8 or 9 SFDR to be 0% TR-aligned and whether the reverse is also true.

[146] Milena Prisco (n 85), 9
[147] Olivier Malherbe (n 29), 26
[148] ibid, 24

3.2.3 Automated Alignment: How financial products falling under one Regulation can eventually conform to the other

As mentioned in the previous section, Article 8 or 9 SFDR financial products can be 0% TR-aligned. The Article 9 SFDR '[s]ustainable investments with an environmental objective might be aligned with the Taxonomy or not'.[149] The following section examines the reasons therefor.

3.2.3.1 SFDR financial products can be TR-aligned or not

Section 2.4.3. mentions that the classification enshrined in the SFDR faces lack of clarity. Moreover, the definition 'sustainable investment' in the SFDR is not ambitious and could include more detailed explanations. Those are reasons why SFDR-aligned financial products are not necessarily TR-aligned. Put it simply, according to practitioners in the field, if an investor has a preference for a certain minimum percentage of TR-alignment, 'that is not certain to happen under Article 8, which contains no specific ESG objectives'.[150] And it is also not certain to happen for Article 9 products because Article 9 products could focus on social sustainability only, without having an environmental objective. Yet, TR-aligned products focus on environmental objectives. Hence, the different material scopes of the regulations create such a discrepancy.

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[149] Delegated Regulation (EU) 2023/363 of 31 October 2022 amending and correcting the regulatory technical standards laid down in Delegated Regulation (EU) 2022/1288 OJ L 50/1, Annex II <http://data.europa.eu/eli/reg_del/2023/363/oj> accessed 9 May 2024

[150] Thomas Helm, Interview with Gavin Haran, 'SFDR: views differ on article 8 net outflows' (2022) ILFR, 2

Another reason why Article 8 or 9 products are not automatically TR-aligned is because they do not necessarily comply with the minimum safeguards, which are part of the sustainable definition under the TR. The minimum safeguards guarantee that human rights under international standards are respected. Thus, 'regardless of how environmentally "green" an activity is, it will not be considered environmentally sustainable if the relevant undertaking has not adopted adequate measures to reduce human rights concerns in accordance with international standards'.[151] Chapter four will further explain those minimum safeguards.

Another question that arises is whether the reverse is true, meaning whether an economic activity aligned with the TR can be SFDR-aligned or not.

3.2.3.2 TR-aligned economic activities are SFDR-aligned

'[A]n activity aligned with the taxonomy criteria is de facto considered as environmentally sustainable under the SFDR (…).'[152] The Commission confirmed in its notice that TR-aligned investments can automatically qualify as sustainable investments under the SFDR.[153] It is nevertheless not clear whether those sustainable investments only refer to Article 9 investments. The labelling in that regard in confusing. Article 9 explicitly mentions in its title 'sustainable investments' where Article 8 only refers to an environmental or social objective, without mentioning the term 'sustainable investment'. However, it is most likely for TR-aligned investments to qualify as underlying investments of Article 8 financial products, which are considered sustainable.

Because of the lack of clarity in that regard, the French Financial Market Authority proposes to clarify the definition of sustainable investment 'to

[151] Diana Ribeiro Duarte (n 36), 3
[152] Groupe BPCE (n 68)
[153] European Commission, notice (n 134), 5

make it concrete given the lack of more detailed and objective criteria'.[154] The AMF wants to align the definition of the SFDR more to the TR since the 'definition of 'sustainable investment' under Article 2 (17) is ambiguous and could lead to misinterpretations.'[155]

It is important to analyse the consequence of such an ambiguous and unclear definition of sustainable investment. FMPs are able to decide subjectively what they consider to be sustainable for their use. First of all, this could lead to greenwashing, as only a very small added value of sustainability factors is necessary to consider a product as falling under Article 8 SFDR. Secondly, it also harms comparability between different products on the market for the investors.[156]

Many Article 8 products may have different degrees of sustainability. Some products that could be classified under Article 9 downgraded themselves to Article 8 products due to the lack of clarity regarding the definition in Article 9. These products are then on the same level as products that invest mostly in non-sustainable companies and have very few sustainable considerations. In general, '[t]his could lead to misunderstandings or misconceptions that may be misleading for the potential investors and clients'.[157]

Not only FMPs interpret sustainable investments under the SFDR differently, but also national supervision authorities. To illustrate this, two different interpretations of the German Supervisory Authority BaFin will serve as examples. The BaFin understands the term 'promote' in Article 8 as 'any activities to encourage the sale of a financial product and for that information to be targeted and communicated externally'.[158] The Commission's interpretation goes beyond, including ESG risks in the investment decision process.[159] Additionally, the BaFin allows Article 9 products to indicate '0% taxonomy-aligned' when no data is collected, without even having made

[154] Milena Prisco (n 85), 9
[155] Paulina Pielichata (n 92), 2
[156] Olivia Adams, 'AMF proposes tighter SFDR rules' (2023) IFLR, 1
[157] ibid
[158] Milena Prisco (n 85), 10
[159] ibid

reasonable efforts to collect the data.[160] Other national supervisory authorities might not agree with this interpretation.

However, even if it is possible to say that TR-aligned investments are SFDR-aligned, it is important to keep in mind that for certain specific investments, FMPs still have to check compatibility with Article 9. This is the case where FMPs are investing in undertakings through general equity or debt, as it is not possible to determine to which project the FMPs are investing into. As a consequence, FMPs still have to check the sustainability degree and the DNSH of the overall economic activity and whether the contribution to the environmental objective according to Article 9 is sufficient.[161]

This examination concluded the comprehensive analysis of the material scope of the regulations and their discrepancies. In order to develop a comprehensive framework on the misalignments between both regulations, it is necessary to explore their approach to the exclusion of adverse investments, which will be examined in the next chapter.

[160] ibid, 10-11
[161] European Commission, notice (n 134), 5

4 Exclusion of adverse investments

The exclusion of adverse investments, meaning investments that are harmful to social and/or environmental rights, is crucial in order to guarantee substantial contribution to sustainability. Minimum safeguards and the 'Do No Significant Harm' (DNSH) principles can 'overall be seen as supplementing the affirmative compliance model of substantial contribution'.[162] Such an exclusion of adverse investments is a safeguard measure ensuring that an investment must not cause significant harm if it is considered sustainable. The safeguard works pre-emptively[163] (*ex-ante*), meaning that while the FMPs have to disclose and demonstrate the sustainable contribution of their investment, they must also prove that they do not result in any significant harm to the environment or human rights.

First, minimum safeguards under the TR are examined before analysing the DNSH principles enshrined in both, the SFDR and the TR.

4.1 Minimum safeguards under the TR

Article 3 (c) TR foresees that an economic activity is sustainable if it is, among other criteria, 'carried out in compliance with the minimum safeguards laid down in Article 18'.[164] Hence, the 'minimum safeguards are an integral part of the [TR]'.[165]

According to Article 18 (1) TR, the minimum safeguards should ensure that the economic activity aligns with the OECD Guidelines for Multinational

[162] Soo-hyun Lee, 'Do No Significant Harm as a Core Principle in Sustainable Finance Regulation in the ASEAN Draft and Singapore Taxonomies, Journal of International and Area Studies' (2022) 29 Journal of International and Area Studies 21, 28
[163] ibid
[164] TR (n 4), Article 3 (c)
[165] European Commission, notice (n 134), 2

Enterprises (OECD MNEs)[166], the UN Guiding Principles on Business and Human Rights (UNGP)[167], and the principles set out in the eight fundamental conventions from the Declaration of the International Labour Organisation (ILO) on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

To those eight fundamental conventions[168], the ILO has added two additional conventions[169] which would be appropriate if the European legislators were to add them to the minimum safeguards in the next amendment to the TR.

The objective of the minimum safeguards laid down in the TR is to prevent that investments that are 'labelled (…) as 'sustainable' involve negative impacts on human rights'.[170] The UNGP, OECD MNEs and the eight ILO conventions are ensuring that the undertakings of the economic activities in question are identifying, preventing, mitigating or remediating the relevant actual and potential adverse impacts in their value chains and stakeholder relationships.[171] The undertakings have to 'comply or explain', which means that if they are not able to address or prevent adverse impacts, it is sufficient to identify them and to explain why it is not possible to mitigate them. In that

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[166] OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (2023) <www.oecd-ilibrary.org/docserver/81f92357-en.pdf?expires=1714981769&id=id&accname=guest&checksum=F902305BA3F3E4B19F9A5D509867C2FC> accessed 9 May 2024

[167] United Nations, 'Guiding Principles on Business and Human Rights' (2011) <www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf> accessed 9 May 2024

[168] Those eight conventions are: the Freedom of Association and Protection of the Right to organise Convention (No 87), the Right to Organise and Collective Bargaining Convention (No 98), the Forced Labour Convention (No 29) and its Protocol of 2014, the Abolition of Forced Labour Convention (No 105), the Age Convention (No. 138), the Worst Forms of Child Labour Convention (No. 182), the Equal Remuneration Convention (No. 100), and the Discrimination Convention (No. 111)
ILO, 'Conventions, Protocols and Recommendations', < www.ilo.org/international-labour-standards/conventions-protocols-and-recommendations> accessed 9 May 2024

[169] The two additional conventions are: the Occupational Safety and Health Convention (No. 155) and the Promotional Framework for Occupational Safety and Health Convention (No. 187

[170] Platform for Sustainable Finance, 'Final Report on Minimum Safeguards' (2022), 7

[171] European Commission, notice (n 134), 3

case, the economic activity is still complying with the minimum safeguards.[172]

The SFDR, in contrast to the TR, does not refer to so called minimum safeguards but nevertheless refers to the same UN and OECD Guidelines and the eight ILO conventions in Article 22 CDR 2022/1288 and in other Articles of the same delegated regulation with reference to website disclosures and Article 8 and 9 financial products. Those disclosures are part of the DNSH principle under the SFDR.

According to Article 18 (2) TR, the minimum safeguards in the TR are not only referring to international standards on human rights, but also to the DNSH principle under the SFDR. The TR consequently establishes a link to the SFDR. The Commission explains that this link 'ensures that minimum social standards are defined at European level, and that there is consistency in European legislation'.[173] This would mean that minimum safeguards are rather harmonised between the SFDR and the TR.

Since the minimum safeguards of the TR refer to the DNSH of the SFDR, it is important to analyse subsequently the DNSH of the SFDR, in order to understand the underlying obligation of the minimum safeguards.

4.2 Do No Significant Harm

As has been explained, the DNSH principle of the SFDR is part of the minimum safeguards of the TR. However, the TR also has its own DNSH principle. Therefore, it is advantageous to analyse first the DNSH principle of the SFDR, in order to understand the complete framework of the taxonomy minimum safeguards. Subsequently, analysing the DNSH principle under the TR and comparing it with the SFDR's DNSH will reveal potential similarities and differences.

[172] ibid

[173] European Commission, notice (n 134), 3

4.2.1 Do No Significant Harm under the SFDR

The DNSH principle under the SFDR focuses on PAI which are mandatory for Article 8 and 9 financial products to assess the DNSH criteria under the SFDR. The disclosures relating to the DNSH principle should explain how the indicators for adverse impacts have been taken into account.[174] It is important to highlight that the DNSH principle applies only to sustainable investments.[175]

The DNSH principle is particularly important for Article 9 financial products.[176] When committing to do no significant harm, Article 9 products can demonstrate that the investments with the sustainable objective do not cause any adverse effects. This has as a consequence the fostering of trust among the investors who are expressing their sustainable priorities.

DNSH and PAI indicators relevant for the DNSH should not be mistaken with the disclosures required by Article 4 (entity level) and 7 (product level) SFDR.[177] Article 4 requires publishing the PAI indicators of investment decisions on sustainability factors, their prioritisation and actions taken at entity level. FMPs have to describe to what extent they apply internationally recognised due diligences and, where relevant, they have to report the degree of the alignment to the Paris Agreement objectives.[178] Article 7 concerns adverse sustainability impacts at financial product level, requiring PAI indicators on sustainability factors for the specific product at question.

The two articles focus on the consideration of PAI indicators in investment decisions for all investments, whereas the PAI indicators under the DNSH principle have to be taken into account only for financial products that make sustainable investments. The latter is a description of how the PAI indicators

[174] CDR 2022/1288 (n 16), recital 22; ESMA, Do no significant harm (n 45), 4
[175] ESMA, Do no significant harm (n 45), 4
[176] CDR 2022/1288 (n 16), recital 22
[177] ESMA, Do no significant harm (n 45), 5
[178] CDR 2022/1288 (n 16), Article 9

are taken into account whereas Articles 4 and 7 focus on transparency of investment decisions.

PAI indicators are a 'set of climate, environment-related and social and employee, respect for human rights, anti-corruption and anti-bribery matters indicators'.[179] They are not associated with specific targets, which is a fundamental difference with the TR, since the DNSH principle under the TR requires specific targets or thresholds.[180] However, FMPs can decide to establish such thresholds. DWS (a German Asset Manager, see section 3.1.2.) for example considers PAI indicators by identifying 'quantitative thresholds and/or qualitative values to determine if an issuer significantly harms any of the environmental or social objectives'. This statement is entailed in its 'publication pursuant to SFDR'.[181] DWS uses 'external and internal factors, such as data availability or market developments'.[182]

These PAI indicators are explained in the RTS. According to Article 4 (1) of CDR 2022/1288, FMPs 'shall publish on their website, in a separate section (…) the principal adverse impacts of investment decisions on sustainability factors'.[183] Table 1 of Annex I lists the indicators applicable. These include greenhouse gas emissions, biodiversity, water emissions, waste, unadjusted gender pay gap and international principles such as the UN Guidelines and OECD Guidelines. Article 6 (2) of the same delegated regulation states that the indicators should describe the actions taken during the preceding year and the actions planned or targets for the subsequent year.[184]

FMPs should add information on additional climate and other environmental-related indicators (Table 2 Annex I) and additional indicators for social and employee matters, respect for human rights, anti-corruption and anti-bribery matters (Table 3 Annex I).[185] Table 2 of Annex I focuses on emissions, energy

[179] ESMA, Do no significant harm (n 45), 4
[180] ibid, 11
[181] DWS (n 76)
[182] ibid
[183] CDR 2022/1288 (n 16), Article 4 (1)
[184] CDR 2022/1288 (n 16), Article 6 (2)
[185] CDR 2022/1288 (n 16), Article 6 (1)

performances, green securities, special indicators for real estate assets, and water, waste and material emissions (such as non-recycled waste ratio and deforestation). Table 3 of Annex I focuses among others on codes of conduct, whistleblower protection, incidents of discrimination human rights policies and anti-corruption policies.

FMPs also have to describe the policies to identify the PAI indicators and indicate who takes the responsibility for implementation of the policies, the methodologies applied to select the indicators and the data used.[186]

Having examined the DNSH principle under the SFDR, the next section will analyse the DNSH principle under the TR.

4.2.2 Do No Significant Harm under the TR

The DNSH principle of the TR refers to the six environmental objectives laid down in Article 9. The DNSH principle in Article 3 (b) TR requires that the economic activity in question does not significantly harm any of those objectives. Thus, it is apparent that the DNSH principle of the TR refers only to those six objectives and not to internationally recognised guidelines. Such guidelines are inherent to the minimum safeguards of the TR, whereas the SFDR's DNSH principle contains both a DNSH principle and internationally recognised human rights protection.

Article 17 TR explains when an economic activity can be considered a significant harm to those objectives. For example, an economic activity significantly harms 'climate change mitigation, where the activity leads to significant greenhouse gas emissions'.[187] In order to assess the DNSH correctly, the activity itself and the products throughout the life cycle shall be

[186] CDR 2022/1288 (n 16), Article 7
[187] TR (n 4), Article 17 (1) a

taken into account, especially by 'considering the production, use and end of life'.[188]

In the TR, the DNSH principle applies to all economic activities for which TSCs have been created, whereas the DNSH principle under the SFDR only applies to sustainable investments.[189] TSCs are important in order to assess whether the economic activity significantly harms any of those objectives. The environmental and climate delegated acts[190] supplement the TR with those TSC indicators.

The Climate Delegated Regulation[191] specifies TSC in the energy sector, particularly for fossil gas and nuclear energy. In the catastrophic context of the Russo-Ukrainian war and 'in order to 'justify' the enactment of (…) [its] delegated act, the European Commission explained that, under certain 'clear and strict' conditions, gas and nuclear energy could play an instrumental role in facilitating the ecological transition'.[192]

Appendix C of this Delegated Regulation has been criticised because it requires a subjective 'essential use' test on 'Substances of Concern' (SoC) regarding the use of chemicals.[193] The 'essential use' is not legally defined and each company must define a subjective definition.[194] This lack of

[188] TR (n 4), Article 17 (2)
[189] ESMA, Do no significant harm (n 45), 9
[190] Commission Delegated Regulation (EU) 2023/2486 of 27 June 2023 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes no significant harm to any of the other environmental objectives and amending Commission Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities
[191] Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022, amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities
[192] Patrizia Tettamanzi, Riccardo Gotti Tedeschi and Michael Murgolo, 'The European Union (EU) green taxonomy: codifying sustainability to provide certainty to the markets' (2023) Springer, 14
[193] Recommendations on Data and Usability (n 53), 52
[194] Kristina Andersson, Anna-Karin Hellström and Jenny Lundahl, 'Challenges and opportunities with the EU Taxonomy Regulation' (2023) Mistra SafeChem, 19

standardisation hinders transparency and comparability, potentially facilitating greenwashing as some companies may set lower thresholds for ‘essential use’ than others.

Likewise, another Environmental Delegated Regulation[195] from the Commission establishes TSC for circular economy and protection of water and marine resources. The TR is supplemented by these criteria on the appropriate use of resources by re-using and recycling.[196]

According to recital 40 TR, TSC identify minimum requirements necessary to avoid significant harm to other objectives. This means that TSC are specifying ‘the minimum requirements that the economic activity should meet to qualify as environmentally sustainable.’[197] TSC set specific numerical values or minimum standards that an economic activity must meet in order to be considered sustainable.

The TSC should not be mistaken for the PAI indicators under the SFDR because the TSC are more ‘science-based criteria per economic activity’[198] whereas the PAI indicators are used to show to what extent the economic activities are aligned with international standards.[199] Additionally, as mentioned above (section 4.2.1.), the TSCs under the TR are associated with specific targets or thresholds, whereas the PAI under the SFDR are not.[200]

As can be seen from the DNSH principle and minimum safeguards, the interplay between the SFDR and the TR can be complex. The DNSH of the SFDR is part of the minimum safeguard definition of the TR. However, the TR also has its own DNSH principle.

[195] CDR (EU) 2023/2486 (n 180)
[196] ibid, recital 11
[197] ibid, recitals 5 and 7
[198] ESMA, Do no significant harm (n 45), 4
[199] ibid, 5
[200] ibid, 11

The question that now arises is whether the regulatory safeguards are comparable, regardless of their categorisation under DNSH or minimum safeguards.

4.3 Interplay and challenges of the exclusion of adverse investments in SFDR and TR

Both refer to the OECD MNEs Guidelines, the UNGP and the eight ILO conventions. This means that the safeguards are covering the protection of the worker's right to join organisations and to affiliate, to bargain collectively and to not be discriminated on employment matters. They both guarantee the prohibition of forced or compulsory labour and child labour. 'Several of those international standards are enshrined in the Charter of Fundamental Rights of the European Union, in particular the prohibition of slavery and forced labour and the principle of non-discrimination.'[201]

The OECD Guidelines additionally cover topics such as the environment, bribery, science and technology, fair competition and taxation.[202] According to ESMA, the environment topic is not relevant for assessing minimum safeguards in the context of the TR because in any event an economic activity is deemed to contribute to an environmental objective and not to harm it if it is TR-eligible. Technology and science are also irrelevant because they concern the promotion of technology in developing countries which 'is not aimed to safeguard against harm'.[203]

The PAI indicators under the SFDR focus on the same topics. 'PAI on gender pay gap and on gender board diversity can be understood as indicators on discrimination.'[204] Discrimination is covered by the UNGP and thus, the TR

[201] TR (n 4), recital 35
[202] Final Report on Minimum Safeguards (n 170), 10
[203] ibid, 11
[204] ibid, 14

and SFDR overlap, even if Article 18 TR does not mention explicitly gender pay gap and board gender diversity. Only controversial weapons are not covered by PAI indicators but are covered under the SFDR RTS and defined as ‘anti-personnel mines, cluster munitions, chemical weapons, and biological weapons’.[205] Since Article 18 TR does not mention controversial weapons, the Platform for Sustainable Finance recommends that those activities do not qualify as TR-aligned because they do not fulfil the DNSH principle under the SFDR.[206]

The Social Taxonomy Report would add such socially harmful economic activities such as weapons or cigarettes[207] but is for now not further considered by the schedule of the Commission until end of 2024.

All in all, both regulations cover very similar, nearly identical safeguards, irrespective whether covered under such minimum safeguards or other the DNSH principle. Both regulations can be similarly criticised by stating that they should identify high-risk sectors such as mining, construction and textile sector, or activities with high income inequalities.[208]

An obstacle encountered in practice is the lack of data availability especially when the investments are executed in non-EU countries.[209] It is difficult to know whether the economic activities in question respect the UNGP and OECD Guidelines and the data used is ‘often based on an assumption derived from external data resources’.[210]

Regarding the PAI indicators analysis in practice, the Luxembourgish bank BIL first explains on its website that it does not take into account PAI indicators on sustainability factors and states the reasons therefor in accordance with Article 4 (5) SFDR (comply or explain). It affirms that the

[205] CDR 2022/1288 (n 16), Table 1 Annex 1
[206] Final Report on Minimum Safeguards (n 170), 14
[207] EIOPA, ‘Prudential treatment of sustainability risks’ (2023) EIOPA-BoS-23-460, 105
[208] ibid
[209] Final Report on Minimum Safeguards (n 170), 14
[210] Final Report on Minimum Safeguards (n 170), 24

information necessary for BIL to consider PAI is currently not available 'in sufficient quantity or quality'.[211]

In another document, however, BIL states that it has hired KPMG to calculate PAI for 2022. In 30 pages, it explains that 'BIL addresses key negative impacts through a wide range of methods from PAI consideration, ESG scoring models, ESG analysis, norms offences diagnostic, and controversial activities exclusion'.[212] Nevertheless, the various methods are not further explained. The lack of data availability is still an issue, especially as BIL relies on the data it receives from investee companies and third-party providers. 'In this context, the calculations are done on a best-effort basis'.[213] BIL's website disclosure serves as an example of confusing disclosures regarding the consideration of PAI due to lack of data availability.

Regarding the interplay between both regulations, the European Commission has confirmed that when an investment aligns with the TR, 'it is unnecessary to comply with Article 2(17) of the SFDR'[214] because the sustainable definition of Article 2 (17) SFDR is deemed to be met when fulfilling the minimum safeguard test of the TR. However, this means that the mandatory PAI indicators will not be analysed.

In addition, since the TR plays on an economic activity level, it will still be necessary for FMPs to consider the 'sustainable definition' of the individual financial products categorised under Article 8 and 9 SFDR and especially their minimum safeguards in order to know if they are taxonomy-aligned.[215] This is because the investment that has 'some degree of taxonomy-alignment (can be realised) through a funding instrument that does not specify the use of proceeds.'[216] Consequently, FMPs need to comply with both regulations in

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[211] BIL, Statement on no consideration of adverse impacts of (i) insurance advice and (ii) investment advice on sustainability factors, <www.bil.com/Documents/documentation-legale/sustainability-no-consideration-en.pdf> accessed 9 May 2024
[212] BIL, Statement on principal adverse impacts of investment decisions on sustainability factors, <www.bil.com/Documents/documentation-legale/sustainability-factors-en.pdf> accessed 9 May 2024
[213] ibid
[214] Diana Ribeiro Duarte (n 36), 3-4
[215] ibid
[216] ESMA, Do no significant harm (n 45), 5

some cases, and TR-alignment does not always reduce the need for compliance with the SFDR.

5 Conclusion

In conclusion, the relationship between the TR and the SFDR is interconnected, with both regulations playing complementary roles for sustainable investments in the EU towards achieving the sustainability objectives set by the 2030 Agenda and the Paris Agreement.

Both regulations share a common objective of enhancing investor's understanding on ESG factors in investments and preventing greenwashing. The regulations aim to comparability among ESG investments, emphasising the importance of standardised reporting. Harmonised standardisation among both regulations also helps to avoid 'disclosure overload'[217] which can result regarding the multiple disclosure requirements.

In addressing the research questions, it becomes apparent that the TR and SFDR overlap in some aspects, such as the exclusion of adverse investments (even if entailing a different approach), and misalign in others such as the broader personal scope of the TR and the different definitions. Risks stemming from such misalignments are especially greenwashing practices and confusion among investors.

Comply or explain approaches and thresholds set in the TR try to ensure genuine ESG financial products. However, the SFDR needs to be revised in order to enhance a clearer disclosure framework. The SFDR, while broader in material scope, lacks specific thresholds for the definitions and for the DNSH principle, whereas the TR outlines six concrete environmental objectives. In general, the TR 'improves the precision and comparability of disclosures'[218] compared to the SFDR which 'lacks substantial environmental criteria to abide by'.[219] 'By setting a classification of sustainable activities,

[217] Maria Gebhardt (n 54), 14
[218] Grégoire Lunven (n 50), 84-85
[219] ibid

the [TR] decisively complements the SFDR'.[220] Particularly the Article 8 label should be revised and the SFDR should include a minimum threshold.

The European Commission confirmed in its report of the consultation on the SFDR assessment that some stakeholders suggest 'that more efforts should be made to simplify the interactions between the definitions of 'sustainable investment'(SFDR) and 'environmentally sustainable' (EU Taxonomy).[221]

However, the TR itself is still evolving. It is a young regulation which lacks maturity.[222] The TR should include social sustainability which will hopefully be concretised by the Commission in 2025.

By addressing the beforementioned challenges, the EU can further advance its commitment to a harmonised sustainable finance framework. In addition, the emergence of new sustainable investment regulations such as the ESRS, the EU Benchmark regulation and the proposal of the ESG rating regulation suggest a continuous need for adaptation of the legal framework of sustainability in the financial sector. A comprehensive analysis of the even broader sustainable finance framework would be valuable for further research.

[220] ibid
[221] European Commission, 'Summary Report of the Open and Targeted Consultations on the SFDR assessment' (2024), 6
[222] Kristina Andersson (n 194), 22

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