

SFDR 2.0 proposals

New sustainability categories for funds marketed in the European Union, but with some last-minute surprises



24 November 2025

1 Introduction

In our [briefing on the leaked draft of the European Commission's proposals](#) to update the EU Sustainable Finance Disclosure Regulation (SFDR), commonly known as "SFDR 2.0", we observed that the proposals may have been one of the worst-kept secrets of recent years. In hindsight, that was perhaps tempting fate, as the publication of the [finalised proposals](#) on 20 November 2025 demonstrated that the Commission was still capable of springing one or two rather unwelcome surprises on the industry.

Although much of the basic architecture of the proposals remains the same since the leaked draft, there have been a number of important changes, the most significant of which is the deletion of the ability of alternative investment funds (AIFs) marketed only to professional investors to opt out of the SFDR regime. This has potentially significant implications for funds targeting institutional investors, as we explain further below.

It is important to note that the publication of the formal proposals is, to borrow a phrase, only the end of the beginning. The European Council and Parliament will now have their say as the text moves through the EU's ordinary legislative procedure, meaning that there will still be plenty of opportunities for changes before the finalised text takes effect. In light of some of the changes since the leaked draft, we anticipate that industry associations and market participants will be engaging extensively with key stakeholders within the European co-legislators with a view to addressing some of the potential difficulties that the current proposals may cause.

Although the precise timing of the updated SFDR regime remains unclear, the text proposes that the updated rules will take effect 18 months after the SFDR 2.0 amending legislation first enters into force. Given the length of time that EU legislative negotiations are likely to require, this suggests that the revised framework will not be operational until some point in 2028 at the earliest.

In this briefing, we first highlight the key changes between the leaked draft and the final proposals. The remainder of the briefing is an updated version of the information in our earlier briefing, explaining the key features of the Commission's proposals for SFDR 2.0. Finally, we set out our updated view of what the Commission's finalised proposals might mean for the asset management industry in the longer term.

2 Key changes from the 6 November 2025 leaked draft text

- **No carve-out for AIFs marketed only to professionals:** The leaked text contained a carve-out from the SFDR regime for AIFs that were made available exclusively to MiFID professional investors. In effect, this meant that the updated SFDR 2.0 framework would have operated on an "opt-in" basis, with institutional-only funds able to make sustainability-related claims about their products without needing to comply with the relevant restrictions under the revised rules. This has been deleted in the Commission's final proposals, meaning that fund managers offering professional-only products will need to decide whether to adhere to the strict limitations applicable to non-sustainability-related products under the new Article 6a rules, or to bring their fund within one of the new product categories. (See below for further information on the Article 6a conditions and the new product categorisation framework.)
- **New names for the new product categories:** In the leaked draft, the Commission had not yet settled on names for each of the new product categories being introduced under the revised rules. Instead, the Commission would have been empowered to specify the relevant names in a future delegated act. The final proposals now include the

following product category names: **Transition** category (new Article 7), **ESG Basics** category (new Article 8) and **Sustainable** category (new Article 9). There will no longer be a power for the Commission to specify names under delegated legislation (though some further consumer testing is anticipated).

- **Exclusion of investments in companies that derive 1% or more of revenues from hard coal or lignite:** In the final proposed text, all three core product categories will be prohibited from investing in companies that derive 1% or more of their revenues from the exploration, mining, extraction, distribution or refining of hard coal and lignite. Previously, this restriction applied only to the Article 9 (Sustainable) product category. In practice, a specific exclusion relating to this subset of fossil fuels may be problematic where a fund is targeting both EU and US institutional investors, and the latter pool of investors includes some Red State investors who would refuse to commit to a fund that has any express fossil fuel investment exclusion. Although the categories are not supposed to have any hierarchy, the use of the new name "ESG Basics" may imply that Article 8 is the least ambitious, though it is not clear that this is necessarily true.
- **Changes to permitted investments and exclusions for the Article 7 (Transition) category:** The final proposed text amends some of the proposed permitted investments for Transition products which may, in practice, have the effect of tightening the eligibility criteria. In particular, the previous permitted category of "investments accompanied with a credible sustainability-related engagement strategy", which was relatively loose, has now been updated so that such investments may only be made in connection with another type of eligible investment permitted by Article 7. In addition, for the categories of eligible investments that reference credible transition plans or targets, the revised text clarifies that the relevant plans or targets must be compatible with the Paris Agreement and the EU framework for achieving climate neutrality. In relation to excluded investments, the updated text specifies that Transition products must not invest in companies that develop new projects for the exploration, extraction, distribution or refining of hard coal and lignite, oil fuels or gas fuels or that develop new products for, or not have a plan to phase-out from, the exploration, mining, extraction, distribution, refining or exploration of hard coal or lignite for power generation.
- **Changes to permitted investments and exclusions for the Article 9 (Sustainable) category:** Investments in European social entrepreneurship funds (EuSEFs) have been added as a permitted investment category for Sustainable products. In addition, the leaked text originally would have permitted investment in EU issuances and funds backed by the EU budget with environmental, social and governance objectives. This has now been amended to clarify that Sustainable products can invest in investments financing the same undertaking, project or portfolio that is identified as benefiting from an EU budgetary guarantee or issuance of financial instruments under an EU issuance programme, where the guarantee or programme is pursuing environmental or social objectives. It seems that this is intended to make it clear that the investment does not itself need to involve participation in the specific EU guarantee or issuance, but rather can be in the same underlying undertaking, project or portfolio that is the subject of such a guarantee or issuance.
- **Principal adverse impact disclosures for Article 7 (Transition) and Article 9 (Sustainable) products:** Providers of both Transition and Sustainable products will now need to identify and disclose principal adverse impacts of their investments on sustainability factors and explain any mitigating action that they have taken. The revised text would allow product providers to comply with this requirement by using "appropriate sustainability-related indicators" (or providing a qualitative explanation of such impacts and any actions taken). There will be a corresponding power for the Commission to specify indicators for this purpose in a delegated act (building on the indicators already contained in Annex I to the SFDR 1.0 Reporting RTS, although that would be repealed as part of SFDR 2.0). However, the Commission power makes it clear that such indicators would be for "voluntary use", which would seem to mean that product providers could choose different indicators for these purposes if they wish. Although seemingly more flexible than the current regime (which requires "consideration" of selected PAI metrics), the reintroduction of the principal adverse impact regime for Article 7 and 9 products will likely be an unwelcome departure from the leaked proposals.
- **Clarification of the Article 9a (Combination) category:** Combination products are those financial products which claim that they combine two or more Article 7, 8 or 9 financial products. This might include fund-of-funds or insurance products, for example. The leaked draft text did not provide any further details about the criteria for qualifying as an Article 9a Combination product, but the finalised text now specifies (although the drafting is still somewhat unclear) that such products must meet a 70% investment threshold of investments in Article 7, 8 and/or 9 products and/or their permitted underlying investments. All investments made by a Combination product must also comply with the exclusions which would be applicable to whatever combination of Article 7, 8 or 9 products they target. When determining if a constituent product is eligible, the Combination product provider may rely on disclosures produced by the provider of an underlying component Article 7, 8 or 9 product, which is helpful in confirming that no detailed investigation into the eligibility of the underlying investments made by a constituent product will be required. There is a similar provision which states that for these purposes, product providers may also

rely on information provided by a portfolio manager providing services to the product provider. Notwithstanding these provisions, in practice, we anticipate that many fund-of-funds may struggle to comply with the exclusion criteria (as such funds would need to ensure that all underlying funds comply with the exclusion criteria). Similar concerns arise for secondary funds which would not be able to impose these exclusions on a secondary portfolio. As a result, such funds may find themselves forced into Article 6a instead. The finalised text also clarifies that providers of Combination products are permitted to make sustainability-related claims when marketing those products, provided that the claims are consistent with the information disclosed about the underlying constituent products.

- **Investment ramp-up provisions:** In the leaked text, each of the new Article 7, 8 and 9 product categories included a provision referring to the phase-in of investment levels to meet the required investment thresholds. The Commission will have the ability to specify the relevant phase-in period in a delegated act. These provisions have been retained, but have also been expanded so that the phase-in language now refers to a phase-in "*following the period necessary to implement the investment strategy*", provided that this is consistent with information included in the product's pre-contractual disclosures. Although the drafting is not entirely clear, this appears to be a helpful addition and may mean that although the Commission may mandate the applicable phase-in periods, the product provider could clarify in the product literature that the phase-in period will not begin until (say) the fund's capital has been fully deployed. In the recitals to the finalised proposal, the Commission recognises the challenges faced by private market funds in relation to meeting investment thresholds and therefore this may be designed to help address those issues.
- **EU Taxonomy reporting:** The leaked text would have expressly deleted provisions in the EU Taxonomy Regulation which required SFDR 1.0 Article 8 or 9 products to disclose their percentage of Taxonomy alignment and to include certain statements confirming that other investments did not take the Taxonomy into account. Those provisions have not been included in the final proposals. The Commission's intention from the explanatory memorandum to the final proposals appears to be to retain the Taxonomy Regulation, but to make its use optional in relation to the new product categories. However, where an Article 7 or Article 9 product pursues an environmental objective, the product provider will need to disclose whether (and if so, the extent to which) it is meeting the minimum investment threshold by investing in Taxonomy-aligned economic activities. The Commission appears to acknowledge that the Taxonomy Regulation currently refers to the existing SFDR 1.0 concept of Article 8 or 9 products to determine existing mandatory Taxonomy reporting obligations, but notes that the relevant SFDR 1.0-derived obligations will effectively become inoperative when the new SFDR 2.0 product categories take effect.
- **Use of external data sources:** The leaked text contained a requirement that where a product provider uses data provided by external providers to comply with its product-related obligations under SFDR, it had to put in place formal documented arrangements with the relevant data provider. This is being retained, but the text has now clarified that this obligation does not apply in relation to open-source information or research that is otherwise freely available to the public.

3 Proposed new SFDR 2.0 product categorisations

THE NEW PRODUCT CATEGORIES

Under the final proposals, the existing categories of Article 6, Article 8 and Article 9 funds will be deleted and will be replaced with a new product categorisation system. Broadly, this would break down as follows:

Category	Updated SFDR provision	Headline description
Transition	Article 7	Invests in the transition of undertakings, economic activities or other assets towards sustainability, or contributes to such transition.
ESG Basics	Article 8	Integrates sustainability factors into the investment strategy beyond risk management considerations.
Sustainable	Article 9	Invests in sustainable undertakings, sustainable economic activities, or other sustainable assets or contributes to sustainability.
Combination	Article 9a	Constituted of two or more underlying financial products falling within the above three categories.

Category	Updated SFDR provision	Headline description
Impact	Article 7 or Article 9, together with Article 2(26)	A product falling within Article 7 (transition) or Article 9 (sustainability-related objective) above, with an objective of making a pre-defined positive and measurable social or environmental impact.
Other	Article 6a	Products that do not fall within any of the above categories.

The "core" product categories will now be contained in Articles 7, 8 and 9 SFDR. The Combination category (Article 9a) is effectively designed for funds-of-funds or similar products which invest into two or more financial products which themselves qualify for one of the core categories and will require an explanation of the composition of the combined product relative to those underlying constituent categories. The Impact category effectively operates as a sub-category of the Transition (Article 7) or Sustainable (Article 9) core categories.

NEW QUANTITATIVE THRESHOLDS AND ELIGIBILITY CRITERIA FOR INVESTMENTS FOR NEW CORE PRODUCT CATEGORIES (ARTICLE 7, 8 AND 9 FUNDS)

The revised rules would introduce new minimum investment thresholds for each of the core new product categories. In addition, they specify investments that can be used to meet the minimum thresholds, as well as investments which do not count towards the minimum investment thresholds and excluded investments in which the product is prohibited from investing. These categories are largely based on the December 2024 recommendations of the Platform on Sustainable Finance. SFDR 2.0 uses a different set of categories from the UK FCA's Sustainability Disclosure Requirements.

The following table provides a broad and simplified overview of the three new core product categories, with examples of their permitted and excluded investments:

Category	Required investment threshold	Examples of specified eligible investments	Excluded investments	Additional conditions
Transition (Article 7)	<p>70% of assets in investments meeting a clear and measurable transition objective relating to sustainability factors, including environmental or social transition objectives</p> <p>OR</p> <p>Align with an EU climate transition or an EU Paris-aligned benchmark</p> <p>OR</p> <p>At least 15% of investments in Taxonomy-aligned economic activities</p>	<ul style="list-style-type: none"> Investments in portfolios replicating or managed by reference to an EU climate transition benchmark or EU Paris-aligned benchmark Investments in undertakings or economic activities with credible science-based targets that are supported by information ensuring integrity, transparency and accountability* Investments in undertakings with a credible transition target set at the level of the portfolio, such as reduction of portfolio emissions over time* <p><i>* The target must be compatible with the transition and global warming limitation objectives set out in the</i></p>	<ul style="list-style-type: none"> Controversial weapons Cultivation and production of tobacco Companies where a benchmark administrator has found a violation of UNGC Principles or OECD Guidelines on Multinational Enterprises Companies that derive 1% or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal or lignite Companies developing new projects for the exploration, mining, extraction, distribution or refining of hard coal and lignite, oil fuels or gaseous fuels Companies developing new projects, or that do not have a plan to phase-out from, the exploration, mining, extraction, distribution, refining or exploitation of 	<ul style="list-style-type: none"> Must identify the principal adverse impacts of their investments on sustainability factors and explain any related mitigating actions

Category	Required investment threshold	Examples of specified eligible investments	Excluded investments	Additional conditions
		<i>Paris Agreement and the objective of the EU framework for achieving climate neutrality</i>	hard coal or lignite for power generation	
ESG Basics (Article 8)	70% of assets in investments integrating the sustainability factors	<ul style="list-style-type: none"> Investments with an ESG rating that outperforms the average rating of the investment universe or reference benchmark Investments that outperform the average investment universe or reference benchmark on a specific appropriate sustainability indicator Investments that favour undertakings or economic activities with a proven positive track record of processes, performance or outcomes related to sustainability factors 	<ul style="list-style-type: none"> Controversial weapons Cultivation and production of tobacco Companies where a benchmark administrator has found a violation of UNGC Principles or OECD Guidelines on Multinational Enterprises Companies that derive 1% or more of their revenues from exploration, mining, extraction, distribution or refining of hard coal or lignite 	
Sustainable (Article 9)	<p>70% of assets in investments with a clear and measurable objective related to sustainability factors, including environmental and social objectives</p> <p>OR</p> <p>Align with an EU Paris-aligned benchmark</p> <p>OR</p> <p>At least 15% of investments in Taxonomy-aligned economic activities</p>	<ul style="list-style-type: none"> Portfolios replicating or managed according to EU Paris-aligned benchmarks Taxonomy-aligned economic activities Investments in EU issuances and funds backed by the EU budget with environmental, social and governance objectives Other investments in sustainable undertakings, economic activities or other assets, provided that a proper justification is included in investor disclosures Investments in EuSEFs 	<ul style="list-style-type: none"> Any company excluded from EU Paris-aligned benchmarks, including those mentioned above plus companies associated to varying degrees with coal, oil, gas or energy-intensive electricity generation New projects to explore, extract, distribute or refine hard coal, lignite, oil fuels or gaseous fuels New projects for, or projects that do not have a plan to phase out from, exploration, mining, extraction, distribution, refining or exploitation of hard coal or lignite for power generation 	<ul style="list-style-type: none"> Must identify the principal adverse impacts of their investments on sustainability factors and explain any related mitigating actions

On the face of it, the eligible investments for each of the above categories are fairly broad, although they have been tightened since the leaked draft and, in practice, a number of the categories of eligible investments may not work for

managers of blind pool funds investing in private assets. While some of the higher-ambition sustainability features or initiatives currently frequently agreed between investors and managers find a place in one or more categories, we suspect that some funds which currently fall into Article 8 SFDR 1.0 may find it difficult to qualify for a product category.

Each category also includes a "catch-all", so that other investments which are not listed but which fit the theme may be included provided that a "proper justification" is included in the product disclosures. However, for Article 7 (Transition) products, the contribution of those underlying investments to the objective of the product must be compatible with the transition and global warming limitations set out in the Paris Agreement and with the objectives of the EU framework on climate neutrality.

The introduction of the new transition category under Article 7 and its associated permitted investments is also welcome, as fund managers seeking to develop transition finance products have frequently struggled under the existing SFDR regime due to a lack of clarity about how their investments would comply with the existing criteria. It is also clear that the Commission has focused on "brown-to-green" transition strategies which pursue asset level impact, rather than those transition strategies which focus on enabling the transition to a low carbon economy through investing in (for example) renewable energy assets.

The Commission will be empowered to supplement the lists of permitted investments by specifying additional conditions that must be met for the investment to contribute towards the product's objective (and therefore to count towards the required threshold). The Commission will also be able to define the methodologies used to calculate the applicable thresholds. There is therefore a risk that, depending on the approach adopted by the Commission, further onerous requirements could be added to the basic eligibility criteria, which would affect whether a fund or other product can meet the necessary conditions in each case. On the other hand, the Commission's power to introduce a phase-in period for each category to reach the requisite threshold of eligible investments is likely to be welcomed. Firms will therefore need to keep a close eye on any consultations or proposals for the development of the relevant Commission delegated acts in due course.

Although the categories are not supposed to have any hierarchy, the use of the new name "ESG Basics" may imply that Article 8 is the least ambitious, though it is not necessarily clear that this is true.

FUNDS THAT ARE NOT SUSTAINABILITY-RELATED PRODUCTS (ARTICLE 6a FUNDS)

The finalised proposals state that products other than those falling within the new Article 7 (Transition), Article 8 (ESG Basic), Article 9 (Sustainable) or Article 9a (Combination) categories can still include in their pre-contractual documents (for example, the Article 23 AIFMD pre-contractual disclosures made by AIFs) information on whether, and how, the product considers sustainability factors. The relevant framework will be set out in a new Article 6a SFDR and therefore in this briefing, we refer to these products as "**Article 6a products**". Note that Impact products, as a subset of either Article 7 or Article 9 products, are not Article 6a products and would be subject to the requirements of either Article 7 (if they are transition impact products) or Article 9 (if they are sustainable impact products), as applicable.

The rules for Article 6a products state that when including information about the sustainability factors that the provider considers in connection with the product, the relevant information must meet the following conditions (unless the product falls within an exemption mentioned below):

- Any **information on sustainability factors must not be a "central element" of the pre-contractual disclosures** for the product – a tightly defined concept, including meaning that the sustainability-related information must account for less than 10% of the space taken up in describing the investment strategy;
- Sustainability-related information must **not be included in any UCITS Key Investor Information Document (KIID) or PRIIPs Key Information Document (KID)** prepared for the product; and
- The information must **not constitute a claim about that product that would fall within the new Article 7, 8 or 9** product categories.

Where an Article 6a product provider discloses information about sustainability factors in the relevant pre-contractual documents for a product, it must include a description of its consideration of those factors in the corresponding periodic report for the product. (For example, for an AIF, this information must be included in the AIF annual report.) However, the restrictions above will apply in relation to any sustainability-related information that the product provider includes in that report, which will act as a practical limit on their ability to provide detailed information in relation to the reporting on such factors.

There will also be a prohibition on including sustainability-related claims in the names or marketing communications of Article 6a products.

The leaked text originally referred to product providers not being prevented from including information about consideration of sustainability factors or sustainability *risks*, but the reference to sustainability risks has been deleted in the final proposed text. This is presumably intended to mean that a product provider could disclose information about sustainability-related risks in its pre-contractual documentation without needing to adhere to the limitations in Article 6a discussed above, which would clearly be a desirable outcome from an investor protection perspective. However, the prohibition in relation to marketing communications prevents the inclusion of any sustainability-related *claims* in promotional materials, and the concept of a "claim" is likely to be broader than information about sustainability-related *factors*. It is therefore unclear whether marketing communications could include sustainability risk disclosures (and if so, whether there is a tipping point at which such disclosures would instead be viewed as prohibited sustainability claims).

As the final proposals no longer permit professional-only funds to opt-out of SFDR, the Article 6a category may become increasingly important – though its utility in practice may be limited. As many institutional investors are likely to want information about a product provider's approach to sustainability risks, even for a product that is not actively marketed as a sustainability product, there is a risk that the strict conditions imposed by Article 6a may force some product providers into one of the other product categories (most probably the ESG Basics category, given that Article 8 might arguably impose the lightest requirements of the three core categories).

4 Exemptions and transitional provisions for SFDR 2.0

A critical question for fund managers will be how their existing SFDR 1.0 Article 8 and 9 products will be treated under the revised rules. This will depend on the type of fund and its current status, as follows:

FULLY-RAISED CLOSED-ENDED FUNDS

- For existing closed-ended funds which are no longer being distributed on or after the date that the new SFDR 2.0 rules take effect, managers may choose not to apply the new rules. This means that where a fund is fully raised and closed by that date, the manager will **not** need to transition the product to the new framework.
- The text appears to indicate that in this situation, a fund manager could choose not to apply SFDR in its entirety to such funds, rather than just preserving the existing SFDR 1.0 framework. Assuming that is the intention, this would also switch off all existing SFDR 1.0 requirements for those funds, including obligations to make periodic reports and to invest only in companies which exhibit good governance. Whether or not SFDR 1.0 processes and disclosures would need to continue would then be determined by reference to existing contractual arrangements.

OTHER FUNDS

- As noted above, the leaked draft text originally included a carve-out for AIFs which are made available only to MiFID professional investors. Unfortunately, this did not survive into the finalised proposals (although whether it, or something similar, will be reinstated as the text passes through the EU legislative process remains to be seen).
- There is a 12-month transitional provision in the text for certain types of pension products, but this is not available to AIFs or UCITS funds.
- The effect of the two above points is that there is no transitional relief or carve-out from the revised SFDR 2.0 rules for any of the following, to the extent that they are marketed in the EU:
 - All open-ended funds; and
 - All closed-ended funds which are not fully raised at the time that the new rules enter into effect.
- However, the SFDR 2.0 framework will not begin to apply until 18 months after the amending legislation technically enters into force. This means that even without the 12-month transitional above, product providers will still have at least that amount of time to assess whether they need to make any changes to their products to either confirm that they fall within the Article 6a category, or otherwise to bring them within one of the new core product categories. Nonetheless, to assess whether it is viable to bring a fund within one of the new categories, the fund manager is also likely to need to see the detail of the Commission's delegated act which expands upon the relevant permitted investments and threshold calculation methodologies. Given that this will not be available immediately, in practice there may still be legitimate questions about whether an additional transitional period is needed for these funds.

5 Other changes under SFDR 2.0

"SUSTAINABLE INVESTMENTS"

The final proposals entirely delete the existing concept of Article 2(17) "sustainable investments", which is currently relevant to SFDR 1.0 Article 8+ and 9 funds. As a result, the "do no significant harm" principle will be deleted from SFDR and the unloved concept of portfolio companies exhibiting "good governance" no longer features as a standalone concept (but could find its way back). Deletion of this definition may increase focus on Taxonomy-alignment as a measure of environmental sustainability for funds in one of the new categories.

ENTITY AND PRODUCT LEVEL DISCLOSURE REQUIREMENTS

Under the proposals, the requirement for entity-level disclosures in relation to the principal adverse impacts (**PAIs**) of investment decisions on sustainability factors is also being removed. However, as noted above, product providers of Article 7 (Transition) or Article 9 (Sustainable) products will still need to make PAI disclosures in connection with the underlying investments they make in relation to those products.

In addition, firms will no longer be required to include information in their remuneration policies on how those policies are consistent with the integration of sustainability risks or to disclose such information on their websites.

There will also be no requirement for all firms to report Taxonomy eligibility or alignment under the new framework, although as noted above, Article 7 and Article 9 funds pursuing environmental objectives will need to disclose the extent to which they invest in Taxonomy-aligned economic activities. In the explanatory memorandum to the finalised proposals, the Commission states that Taxonomy reporting will no longer be a "blanket obligation", but will instead apply only to the extent that a product provider chooses to use the Taxonomy in relation to the new SFDR 2.0 product categories.

PORTFOLIO MANAGERS AND ADVISERS

Portfolio managers and financial advisers will be removed from the scope of SFDR, on the basis that the Commission considers that they do not manufacture or manage the underlying sustainable products in relation to which they provide their services. In practice this means that it will often be possible for separately managed accounts and funds-of-one to fall outside the scope of SFDR 2.0 altogether, although in some cases the arrangement may be structured in a way that brings it within scope – for example where a fund-of-one is constituted as an AIF.

DATA METHODOLOGIES

The finalised proposals contain new rules in relation to the use of data and estimates for the purposes of complying with the new product category rules and related disclosure and reporting requirements.

Broadly, where a firm is using data provided by external data providers for these purposes, it will need to ensure that the relevant arrangements with the data provider are formally documented. However, this will not apply where the relevant data is open-source information or research that is freely available to the public. Where the firm uses estimates that are not based on data provided by an external data provider, it will need to ensure that it has formal, documented methodologies for determining those estimates.

Upon request, the firm will need to provide clients with information about the sources of data it uses and the methodologies it applies.

ISSUANCE AND USE OF ESG RATINGS IN MARKETING COMMUNICATIONS

Where a product provider issues an ESG rating (as defined in the EU ESG Ratings Regulation) and includes this in its marketing communications, the finalised proposals require it to include on its website the minimum public disclosures required under that Regulation and to include a link in the relevant market communication to those website disclosures.

6 Implementation timeline for SFDR 2.0

The precise timeline for the SFDR 2.0 amendments taking effect is not yet clear and will depend upon the speed with which the European Council and Parliament can agree the text through the ordinary legislative process. The final proposal states that the revised rules will (broadly speaking) take effect 18 months after the final agreed legislation is published in the EU Official Journal. Allowing for a reasonable period of time for the legislative process and for

translation of the final adopted text thereafter, and assuming that the 18-month period is retained in the final text, this suggests that the new framework will not apply **before mid-2028 at the earliest**.

The Commission's legislative statement indicates that there will be "*implementation with a start-up period from 2027 to 2028...followed by full-scale operation*". It seems likely that the "start-up period" will be the 18-month window between the legislation being finalised and the new rules actually coming into effect, during which time the Commission will (presumably) adopt the necessary delegated acts to flesh out the basic framework.

However, firms will need to start planning well in advance of the final go-live date, given that they are likely to need to make some strategic decisions about how to position their products and may also need to amend product documents and if necessary, seek investor consent to changes. As the timetable becomes clearer, firms that are planning potential fundraises that straddle the go-live date will also need to decide how to address the associated risks and complexities – for example, in some cases, they might choose to accelerate their fundraising timelines to benefit from the proposed transitional period for fully-raised, closed-ended funds.

7 Travers Smith's (updated) view on the finalised SFDR 2.0 proposals

When the leaked draft was first published, our view was that it was broadly pragmatic and positive for the asset management industry. In particular, we thought that the proposals in their draft form largely struck an appropriate balance between providing clarity and protection for retail investors, while also leaving institutional-only fund managers the flexibility to decide whether to opt in to the SFDR regime, based on investor demand.

For the retail market, the Commission's finalised proposals largely make sense and the new product categories (which broadly reflect the recommendations from the Platform on Sustainable Finance in December 2024) will contribute towards a more coherent framework, which may improve comparability and investor understanding. Whether retail product providers can bring their products within each of the new product categories will depend upon the additional details the Commission includes in its delegated acts, which are likely to become a key focus of the industry's attention once the Level 1 SFDR 2.0 text has been enacted.

Unfortunately, the demise of the opt-out for professional-only funds introduces potentially significant new challenges for fund managers who are targeting sophisticated institutional investors. On the one hand, some product providers may find that institutional investors demand that their products fall within one of the new core categories, in which case the path forward for those products will be relatively clear (although not necessarily one that it will be easy for private markets managers to follow). However, the strict conditions that are required for a product to fall within the Article 6a classification make it very difficult for fund managers who do not want to offer any of the new core product types to have sophisticated, iterative discussions with their target investor base. This is because the restrictions that the Article 6a regime would impose on the content of marketing communications are likely to make it impractical for a fund manager to explore and develop the sustainability features of a potential fund without potentially crossing into one of the new product types. In practice, this may drive more funds towards (at least) the new Article 8 (ESG Basics) product category, even though the fund manager does not intend to, or wish to, offer a sustainability-related product. The time and money spent navigating these new restrictions may discourage innovation and reduce the opportunity to tailor funds to institutional investor needs.

Still, there is a long way to go before SFDR 2.0 becomes law (assuming that political agreement can eventually be reached). The Commission's formal proposal is just the first step in the legislative process, which now seems likely to become the subject of intensive lobbying by industry associations to reinstate the professional fund opt-out, or at least to add in some additional flexibility.

Could the final text of SFDR 2.0 end up in a better place than where it is currently starting? That would be a pleasant surprise indeed.

FOR FURTHER INFORMATION, PLEASE CONTACT



Tim Lewis
Head of Financial Services and Markets
tim.lewis@traverssmith.com
+44 (0)20 7295 3321



Sarah-Jane Denton
Director, Operational Risk and Environment
sarah-jane.denton@traverssmith.com
+44 (0)20 7295 3764



Phil Bartram
Partner, Financial Services and Markets
phil.bartram@traverssmith.com
+44 (0)20 7295 3437



Michael Raymond
Partner, Financial Services and Markets
michael.raymond@traverssmith.com
+44 (0)20 7295 3487



Danny Riding
Partner, Financial Services and Markets
danny.riding@traverssmith.com
+44 (0)20 7295 3074



Henriika Hara
Partner, Financial Services and Markets
henriika.hara@traverssmith.com
+44 (0)20 7295 3688



Sam Brewer
Partner, Financial Services and Markets
samuel.brewer@traverssmith.com
+44 (0)20 7295 3015



Nick Glynn
Partner, Financial Services and Markets
nick.glynn@traverssmith.com
+44 (0)20 7295 3083



James Barnard
Partner, Financial Services and Markets
james.barnard@traverssmith.com
+44 (0)20 7295 3438



Simon Witney
Senior Consultant, Financial Services and Markets
simon.witney@traverssmith.com
+44 (0)20 7295 3957