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Loan Market Association Response and Recommendations on the European Commission's Sustainable Finance Disclosure Regulation Proposals

The Loan Market Association (**LMA**)[1] welcomes the European Commission's recently published proposals (the **Proposals**) to amend the Sustainable Finance Disclosure Regulation (**SFDR 2.0**).[2] These proposals represent an important step towards addressing the complexity of the existing disclosure regime, lowering the administrative burden on financial market participants (**FMPs**) and moving towards a clearer labelling regime for sustainable finance products.

We recognise and welcome the Commission's efforts to simplify the framework, enhance clarity for market participants and investors, and address challenges that have emerged during the implementation of the current regime. We support the Commission's objective of moving towards a clearer and more practical labelling regime for sustainable finance products. Greater simplicity, legal certainty and usability are essential to ensuring that the SFDR framework continues to support the EU's objectives, whilst remaining workable across a diverse range of asset classes and business models.

Disclosure regimes such as SFDR underpin investment processes relating to sustainable lending and are key to the assessment of sustainability-related risks and opportunities. It is therefore vitally important for our members that SFDR 2.0 addresses concerns with the existing SFDR regime and helps to support the market for sustainable lending.

The recommendations and views set out in this paper draw on feedback from our members and the wider market in relation to the Proposals. We highlight usability challenges and specific areas of ambiguity and provide recommendations to address these issues.

About the LMA

The LMA is the voice of the loan markets across EMEA. With over 850 members across over 65 jurisdictions, we represent an ever-growing diversity of participants in international capital markets, including institutional investors, private and public sector issuers, banks, non-banks, technology solution platforms and market infrastructure providers, spanning EMEA and other global jurisdictions.

Our work on sustainable finance aims at protecting integrity in the sustainable lending market, supporting innovation and driving increased liquidity towards sustainable outcomes. We have played a leading role in developing market standards in sustainable finance, such as through the Green Loan Principles, Sustainability-Linked Loan Principles and Social Loan Principles which are widely used throughout the loan markets globally, as well as our recently released Guide to Transition Loans. To inform our work, we have a dedicated Sustainability Committee, as well as a Sustainable Finance Regulatory Committee, comprising of leading financial institutions active in sustainable finance. Full details can be found here.

Summary of LMA view and recommendations

Overall, the LMA and its members welcome the Commission's proposals to amend SFDR. The proposed categorisation system and introduction of three new criteria-based

[2] Regulation (EU) 2019/2088

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categories is an important step. It reflects prevailing market practice, addresses inconsistency and will improve efficiency in the market.

The introduction of a new "Transition" category (Article 7) for products which invest in, or otherwise contribute to, clear and measurable transition objectives is also helpful. It provides clarity for market participants implementing brown-to-green strategies without the need to rely on (and potentially stretch) the definition of "Sustainable Investments" and is an important step for mobilising capital towards transition investments.

The ability for FMPs to choose between the three proposed categories is further enhanced by the formal recognition of impact investing, subject to additional conditions that protect impact investment strategies and address potential greenwashing.

We have, however, identified several areas where the Proposals remain unclear and/or may present challenges to FMPs. With a view to ensuring that SFDR 2.0 is practicable and provides the requisite regulatory certainty for FMPs, the LMA's recommendations for amending or clarifying the Proposals are set out below.

Recommendations on general aspects of Proposals: alignment and interoperability of regulatory regimes, timing and requirements in Level 2 delegated act

Alignment and interoperability of regulatory regimes and disclosure standards

Given the global nature of financial markets, we recommend careful consideration of the Proposals to ensure alignment and interoperability with (i) international and jurisdictional sustainability-related regulatory regimes (including taxonomies and transition pathways and with sustainability preference rules under MiFID II and Insurance Distribution Directive); (ii) international sustainability disclosure standards (e.g., alignment of Principal Adverse Indicators (**PAI**) with International Sustainability Standards Board); and (iii) amendments to wider regulatory regimes (including changes to the MiFID definition of "professional investor").

Greater alignment and interoperability will achieve the overarching goals of reducing the administrative burden on FMPs, lowering compliance costs and improving comparability and efficiency.

Support smooth transition to the new regime, with clear timelines for the application of SFDR 2.0 and Level 2 delegated act, grandfathering and transitional provisions

It is essential to have clear and realistic timelines for the introduction of the new regime. The transition to SFDR 2.0 should be managed with clear dates of application, phased implementation, and practical guidance for firms navigating the change. This includes staggered implementation of SFDR 2.0 for fund-of-funds to allow any down-stream FMPs enough time to received and process relevant data.

The majority of our members are of the view that SFDR 2.0 should also expressly cover (i) the treatment of legacy products through the inclusion of grandfathering provisions; (ii) transitional arrangements for new fund launches; and (iii) options for early adoption or opt-out where appropriate. Issuing guidance on the treatment of fund launches during the transition phase should be addressed as a priority. This will help minimise operational disruption and provide confidence to both investors and FMPs.

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Avoid excessive technical layering of requirements in Level 2 delegated act and ensure clarity and usability of new templates and definition

Our members welcome the focus on reduced administrative burden with simplified Level 2 templates and minimal website disclosures.

In this context, the Level 2 delegated act should continue to ensure alignment and interoperability of relevant regulation (particularly in the context of any amendments to relevant regulations) and avoid excessively prescriptive technical layering of requirements. The timely publication, calibration and proportionality of Level 2 criteria and careful consideration of phase-in periods is essential to allow for a sufficient and effective transition from disclosures under SFDR to the new product categorisation.

Going forward, we recommend close engagement with industry stakeholders to test the usability of proposed disclosure templates before finalisation, ensuring that they are intuitive, reduce administrative burden, and support consistent application across different types of FMPs and asset classes. Ambiguous or overly complex templates risk undermining the objectives of the Proposals and increasing compliance costs in the process.

Comments and recommendations relating to exclusions

Mandatory exclusions should be aligned with existing regulation

The list of exclusions for the product categories is generally considered to be helpful. In particular, the inclusion of minimum EU Climate Transition Benchmark (**CTB**) and Paris-aligned Benchmark (**PAB**) exclusions provide consistent references for sustainable investment strategies as well as alignment with the approach set out in the ESMA "Guidelines on funds' names using ESG or sustainability-related terms" (**Fund Naming Guidelines**).

However, the majority of our members oppose the additional mandatory exclusions intended to apply to Article 7 and 9 product categories in addition to the CTB and PAB exclusions. These additional exclusions relate to stricter fossil-related restrictions across the value chain.

FMPs complying with the Fund Naming Guidelines may need to consider PAB exclusions under SFDR 2.0 in order to maintain specific terms in their names and to be eligible for a product category. The additional fossil-fuel related exclusions diverge further from requirements under the Fund Naming Guidelines and are likely to have a significant adverse impact on mobilisation of private sector capital for the energy and utilities sectors. In particular, these exclusions may significantly reduce the investable universe available to FMPs, adversely impact companies operating in the utilities sector and limit the flow of private sector capital for the purposes of financing the transition.

Many of our members are strongly of the view that the unintended consequences of these additional fossil fuel-related exclusions should be carefully considered. The LMA proposes that exclusions are (i) aligned with CTB and PAB and any additional layering is removed to ensure alignment and interoperability across disclosure standards; or (ii) revised in the context of the issues identified above with additional fossil-fuel exclusions applying in limited circumstances (e.g., by including exemptions to such exclusions for companies with credible transition plans).

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Further consideration is also required in respect of "automatic equivalence" included in SFDR 2.0 for funds tracking or managed by reference to CTB or PAB referenced strategies. This allows such funds (including passive funds) to be eligible for Article 7 or 9 categorisation without the need to comply with additional safeguards applicable to such product categories thereby resulting in potential variation of standards under the same product category.

Changes relating to use of PAI indicators

Provide further clarity on the discretionary use of PAI indicators at product level whilst continuing to monitor the administrative burden on FMPs

Our members welcome the removal of entity-level PAI statements. This is a particularly helpful amendment to SFDR and reduces the reporting burden on FMPs significantly.

The majority of our members are also in support of the approach set out in the Proposals which gives FMPs flexibility to identify and assess relevant PAI indicators (rather than use the indicators listed in Annex 1 of the SFDR RTS). Whilst further guidance is anticipated in the Level 2 delegated act, our members emphasise the need to focus on cross-regime harmonisation (including but not limited with the ESMA Fund Naming Guidelines and simplification of CSRD) and avoid an overlay of complexity and technical requirements in respect of PAI.

Specific recommendations relating to Article 6a and Article 8

Provide further detail for uncategorised Article 6a products on how to disclose sustainability/ESG claims, to avoid inadvertent greenwashing risk

Article 6a applies to uncategorised financial products. As currently drafted, the proposed restrictions under Article 6a could significantly curtail the ability of such products to make ESG-related references or to explain whether, and how, sustainability factors are considered as part of the investment process.

Article 6a provides that sustainability-related information must not constitute a "central element" of pre-contractual disclosures. In practice, this means that any such information must be secondary to the presentation of product characteristics both in terms of breadth and positioning, neutral in tone, and limited to less than 10% of the volume occupied by the description of the financial product's investment strategy. For many products, particularly alternative investment funds, this quantitative and qualitative limitation is likely to result in only minimal, high-level references that provide limited informational value to investors.

In addition, the scope of what constitutes adequate disclosure regarding the "consideration of sustainability factors" under Article 6a remains unclear. Article 6a requires that any sustainability-related statements must not result in, or suggest, that the product falls within Articles 7, 8, 9 or 9a. However, this requirement sits uneasily alongside Article 8(1), which restricts claims that a product "integrates sustainability factors beyond the consideration of sustainability risks".

As a result, it is uncertain how detailed a discussion of sustainability considerations under Article 6a may be before it is deemed to amount to a claim of "integration" and therefore triggers the prohibition under Article 8. In the absence of clearer guidance or more precise

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drafting, FMPs may struggle to distinguish between permissible factual explanations and prohibited sustainability claims.

In practice, this legal uncertainty may lead FMPs to adopt overly cautious approaches, potentially restricting marketing, disclosure and product development unnecessarily. To address these issues, further guidance or targeted amendments to Article 6a should be considered to clarify the types of sustainability-related statements that may be made by uncategorised products, and the boundary between "considering" and "integrating" sustainability factors. In our view, a more principles-based approach would better support SFDR's transparency objectives, while maintaining robust safeguards against misleading claims.

Consider renaming the Article 8 (ESG Basics) category

As the market moves towards a prescriptive categorisation system, our members have expressed concern around the proposed naming of the "ESG Basics" category (Article 8). The reference to "basics" is not reflective of the substantive integration of ESG considerations required for this category (noting the threshold, qualitative criteria, minimum exclusions and eligible investments) and this may, in turn, discourage adoption of the category in the market.

Our recommendation is therefore that Article 8 should be renamed using terminology that better reflects the analysis required for this financial product.

Other Issues

Improve the suitability of product categories for integration of private markets and real assets and introduce proportionality

Given the unique characteristics and data challenges associated with private markets and real assets, we recommend that the application of the product categories in these contexts be explicitly addressed within the Proposals and delegated act.

The Proposals should also provide for a proportionate approach for smaller firms and funds to ensure that reporting requirements are not unduly burdensome with appropriate guardrails in place for use by pooled funds and similar investment vehicles.

Seek further feedback on the market on inclusion of an exemption for alternative investment funds marketed to professional investors

The Proposals do not include an exemption for alternative investment funds which are marketed exclusively to professional investors. The LMA understands that such an exemption may previously have been under discussion.

The absence of a professional investor exemption in the final Proposals has elicited mixed views from our members with some members requesting reinstatement of the professional investor exemption on the basis of the sophisticated nature of such investors.

Given the potential impact of this exemption, the LMA proposes further active engagement with industry to determine the full impact of the removal of this exemption.

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Support collaboration with industry

In our view, ongoing dialogue with industry stakeholders is essential to the successful implementation of SFDR 2.0. We encourage an ongoing dialogue to gather feedback on any emerging challenges and unintended consequences with the new regime. This will help to ensure that SFDR 2.0 is fit for purpose, supports market integrity, and provides legal certainty for FMPs.

As the voice of the loan market in Europe, the LMA appreciates the opportunity to contribute to the discussions on the future of SFDR 2.0. We believe that continued dialogue between EU institutions and market participants will be critical to ensuring that the revised regime achieves its objectives of clarity, comparability and credibility, while being practicable for use across different asset classes and investment strategies.

We would welcome the opportunity to discuss the points raised in this paper further, to share additional market insights, and to support the effective implementation of SFDR 2.0, and invite you to contact gemma.lawrence-pardew@lma.eu.com or evelien.alblas@lma.eu.com should you wish to discuss this response in more detail.

Yours faithfully,

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