

European Commission announces overhaul of SFDR regime

November 2025

What has the European Commission published and why?

On 20 November 2025, the European Commission published its much-anticipated **proposal** to overhaul the SFDR regime (**Proposal**).

Acknowledging several shortcomings in the existing SFDR framework, the reforms are intended to simplify and reduce the burden of sustainability-related disclosures and requirements under the SFDR and improve end investors' ability to understand and compare sustainability-related financial products.

At a glance, what are the key elements of the Proposal?

- Introduction of a voluntary opt-in product categorisation regime for “sustainability-related” products which comprises of three categories, namely (i) a transition category, (ii) a basic ESG category and (iii) a sustainable category. Further details on each of these categories are set out below.
- All mandatory EU Taxonomy-related disclosure obligations are removed
- All entity-level PAI and remuneration disclosure obligations are removed
- The concept of “sustainable investment” has been removed from the framework
- Closed-ended funds created and distributed before the reforms are implemented fall outside of the scope of the revised framework
- Pre-contractual and periodic report templates will be simplified and shortened to a maximum of two pages
- No changes have been made to the existing sustainability risk disclosure obligations

What are the product categories put forward under the Proposal?

It is worth noting at the outset that not all funds which currently fall within the scope of Article 8 or Article 9 of the SFDR (and thus currently marketed as “ESG funds”) will automatically meet the criteria applicable to the relevant product categories under the revised framework. Depending on the current investment strategy of the relevant ESG fund, we expect that there may be some uplift required in order to avail of the new product categorisation regime.

While some of the more technical criteria applicable to each category will be set down in secondary legislation, the Proposal sets down a comprehensive framework for each of the categories, as detailed in the boxes below.

Transition Category

- Covers products making investments in companies and/or projects that are not yet sustainable but that are on a credible transition path or contribute to such transition
- 70% minimum investment in transition-related assets. These include:
 - Investments in portfolios replicating/managed in reference to an EU Climate Transition Benchmark or EU Paris-aligned benchmarks
 - EU Taxonomy-aligned investments²
 - Investments in undertakings/economic activities with a credible transition plan (as regards at least one sustainability factor)
 - Investments in undertakings/economic activities with credible science-based targets
 - Investments accompanied with a credible sustainability-related engagement strategy
 - Investments eligible for investment by products categorised as “sustainable” under the new framework
 - Investments following a credible transition target set at the level of the portfolio (such as reduction of portfolio emissions over time)
 - Other investments in undertakings/economic activities/other assets that credibly contribute to the transition to sustainability provided proper justification is provided in pre-contractual disclosures
- Must exclude investment in companies involved in tobacco or controversial weapons or found in violation of human rights or those generating significant revenues from coal or expanding their fossil fuel activities. An exemption is provided for certain use-of-proceeds instruments of otherwise excluded issuers.
- Must identify and disclose principal adverse impacts of their investments on sustainability factors and explain any action taken to address those impacts.
- Can be availed of by funds implementing an impact strategy. Such funds will be subject to specific disclosure obligations.

¹ This condition will be deemed satisfied for any transition product that invests at least 15% of investments in EU Taxonomy-aligned investments

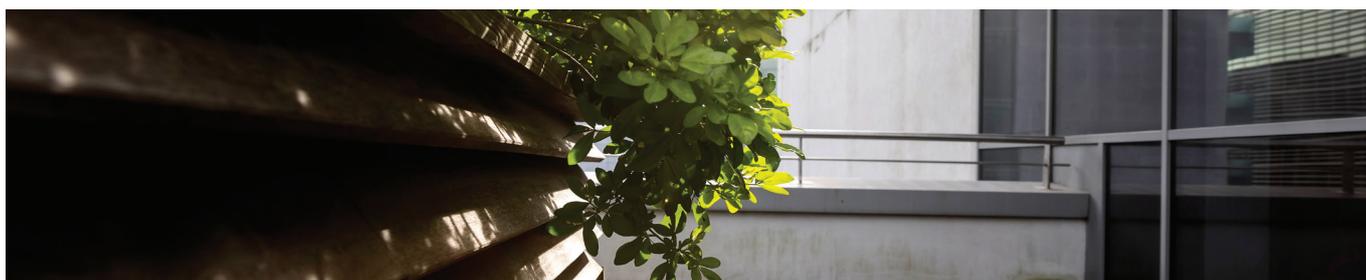
² This includes “transitional” taxonomy-aligned investments or CapEx plans

Sustainable Category

- Covers products contributing to sustainability goals (e.g. environmental or social goals) such as investments in companies or projects that are already meeting high sustainability standards.
- ³70% minimum investment in assets which have a clear and measurable sustainable objective. These include:
 - Investments in portfolios replicating/managed in reference to an EU Paris-aligned benchmark
 - EU taxonomy-aligned investments
 - EU green bonds
 - Comparable assets to those listed above
 - Investments and co-investments in EU budget-backed ESG instruments
 - Investments in European social entrepreneurship funds
 - Other investments in undertakings, economic activities or assets that contribute to an environmental or social objective⁴.
- Must disclose identify and disclose the principal adverse impacts of their investments on sustainability factors and actions taken to address those impacts.
- Must exclude investment in companies involved in tobacco or controversial weapons or found in violation of human rights or active in fossil fuels or high-emitting energy activities or expanding their fossil fuel activities.
- Can be availed of by funds implementing an impact strategy.

³ This condition will be deemed satisfied for any sustainable product that invests at least 15% of investments in EU Taxonomy-aligned investments

⁴ Environmental objectives should be understood as including those set down in the EU Taxonomy Regulation while social objectives should be understood as including the principles of the European Pillar of Social Rights and the United Nations Sustainable Development Goals.



ESG Basics Category

- Covers products which claim to integrate sustainability factors in their investment strategy beyond sustainability risks
- 70% minimum investment in assets which integrate sustainability factors which include:
 - Investments with an ESG rating which outperform their universe/reference benchmark
 - Investments which outperform the average investment universe/reference benchmark with reference to a specific appropriate sustainability indicator
 - Investments that favour companies or economic activities with a proven positive track record in terms of processes, performance or outcomes related to sustainability factors
 - Investments which are eligible for investment by the transition category and the sustainable category
 - Other investments which integrate sustainability factors (beyond risk management considerations)
- Must exclude investment involved in tobacco or controversial weapons or found in violation of human rights or those generating significant revenues from coal. An exemption is provided for certain use-of-proceeds instruments of otherwise excluded issuers.
- Cannot be used by funds implementing an impact strategy. Such funds will be subject to additional disclosure requirements.

The European Commission has also proposed that those products which invest in other categorised products (such as fund-of-fund structures for example) may avail of the product categorisation regime if they (i) meet the 70% threshold of investments by way of investment in categorised products and (ii) comply with applicable exclusion criteria.

What happens to those funds that do not avail of the product categorisation regime?

Non-categorised funds can include limited disclosures on whether and how they consider sustainability factors in their pre-contractual disclosures provided that such information is not a “central element” of such disclosures. To the extent that a non-categorised fund does choose to include such information in its pre-contractual disclosures, it will then be required to include a description of such consideration of sustainability factors in its periodic report.

In addition, non-categorised funds will not be permitted to make any sustainability-related claims in their marketing communications, in their names or in their PRIIPS KID/UCITS KIID (if relevant).

Existing disclosure requirements relating to the integration of sustainability risk into the investment decision-making process will continue to apply to non-categorised funds

What happens to the “sustainability preference” framework under MiFID II and the Insurance Distribution Directive (IDD)?

Under the existing MiFID II and IDD frameworks, those distributing financial products are required to gather information on the sustainability preferences of investors before recommending suitable financial products. The European Commission has confirmed that these frameworks will be updated to align with the new product categorisation framework under the SFDR. This is intended to help investors to find products with the level of sustainability ambition that match their preferences.

What next?

The Proposal must now be considered by both the European Parliament and the Council of the EU who will each publish their own position on the proposed revisions to the SFDR. Thereafter, triilogue negotiations between the three EU institutions will begin. In light of this, we would expect the revised framework to apply from late 2027/2028 at the earliest.

Contact Us

If you would like to discuss the above in further detail, please get in touch with your usual contact in Dillon Eustace or the authors listed below.

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