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SFDR 2.0 Asset Owner Considerations

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Introduction

This paper covers the updates that the European Commission (EC) is proposing to the Sustainable Finance Disclosure Regulation (SFDR), in what is known as SFDR 2.0. This follows on from the original examination paper by Cardano.

Whilst we acknowledge the many benefits that the original regulation brought to sustainability disclosures, we note that the regulation has been less fit for purpose for Asset Owners (AOs) with diversified portfolios such as pension schemes and insurers who fall under its scope. Mercer works with a wide variety of AOs globally and our clients have voiced concerns about the SFDR 2.0 proposed by the EC as lacking an AO perspective. We therefore highlight Mercer's key thoughts in this paper and provide comparisons with other global sustainability regulation which have provided positive outcomes for AOs.

As background, SFDR was originally introduced as part of the EU's Green Deal to help align private investor capital with the European Union's sustainability agenda, such as the 2050 net zero target. Prior to SFDR, it was difficult for AOs to compare funds and to help prevent greenwashing. In this regard there were many positive aspects to the regulation such as:

- Establishing a consistent disclosure regime: aligning funds, mandates and entities with SFDR Articles 6, 8 and 9 backed up by mandatory disclosures made it easier to evaluate funds and understand their sustainability objectives.
- Data standardisation: through the Principal Adverse Impacts (PAIs), which are uniform datasets covering various environmental, social and governance risks, AOs enjoyed enhanced transparency and comparability of sustainability factors.
- Capital realignment: high demand for SFDR Article 8 and 9 funds incentivized asset managers to create new investment products that had positive environmental or social impacts.

Notwithstanding these positives, SFDR has presented a challenge for AOs, who have borne a large technical burden of aligning with the regulation and reporting across highly diversified portfolios, while typically operating with significantly smaller internal sustainability teams.

For AOs who have pursued SFDR Article 8 status or PAI reporting, the "data chain" can be onerous. For example, AOs often rely on third parties for underlying portfolio data, yet inconsistencies in the interpretation of SFDR requirements lead to fragmented reporting across different third parties. This has forced some AOs into a time consuming process of data reconciliation to ensure their own entity-level disclosures are accurate.

Furthermore, many AOs find the SFDR disclosure templates rigid and designed for retail products rather than institutional investors with a diversified portfolio including a mix of funds, mandates and private assets. This creates a "compliance-first" culture where limited resources are spent on meeting reporting deadlines or data reconciliation.

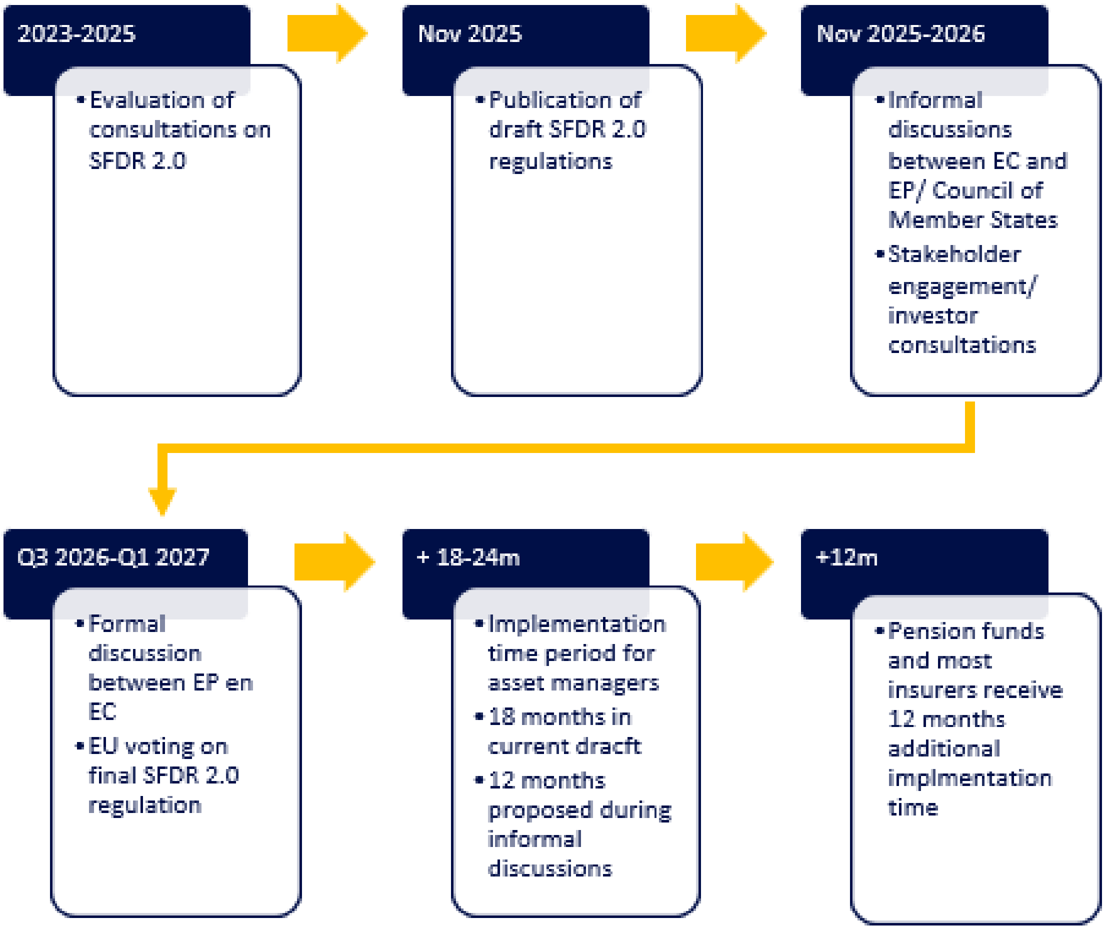
Our observation is that these challenges have often created a disincentive for many AOs to produce sustainability reporting under SFDR and has diverted resources away from driving positive environmental or social impacts through capital allocation. For example, many asset owners have sought to align with the Article 6 regime, whereby there are no sustainability objectives disclosed, or have opted out of PAI reporting. SFDR 1.0 has therefore had the perverse consequence of creating an environment of regulatory-led green hushing where many AOs do not publicly announce sustainability commitments or set climate targets for fear of opting into binding and time intensive disclosures. This is the opposite to what SFDR set out to do – to encourage sustainability action.

We feel it is important that in formulating SFDR 2.0, lawmakers place the AO perspective as a central pillar of the updated regulation.

SFDR 2.0 Process Update

Between 2023 and 2025, the EC conducted consultations to evaluate the functioning of the SFDR and to gather input for a potential revision. This process culminated in the publication of the draft SFDR 2.0 proposal by the EC on 20 November 2025. Throughout 2026, this proposal is being discussed in informal exchanges between the EC, Council of the European Union (EU Council) and European Parliament (EP). This phase is characterized by extensive stakeholder engagement, including the publication of position papers and active lobbying.

Timeline of SFDR 2.0



Recalibrating SFDR for diversified asset owners

A key concern among European AOs is the practical fit of the revised SFDR. In this paper, we highlight two examples that illustrate this misalignment and represent core focus areas of our engagement efforts.

1. The absence of legislative thresholds creates challenges for smaller AOs. Many AOs lack the resources required to meet the full set of SFDR 2.0 obligations needed for categorizations. As a result, they risk their products being "uncategorized," which, under the current proposal, would prohibit them from making any sustainability claims. This outcome appears disproportionate, particularly as these AOs may actively pursue sustainability objectives driven by client or participant preferences. Moreover, other EU frameworks, such as IORP II, already require these institutions to disclose sustainability-related information. While current discussions suggest that no formal threshold will be introduced – meaning smaller AOs will remain in scope – there is increasing momentum to better define what constitutes a "sustainability claim." We support an approach which enables smaller AOs to continue communicating and pursuing their sustainability strategies even when their products are uncategorized, rather than the regulation acting as a disincentive.

2. The categorizations framework itself poses significant challenges for AOs with diversified portfolios. SFDR 2.0 introduces three new product categories: ESG Basics, Transition, and Sustainable. To qualify for a category, AOs must meet specific criteria, including alignment of at least 70% of underlying investments with the category's objectives (or a certain EU-taxonomy alignment) and adherence to defined eligible investments. In addition, each category is subject to mandatory exclusions. Meeting these criteria is particularly difficult due to several structural factors.

   - Some AOs maintain a substantial allocation to government bonds. However, it is unclear whether government bonds can be considered eligible for meeting the proposed 70% investment threshold for the ESG Basics, Transition or Sustainable category. The EU Council has proposed government bonds to be fully eligible for the investment threshold for the ESG Basics category and partially eligible (for up to 15% of investments) for the Transition category, based on appropriate methodologies to assess the sustainability of those investments.

   - The categorization framework requires mandatory exclusions. However, many AOs rely on active ownership strategies – such as engagement and stewardship – rather than immediate exclusion. This is widely recognized as a valid and effective sustainability approach, especially for AOs that are long-term investors. Moreover, exclusions may be more difficult to apply consistently, for example in private markets, which are often part of diversified portfolios.

Taken together, these factors make it challenging for AOs to meet the 70% investment threshold for any of the categories, with ESG Basics appearing to be the only realistically achievable category in many cases, significantly reducing AOs' ability to make sustainability disclosures.

Learnings from other regulation

As a global investment consultant, we work with clients around the world who fall under a variety of different regulatory regimes. We examine a sample of these regulations that have been designed to guide investor action towards environmental and social objectives. We highlight the key features that we believe have helped to encourage participation amongst AOs in sustainability regulation, that could be considered in the design of SFDR 2.0.

Australia's Climate-Related Financial Disclosures (CRFD) was implemented in 2025 with the purpose of providing investors with transparent and comparable data to assess the potential impacts of climate change on the financial position of companies.

- Alignment with international standards: The Australian sustainability accounting standards which are aligned to international (IFRS ISSB) standards, enable data symmetry across investee companies. The regime was designed to address issues such as a lack of consistency and comparability in earlier voluntary climate disclosures, improving the decision-usefulness of reported data for AOs.
- Modified liability settings: For the first three years, reporting entities have protection from private litigation with regards to Scope 3 greenhouse gas emissions, scenario analysis and transition plans. Whilst there are some critics of this provision, it does encourage best-efforts reporting rather than defensive under-classification and fear of legal reprisal.
- Asset-size proportionality: Unlike SFDR, which entails a heavy reporting burden for all reporting entities, Australia's CRFD phases in its requirements. The largest entities are required to begin reporting in the first year, followed by medium-sized companies and large asset owners (with >A$ 5 billion in funds under management) in the second year, with smaller entities phased in in the third year.

Singapore: Monetary Authority of Singapore (MAS) Guidelines, updated March 2026: aim to prevent "emissions divestment bias" by financial institutions:

- Anti-divestment mandate: MAS explicitly guides AOs not to indiscriminately divest from high-emission sectors or emerging market regions. The regulation's focus is asking investors to evidence their work to support "dirty sectors" undergoing transition, rather than hitting an emission reduction target.
- Stewardship as a means of compliance: under MAS, a high-quality Engagement Log is a valid compliance document. This is used to evidence sustainability actions taken, for example an engagement with a utility company to request they progress their transition objectives.
- Governance around climate risk: MAS requires that the Board's Risk Appetite Statement must include climate variables. This moves sustainability into financial institutions' central risk function.

The UK Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations (2021): embeds climate change into governance, investment decision-making, and public reporting for occupational pension schemes with £1 billion or more of relevant assets.

- Trustee knowledge and understanding: Trustees subject to the regime must have sufficient knowledge and understanding of climate-related risks and opportunities to properly exercise their functions. The regulations have required trustees to upskill so trustee boards can interpret outputs and challenge advisers constructively.
- Requirement to set portfolio climate-related targets: Trustees are required to set at least one climate-related target and monitor progress against it on an annual basis. The UK government limited these targets to no more than 10 years in the future to ensure they remain decision-useful and encourage interim action rather than distant aspirational goals.
- Asset-size proportionality and reporting burden: The UK mandates that only the largest AOs (>£1 billion in assets under management) fall under this regulatory regime, so disclosure requirements are proportional to AO resources. This regulation is under review currently by the UK's Department for Work and Pensions to try and reduce reporting burdens as some pension trustee boards question the continuing value of annual climate reporting, particularly where their schemes have limited exposure to growth assets and fewer obvious levers to support the climate transition.

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