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Bridging the sustainability information gap: an assessment of the European sustainable finance framework

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Citation

Hartman-Ohnesorge, L. G. L. (2026, February 4). *Bridging the sustainability information gap: an assessment of the European sustainable finance framework*. *Meijers-reeks*. Retrieved from https://hdl.handle.net/1887/4288732

Version:	Publisher's Version
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Downloaded from:	https://hdl.handle.net/1887/4288732

Note: To cite this publication please use the final published version (if applicable).

6 Conclusion

1 Introduction

The European Sustainable Finance Framework ("EU SFF") is a collection of legislation that aims to increase sustainable investments to facilitate the transition to a climate neutral Europe, in line with the goal of the Paris Agreement of "[h]olding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels."[1] According to the Commission, there is an estimated annual investment gap of EUR 477 billion to bring the EU's economy in line with these sustainability ambitions.[2] In response to this, the fundamental idea behind the EU SFF is that investors who are provided with information on the sustainability impact, risks, and opportunities of their investment decisions will be enabled to make a well-informed investment decision that incorporates sustainability considerations. This transparency should increase the reallocation of capital toward sustainable economic activities.

To realize this aim, sustainability information must flow from issuers to investors. Often, there will be an intermediary between these two parties. The flow of information thus often has at least two stages, with information passing through several parties before reaching the final recipient, the investors. The legislation in the EU SFF regulates the generation and transmission of sustainability information both at issuer level and at intermediary level. To assess the effectiveness of the EU SFF, I have analysed five pieces of legislation that influence what sustainability information the investor receives. At issuer level, I have analysed the Corporate Sustainability Reporting Directive ("CSRD") and its European Sustainable Reporting Standards ("ESRS"), the Taxonomy Regulation ("TR"), the Prospectus Regulation ("PR"), and the European Green Bond Regulation ("EuGBR"). At intermediary level, I have discussed the Sustainable Finance Disclosure Regulation ("SFDR"), which regulates the sustainability disclosures by financial market participants and financial advisers.

1 Article 2 (1) (a) Paris Agreement.

2 Commission Staff Working Document Investment needs assessment and funding availabilities to strengthen EU's Net-Zero technology manufacturing capacity SWD(2023) 68 final, p. 3.

To assess the effectiveness of EU SFF in achieving its intended objectives, I have formulated the following research question: *To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities?* To answer this question, I have formulated three sub-questions that I addressed in Chapters 3, 4, and 5, respectively:

1. How effective are the ongoing disclosure requirements from the CSRD and article 8 TR in reducing information asymmetries regarding sustainability between issuers and investors?
2. How effective are the initial disclosure requirements from the Prospectus Regulation and the European Green Bond Regulation in reducing information asymmetries regarding sustainability between issuers and investors?
3. How effective are the disclosure requirements from the Sustainable Finance Disclosure Regulation in reducing the principal-agent problem between intermediaries and investors?

My research uses Law & Economics ("L&E") as a qualitative research method. This enables me to review the legislation through the lens of the market failures that have been established in L&E theory and evaluate whether the legislation is suitable to address those failures. By this process, I found that although the EU SFF can be considered a success from an L&E perspective in general terms, all legislation that I reviewed has some shortcomings, which, however, greatly vary in severity and impact. In paragraph 2, I provide an overview of my research. Beyond the flaws identified in individual legislation, my research has also revealed three fundamental flaws in the EU SFF. These systemic flaws and potential solutions are addressed in, respectively, paragraph 4 and paragraph 5 of this Chapter.

2 Overview

2.1 Normative Framework

For my analysis, I have relied on L&E as the qualitative research method that underpins my normative assessment of the EU SFF. This legal school of thought evaluates rules and institutions in terms of economic efficiency. In L&E, the market is seen as a vehicle of social progress and general welfare, whereby the law serves as a tool to eradicate the market failures that inhibit the market from functioning efficiently.

In Chapter 2, I discuss two fundamental premises of L&E. The first premise is that efficient markets result in the maximization of welfare. I argue that the concept of welfare must be interpreted as 'the value of everything'. More limited interpretations, such as the aggregate value of tradeable goods or GDP,

disregard the impact of non-marketable dimensions on collective well-being. This is particularly evident in relation to environmental and climate matters, which have historically been neglected in the maximization of wealth through markets, contributing to the current environmental and climate crisis. The second premise adopts the Kaldor-Hicks definition of efficiency. In this definition, efficiency is approached as a collective concept, namely, a state in which no aggregated gains can be realized that exceed aggregated losses. This definition is necessary in the context of sustainability, as the abandonment of harmful activities necessary to increase aggregate welfare may result in economic losses for some.

The core problem that the legislation in this thesis aims to tackle is the market's failure to reorient sufficient financing from non-sustainable to sustainable activities, even though this would increase overall welfare. This failure stems from the fact that parties that engage in activities with negative sustainability impacts profit from the externalization of costs, as society ultimately bears these negative externalities. This dynamic is repeated in investing, where investors who invest in those activities similarly profit from externalising costs, too, whilst sustainable economic activities are underfunded as investors may not realize the same benefit of externalising part of the costs. In other words, the current underfunding of sustainable economic activities is directly related to the failure of the market to align economic incentives for investors with general welfare.

The EU SFF focuses on two specific market failures that inhibit the flow of capital toward sustainable economic activities: information asymmetries and the principal-agent problem. Information asymmetries prevent investors from taking sustainability considerations into account in their investment decisions. The principal-agent problem is a situation in which these information asymmetries are exploited by the agent to realize its own interest contrary to the principals'. Both problems can diminish the ability and willingness to invest more sustainably.

Addressing information asymmetries and the principal-agent problem may contribute to mitigating the market failure of transaction costs due to their interconnected nature. However, the question remains whether investors will collectively and effectively reorient capital toward sustainable economic activities or whether other market failures such as biases in individual decision making and non-rational behaviour, externalities, free-riding and the tragedy of the commons will continue to stand in the way. More fundamentally, the idea of the self-interested and autonomous individual may be a significant obstacle to realizing the transition to a sustainable future through markets. It should, therefore, be kept in mind that the EU SFF is only aimed at resolving part of the problematic relationship between a market economy and anthropogenic climate change. My research question – *To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this*

framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities? – reflects this limitation by narrowing the scope of the research to the flow of information from issuer to investor.

2.2 Sustainability Disclosures for Issuers

The first level at which information is disclosed in the information chain is at issuer level. At this level, I have analysed five pieces of legislation that all influence what sustainability information is disclosed by issuers. These fall into two categories: disclosure obligations that apply on an ongoing basis, for example, every year, and disclosure obligations that only apply upon the moment that securities are issued, the initial disclosures.

For the ongoing disclosures, I have analysed the CSRD/ESRS and TR. For initial disclosures, I have looked at the PR and the EuGBR. In general, the ongoing disclosures are intended to provide an overview of how the entire business performed during the reporting period. These disclosures are aimed not only at investors but also at, for example, creditors of the business, civil society, NGOs, and social partners. Conversely, the initial disclosures focus primarily on the specific securities that are issued and are aimed at potential investors. This is also reflected in the sustainability information that is disclosed: whereas the ongoing sustainability information is more focused on the business in its entirety, the initial disclosures may contain more specific sustainability information related to the investment. To analyse how effective the legislation is in decreasing information asymmetries about sustainability at issuer level, I have assessed whether the disclosed information is:

1. Complete, meaning that it (a) covers all four aspects of the double materiality principle and (b) includes quantitative data; and
2. Coherent, meaning that core terminology and concepts are defined and used coherently throughout the legislation; and
3. Accurate, meaning that qualifying a financial product as sustainable either (a) is based on the Taxonomy Regulation or (b) is warranted by procedural safeguards that ensure the qualification is supported by scientific evidence.

2.2.1 Ongoing Disclosures

The CSRD/ESRS and the TR rely on complementary regulatory strategies to ensure that information disclosed by issuers is both comprehensive and accurate. The CSRD/ESRS mandate disclosures that are comprehensive, relevant, and neutral, thereby enabling investors to make independent assessments of an issuer's sustainability profile. The TR, in contrast, establishes normative and precisely delineated thresholds for qualifying activities as 'environmentally sustainable economic activities'.

This is reflected by CSRD requiring the disclosure of positive and negative impact on sustainability matters, and financial the risks and opportunities that arise by sustainability matters. These disclosures thus reflect the double materiality principle that is central to informed decision-making in relation to sustainability. The double materiality principle is further elaborated in the ESRS, which also contain detailed guidance on disclosure topics and metrics. The sustainability reporting on the basis of the CSRD/ESRS meets the standard of complete and provides investors with a comprehensive overview of the sustainability position of the business. Moreover, disclosures on the basis of the CSRD/ESRS are 'neutral' – they do not contain a normative judgement about whether sustainability impacts should be considered as positive or negative. Complementary to these disclosures is the qualification of issuer's activities, for which the TR establishes explicit criteria determining which economic activities qualify as 'environmentally sustainable economic activities.'

The investor thus not only receives comprehensive sustainability information necessary for a more holistic evaluation of the issuer but also standardised information on how to interpret the sustainability position of a business, necessary for comparisons between issuers. I therefore conclude that in general, the answer to the question: *How effective are the ongoing disclosure requirements from the CSRD/ESRS and article 8 TR in reducing information asymmetries regarding sustainability between issuers and investors?* should be answered positively, as both the CSRD/ESRS and the TR contribute to an effective flow of information from issuers to investors that includes both comprehensive and neutral information enabling independent assessments by investors, as well as more normative information that enables an efficient assessment of how the businesses performs in relation to the Taxonomy-regulation.

While the disclosures of sustainability information on the basis of the CSRD/ESRS and the TR at the beginning of the investment chain thus is suitable to enable informed investment decisions, the ongoing disclosures could be better streamlined. The various incoherencies that I identified in Chapter 3 pose a significant challenge for the effective transmission of information. The first type of incoherence is superfluous text that undermines an easy understanding of the law. Second, the structure of sustainability reporting that can be deduced from the article 19a (2) (a) – (h) CSRD, which contains reporting topics, does not match the structure of the ESRS at all – which are aligned to the TR. The third type of incoherence arises from illogical or ambiguous definitions where specificity is necessary. Another point is that the ongoing disclosure requirements are extremely complex, making compliance costly and possibly overloading investors with information. This may negatively impact the efficient functioning of the market in sustainable investments and can form a serious obstacle for reaching an (investment) decision.

2.2.2 *Initial Disclosures*

Sustainability disclosures in initial disclosures are significantly less regulated than ongoing sustainability disclosures. Initial disclosures are primarily regulated by the PR, which is not part of the EU SFF and predates this framework. Consequently, there is no explicit regulation of sustainability information in the prospectus, even though it is the primary instrument to inform investors on the securities that are issued.[3] This will change with the entry into force of the Listing Act in 2026, which will introduce a limited number of sustainability disclosures in the Prospectus regime. The new sustainability disclosure requirements differ between equity and non-equity securities. For equity securities, issuers must disclose in the prospectus summary whether their activities are Taxonomy-aligned, declare whether they prepare a CSRD sustainability report, and incorporate that report by reference into the prospectus. For non-equity securities like bonds, issuers must disclose whether the bonds are marketed as considering ESG factors or pursuing ESG objectives, and European Green Bond issuers must incorporate the required factsheet by reference. Consequently, the new disclosure requirements largely overlap with existing transparency obligations under the CSRD, Taxonomy Regulation, and EuGBR. The only substantively new requirement is the disclosure of whether non-equity securities are advertised with ESG considerations, though the exact details await further refinement in Delegated Acts.

Therefore, most sustainability disclosures in prospectuses will continue to be regulated by general open norms of the PR, in particular, the materiality principle, the obligation to specify the use of proceeds, and the obligation to disclose risk factors. Given the relevance of sustainability information to investment decisions, both for impact investors and for value-driven investors, sustainability disclosures will likely need to be made under these sections, both for sustainable and for non-sustainable issuances. In Chapter 4, I included a list of the minimum sustainability disclosures that I deem necessary under

3 When the Listing Act enters into force in 2026, a limited number of sustainability disclosures will be introduced in the Prospectus regime. These disclosures differ for equity securities and non-equity securities. For equity securities, the issuer must comply with three new disclosure obligations. First, the key information to be contained in the prospectus summary should include whether the activities of the issuer are Taxonomy-aligned (new art. 7 (6) (a) PR). Second, the prospectus should declare whether the issuer must draw up a sustainability report on the basis of the CSRD (new art. 13 (1) (f) PR). Third, the sustainability report should be included (by reference) in the prospectus (new article 19 (a) (f) PR). All these requirements will be further elaborated in Commission Delegated Acts. For non-equity securities, such as bonds, the issuer must disclose whether the bonds are advertised as taking into account ESG factors or are pursuing ESG objectives (new article 13 (1) (g) PR). See: Regulation (EU) 2024/2809 of the European Parliament and of the Council of 23 October 2024 amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises (Listing Act Regulation).

the open norms of the PR. Most importantly, in the case of sustainable issuances, issuers will have to explain in the prospectus why these are considered sustainable and how the proceeds of the bonds contribute to sustainability objectives. For non-sustainable issuances, issuers should at least disclose sustainability risks.

Even though the PR falls outside the EU SFF, it thus is likely that issuers will disclose some sustainability information in the prospectus because this information is material to investors. However, the absence of an explicit regulatory framework means that these disclosures are based on open norms that do not meet the parameters that I set for assessing whether the disclosures are successful in decreasing information asymmetries: completeness, coherence, and accuracy. One particular problem is that even if the issuer discloses meticulous information in the prospectus, the information will be idiosyncratic to that issuer. While this approach corresponds to the procedural transparency function of the PR, which encompasses issuers' interests in presenting security-specific information, the absence of guidelines on material sustainability topics and disclosure formats inevitably results in heterogeneous disclosures. This undermines the functioning of the market as it inhibits investors from comparing investment opportunities. The sustainability disclosures introduced under the Listing Act do not remedy this shortcoming due to both their limited scope and their lack of substantive new disclosure requirements.

If the activity that is financed by the issuance is Taxonomy-aligned, the issuer can decide to issue European Green Bonds in line with the EuGBR framework. As a label, the European Green Bond employs a regulatory strategy diametrically opposed to that of the PR, focusing not on the disclosure of comprehensive and neutral information but on conveying a singular, normative information point based upon strict material thresholds. This enables investors to efficiently identify whether bonds are Taxonomy-aligned without having to conduct their own analysis of the sustainability information that is disclosed by the issuer. In a market susceptible to information overload – stemming from extensive disclosures mandated by both the prospectus regime and the CSRD/ESRS framework, which can constitute a significant impediment to effective investment decision-making – the EuGBR label is exceptionally easy to interpret and is, therefore, a valuable tool.

The EuGBR meets my criteria for accuracy and coherency. However, it fails to correct the information gap that is left by the PR. The reason for this is that the EuGBR does not complement the PR in a manner that would create synergy between the two initial disclosure legislations – unlike the complementary dynamic between the CSRD/ESRS and the TR in the context of the ongoing disclosures. Two factors impede such a dynamic for the initial disclosures. First, the binary approach of the EuGBR, according to which a European Green Bond is Taxonomy-aligned, whereas all other bonds fall outside of the scope of the label. This binary approach, however straightforward, impairs the ability of investors to compare investments within one category.

This is especially problematic for the investment opportunities that are not European Green Bonds, which encompass the vast majority of the market. For this entire market, the EuGBR does not contribute to reducing information asymmetries. Second, the EuGBR may not become very popular: its extensive disclosure requirements represent a high regulatory burden, rendering the EuGBR less attractive for issuers than alternative market-based standards. Another problem that may negatively impact the usage of the EuGBR is that the Taxonomy requirements are so strict that it may be difficult to find eligible projects, especially outside of the EU.

In general, it is also evident that the initial disclosure regime does not match the ongoing disclosure regime. On the one hand, there can be advantages to using different disclosure frameworks: they can provide a more varied picture and complement each other's shortcomings. However, this is not the case for the PR and the EuGBR: neither complement the ongoing disclosures – but for different reasons. On the one hand, the PR is not part of EU SFF and does not contain any explicit sustainability disclosures that could complement the ongoing disclosures. On the other hand, the EuGBR is well-integrated into the EU SFF but will only be used by a very limited segment of the market and, therefore, cannot effectively enable investors to make better informed investment decisions across the market. In general, I therefore conclude that the question of: *How effective are the initial disclosure requirements from the Prospectus Regulation and the European Green Bond Regulation in reducing information asymmetries regarding sustainability between issuers and investors?* must be answered with some caution. While both instruments undeniably contribute to the flow of sustainability information to investors, there is minimal synergy both between themselves and with the ongoing disclosure regime. This results in a situation in which there is plenty of opportunity for improvement to mitigate information asymmetries between issuers and investors concerning specific securities.

2.3 Disclosures for Intermediaries

The second level in the information chain at which sustainability information is disclosed to investors is at intermediary level. These disclosures are regulated by the SFDR, which applies to financial market participants and financial advisers – intermediaries between issuer and investor that either provide investment advice or make investment decisions on behalf of end-investors. I have analysed the disclosures on the basis of the SFDR through the lens of the principal-agent problem, seeking an answer to the question of: *How effective are the disclosure requirements from the Sustainable Finance Disclosure Regulation in reducing the principal-agent problem between intermediaries and investors?* The principal-agent problem can be resolved by two mechanisms: better aligning the interests of the principal and the agent or decreasing information asym-

metries between both parties. The SFDR follows the latter approach by requiring sustainability disclosures. My analysis of the SFDR, therefore, focused on whether the SFDR sufficiently decreased information asymmetries. For this, I followed similar criteria as in the analysis of disclosures at issuer level. I assessed whether the sustainability information disclosed on the basis of the SFDR is:

1. Complete, meaning that it covers all four aspects of the double materiality principle; and
2. Standardised, meaning (a) that the information is harmonised between intermediaries to enable the investor to make a meaningful comparison between intermediaries, and (b) that information is standardized for financial products to enable comparisons; and
3. Accurate, meaning that (a) the information flow from issuer to intermediary is consistent to prevent information from being obscured or lost in translation and (b) that labels used on the basis of the SFDR are accurate.

The SFDR entails sustainability disclosure requirements on entity and on product level. However, while the SFDR significantly enhances the flow of information from intermediaries to investors, it fails to meet these criteria for multiple reasons.

In general, the double materiality principle is reflected throughout the SFDR, even though it is never explicitly acknowledged: entity level disclosures pertain to both the negative impact of the FMP or FA on sustainability factors and the negative impact of sustainability risks on the FMP or FA. Similarly, the product level disclosures contain information on sustainability risk (article 6), negative impact of the product on sustainability factors (article 7), and positive sustainability impact (article 8 and 9). However, the mandatory disclosures for a single financial product do not cover all four aspects of the double materiality principle since the topics of disclosure differ per financial product category. For 'neutral' products (article 6), the sustainability risk and the negative sustainability impact must be disclosed. For 'light green' and 'dark green' products (articles 8 and 9), the sustainability risk and the positive sustainability impact must be disclosed.

Under the SFDR, FMP or FA must disclose how they integrate sustainability considerations into their processes. Therefore, the SFDR contains no material thresholds and instead allows FMP and FA a relatively wide margin of discretion to finetune the disclosures to their specific context. A consequence of this is that substantive standardisation of the disclosed information is limited, making it difficult to compare financial products between intermediaries. While this generally aligns with the SFDR's regulatory strategy of enhancing procedural transparency, the inconsistent standardization requirements between articles 6, 7, 8, and 9 SFDR cannot be explained. The imposition of specific disclosure formats for sustainability risks and impacts for certain products (articles 6 and 7 SFDR), contrasted with the absence of equivalent format

requirements for others (articles 8 and 9 SFDR), represents an internal inconsistency that contradicts the procedural transparency approach on which the SFDR is based.

The most significant challenges for the SFDR are those concerning the accuracy of the disclosures. While no inherent reason exists to presume inaccuracy in SFDR-based disclosures when examining the regulation in isolation, fundamental challenges emerge when looking at the SFDR in the context of the EU SFF and its practical use. The first major challenge concerns the conversion of information on individual investments into aggregated disclosures at the financial intermediary level. Although the CSRD aims to generate issuer-level information that intermediaries require under the SFDR, the respective reporting formats diverge significantly. For example, the format of the principal adverse impacts ("PAI") that have to be used for indicating (negative) sustainability impact differs in structure from the ESRS. Consequently, intermediaries face the fundamental challenge of aggregating sustainability information based on issuer-level reporting that follows a structure materially different from SFDR requirements. This complexity is further exacerbated when financial products under the SFDR include investments in non-EU issuers for whom sustainability information may be either unavailable or non-harmonized. The second challenge for the accuracy of SFDR disclosures lies in the fact that article 8 and article 9 SFDR products are treated as labels in practice rather than procedural transparency requirements. However, labelling is a fundamentally different regulatory strategy from procedural transparency. Whereas procedural transparency necessitates comprehensive, relevant, and neutral information enabling investors to form independent assessments, labelling requires clear, predefined material thresholds that incorporate normative judgments. However, being of a procedural nature, articles 8 and 9 SFDR are fundamentally unsuited to function as labels, as they lack the material accuracy that investors presume they possess.

This assessment leads to a nuanced answer to the question of: How effective are the disclosure requirements from the Sustainable Finance Disclosure Regulation in reducing the principal-agent problem between intermediaries and investors? The SFDR greatly contributes to enhancing sustainability disclosures at intermediary level in a regulatory landscape where there was no harmonisation and investors had to rely on commercially driven practices to inform themselves. However, it must also be recognized that the SFDR has a number of fundamental shortcomings. Some of these are created by the regulation itself, such as the diverging disclosure topics for different product categories. Others are more practical, such as the challenges surrounding the conversion of information from issuer to intermediary level and the use of the SFDR as a labelling system. These shortcomings mean that there is still room for improvement to enhance the effectiveness of the SFDR in decreasing information asymmetries and thus minimise the principal-agent problem between intermediaries and investors.

3 Answer to the Research Question – Part I

3.1 Introduction

To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities? Through my research, I have arrived at a nuanced response to the first part of this question, comprising both a generally positive assessment of the EU SFF as a whole through an L&E lens while acknowledging that all legislation examined contains opportunities for improvement. Moreover, certain fundamental problems reverberate throughout the entire framework. In this paragraph, I first discuss why the EU SFF should be considered a success. Then, I discuss three fundamental flaws that impede the integration of sustainability considerations into investment decisions: misalignment of disclosure obligations throughout the information chain, the binary nature of the TR, and superfluous and overly complicated disclosures.

3.2 The EU SFF Enables Better Investment Decisions

The EU SFF is based on the presumption that the current underfunding of sustainable economic activities is caused by inadequate sustainability information in financial markets, as is recognised in the Action Plan: "[a] lack of clarity among investors regarding what constitutes a sustainable investment is a contributing factor behind this investment gap (…)."[4] The primary focus of the EU SFF thus is on limiting information asymmetries, which manifests across aspects and levels.

First, to make better-informed investment decisions, investors require comprehensive sustainability information about issuers. However, investors frequently engage with issuers indirectly through financial intermediaries. This presents a challenge: not only must information be generated at issuer level, it must also be transmitted accurately throughout the investment chain.[5] The EU SFF addresses this by introducing transparency requirements at different

4 Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: Action Plan: Financing Sustainable Growth COM/2018/097 final, paragraph 1.1.

5 Note that Securities are held via a chain of intermediaries in various countries (multi-tier holding). Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement (the Revised EU Shareholder Rights Directive), obliges custodians to assist an issuer in the transmission of information regarding shareholder rights for equity securities. Such legislation is lacking where bonds are concerned.

levels in the investment chain and at different moments. The CSRD/ESRS, TR, PR, and EuGBR govern issuer-level disclosures, with the CSRD/ESRS and TR mandating ongoing disclosures focused on the issuer as a whole, while the PR and EuGBR primarily information concerning specific securities for specific issuances. Complementarily, the SFDR regulates intermediaries, governing the disclosure of aggregated sustainability information across multiple investments at the intermediary level, encompassing both pre-contractual and periodic disclosure requirements. The EU SFF thus comprehensively covers the information chain in several ways.

Second, the various regulatory instruments employ different and complementary regulatory strategies. On the one hand, the CSRD/ESRS, the SFDR, and the PR are more focussed on (procedural) transparency by mandating comprehensive information of unevaluated and neutral information. This regulatory approach effectively balances businesses' need to provide context-specific disclosures with investors' need for material and complete information to form independent assessments of the sustainability profiles of issuers, intermediaries, or investments. On the other hand, the TR and EuGBR require the disclosure of whether certain material, normative thresholds have been met, thereby satisfying the investors' need for efficient assessments of the businesses' performance relative to those predetermined sustainability criteria. By combining different regulatory strategies, the EU SFF facilitates an information flow that is both comprehensive and efficiently interpretable, enabling investors to make investment decisions based on both detailed sustainability information and standardized sustainability qualifications. This enhances market efficiency by reducing information asymmetries while simultaneously providing standardized sustainability benchmarks against which investments can be evaluated.

My analysis of the EU SFF demonstrates that the framework should be considered a significant regulatory success from an L&E perspective. The EU SFF substantially reduces information asymmetries at multiple levels throughout the investment chain, at different moments in time in the investment process, and through complementary regulatory strategies. This significantly enhances the capacity of investors to incorporate sustainability considerations into their investment decisions and facilitates the redirection of capital flows toward sustainable economic activities. However, the effectiveness of the framework is also constrained by several structural deficiencies: misalignment of disclosure obligations throughout the investment chain, the binary nature of the Taxonomy, and unnecessary regulatory burden. While not undermining the overall value of the framework, these deficiencies do represent opportunities to enhance the effectiveness of the EU SFF.

3.3 Misalignment throughout Chain

Misalignment of disclosure obligations is the biggest obstacle to a comprehensive EU SFF that truly enables investors to make informed investment decisions that include sustainability considerations. Currently, the framework provides information to investors at three different moments and locations in the information chain. At issuer level, disclosures take place both on an ongoing basis and by means of initial disclosures. Additionally, investors receive information through intermediaries. This fragmented framework is necessary because the information needs of the investor vary at different levels and temporal moments in the information chain. Within this fragmented disclosure framework, the challenge lies in ensuring that all sustainability information accurately reflects the sustainability situation of the individual issuer or securities. However, as the disclosure obligations build upon one another, the process can become analogous to a telephone game, where the original message is distorted as it passes through different stages of the information chain. For example, the input used by intermediaries to generate sustainability information depends on previously disclosed issuer information. As the contents and formats of the mandatory disclosures differ, there is a significant risk for progressive misrepresentation.

A potential counterargument to this problem could be that investors receive information at all points in the investment chain, which may mitigate the problem that not all information is equally precise. Additionally, it could be argued that receiving information in different formats at different moments provides a more diverse and comprehensive picture of sustainability circumstances, thus enabling an even better-informed investment decision. This, however, overlooks two issues. First of all, it is not an argument to justify that some information is not representative of the sustainability status of the issuer. Second, the argument assumes that investors systematically use all information that is provided to them at different stages in the investment chain. This is not congruent with reality, as investors often only rely on limited information. For example, an investor may rely heavily on information provided by the intermediary but not familiarize herself with the annual sustainability reporting of all the issuers in her investment portfolio. Therefore, it is essential that disclosures at any point in the information chain accurately reflect the issuers' sustainability situation.

3.2.1 Misalignment between CSRD/ESRS and TR

The first risk for misalignment in the information chain is between the ongoing disclosure requirements of the CSRD/ESRS on the one hand, and the criteria for qualifying an economic activity as environmentally sustainable on the other hand under the TR. The CSRD/ESRS lay down very comprehensive disclosure requirements in three types of standards: the cross-cutting standards, the

topical standards on Environment Social and Governance, and the sector-specific standards which have not yet been released. These comprehensive disclosure requirements have deliberately been designed to provide an extensive overview of the business's positive and negative impacts on sustainability matters and of the financial risks and opportunities that arise from sustainability matters. The TR establishes the criteria for determining when an economic activity qualifies as environmentally sustainable. For this, the TR sets out individualized Technical Screening Criteria ("TSC") for predetermined categories of economic activities, as well as individualised do no significant harm ("DNSH") criteria. The categorisation in the TR follows the Statistical Classification of Economic Activities in the European Community ("NACE").

It is the explicit intention that the CSRD/ESRS aligns to the requirements in the TR.[6] At the moment, this is, for example, reflected in the fact that the ESRS follows the same reporting areas as the TR on the topic of environment. However, there are two points where alignment at the moment is flawed. First, the specific reporting topics of the individual activities in the TR are not (yet) incorporated in the ESRS. This makes sense as the current ESRS only include the general cross-cutting and topical standards whilst the TR are much more granular. The question is how well the topical standards will be aligned to the TR – will they follow or at least cover the NACE categorisation of the TR? And if so, will they include the same reporting metrics of the TR? When the reporting areas and metrics under the CSRD/ESRS do not correspond to the categories of economic activities and the metrics used under the TR, businesses must effectively navigate distinct disclosure frameworks. This is an extremely inefficient regulatory approach to generating sustainability information.

Second, under the TR, businesses must not only assess whether they meet the standards formulated in the TSC but also whether they meet the DNSH criteria. For some activities, these DNSH criteria have been specified, but mostly, businesses will have to use the generic DNSH criteria in the appendices of the TSC. These generic DNSH criteria contain general norms on the topics of climate, sustainable use and protection of water and marine resources, pollution prevention and use of chemicals, and protection and restoration of biodiversity and ecosystems. For any activity in the TR, there is a high likelihood that the business will have to report these generic criteria. It is therefore surprising that not all of these are included explicitly in the topical ESRS for Environment, which cover the same topics. Whereas those on climate are included, the others are not reflected sufficiently to prevent double reporting.

6 Recital 38 CSRD.

3.2.2 *Misalignment between Ongoing and Initial Disclosures*

The second misalignment in the information chain is between the ongoing disclosure requirements of the CSRD, ESRS, and TR and the initial disclosures required by the PR and the EuGBR. The initial disclosures are primarily regulated by the PR. This regulation predates the EU SFF and does not incorporate explicit sustainability disclosures. This means that sustainability disclosures in prospectuses are based on general norms from the PR, such as the materiality principle. That is hardly a guarantee that the disclosures adequately reflect the sustainability information that the issuer generates on the basis of the initial disclosures. An investor who relies exclusively on the prospectus without consulting the annual sustainability reporting, therefore, is at risk of obtaining an incomplete picture of the sustainability situation of the business in its entirety and the sustainability circumstances of the specific securities offered. This means that the investor is hardly able to make an informed investment decision. The EuGBR, which demands extensive sustainability disclosures for European Green Bonds, fails to close this information gap as it applies only to a small fragment of issuances due to its strict criteria and burdensome usage for issuers.

3.2.3 *Misalignment between Issuer Level and Intermediary Level*

The third misalignment in the information chain is between issuer- and intermediary-level disclosures, in particular, the mismatch between information generated and disclosed by issuers on the basis of the CSRD, ESRS, and TR and disclosures made by intermediaries pursuant to the SFDR. Maintaining the integrity of sustainability information from issuer disclosure to intermediary disclosures is challenging in itself, as issuer disclosures focus on individual issuers or securities, whereas intermediary disclosures aggregate sustainability information on multiple investments pooled together.

In light of this challenge, the SFDR falls short in preserving the authenticity of the information that is originally disclosed by issuers in two respects. First, the issuer disclosures under the CSRD/ESRS always cover four dimensions of the double materiality principle: the issuer's positive and negative impact on sustainability matters and the financial risks and opportunities by sustainability matters. In contrast, the SFDR does not have a single financial product type for which all four disclosures are mandated. Second, the TR establishes thresholds for qualifying activities as environmentally sustainable. However, the SFDR disregards these qualifications and introduces its own classification system for grey, green, or dark green financial products without any clear or specific thresholds. Consequently, an investor who only relies on information disclosed under the SFDR is at risk of not having an accurate picture of the (aggregated) sustainability impact, risks and opportunities associated with the financial product.

3.2.4 *Misalignment in Respect of Individual Securities*

The fourth misalignment is of a different type: diverging disclosure requirements for different types of securities. Ideally, the four disclosure aspects of the double materiality principle should be consistently available for each security. However, the current disclosure framework fails to mandate this. There are two levels in the disclosure framework where the consistent disclosure of the double materiality principle for all securities is undermined.

The first level in the framework where diverging disclosures for different types of securities appear is at issuer level in the initial disclosures. These are primarily regulated by the PR, which contains no explicit sustainability disclosures and thus fundamentally fails to harmonize sustainability disclosures across different types of securities. While the EuGBR does mandate the initial disclosure of comprehensive sustainability information in initial disclosures, due to its limited applicability, it fails to remedy the shortcomings of the PR. This creates a situation in which most securities will have no or little harmonised sustainability information in initial disclosures, whilst for a small segment, there will be extensive disclosures. Second, the SFDR contains mandatory disclosures of sustainability impact, risks and opportunities but fails to mandate them uniformly across all financial product types. Instead, for some products, the negative sustainability impact has to be disclosed, whilst for others, the positive impact must be disclosed. This approach further fragments sustainability disclosures for financial product types. The consequence of these two shortcomings is that the availability of sustainability information will vary greatly for individual investment opportunities. This is in direct contrast to the aim of enabling investors to compare sustainability across different investments.

3.4 Binary Taxonomy

The binary nature of the TR divides economic activities into two categories: environmentally sustainable and non-sustainable. This dichotomy is too reductive and creates multiple challenges that undermine the objective of the EU SFF to provide the nuanced information that is necessary for investors to incorporate sustainability considerations into their investment decisions in a meaningful manner.

3.4.1 *Binary Nature Undermines Useability for Investors*

The binary approach of the TR, whilst in line with the regulatory strategy of creating a normative and precisely delineated threshold for qualifying activities as 'environmentally sustainable economic activities,' fails to provide the nuance that is necessary for investors to make an informed investment decision. The

fundamental problem with this approach is that most activities are non-Taxonomy aligned due to the stringent criteria of the TR. However, as investors do not receive any indication of the relative environmental impact – whether an activity has an extremely negative sustainability profile or merely falls marginally short of the Taxonomy's criteria – the comparative value of the TR is undermined as no indication is provided on how the vast majority of economic activities relate to each other in respect of sustainability.

A potential counterargument to this is that the information that is provided in the sustainability reporting on the basis of the CSRD/ESRS provides the granular insights necessary to fully understand the sustainability impact of an economic activity and that the TR is a complementary tool to interpret that information. This argument, however, overlooks that a binary approach undermines the TR's ability to be a tool to interpret CSRD/ESRS disclosures. Instead, the binary nature of the TR creates a dilemma for investors. Either investors exclusively rely on the TR, which is efficient but means that they lack essential information on the relative sustainability impact of different investment opportunities across multiple issuers. Investors can overcome this shortcoming by familiarizing themselves with the extensive sustainability report of the issuer, which will render the TR largely superfluous. In either case, the TR is at the risk of failing both investors who want to inform themselves quickly and investors who conduct diligent research. For quick insights, the TR lacks necessary nuance; for extensive insights, the TR lacks added value. The binary nature thus creates the risk of rendering TR too reductive to be genuinely informative for investors.

3.4.2 *Watering Down of the Taxonomy*

That the binary nature of the TR is too restrictive is also reflected in two legislative choices that test the limit of the current reductive classification approach of the TR. The first example of this is the inclusion of 'enabling activities' and 'transitional activities' in Taxonomy-aligned activities. These two activities do not meet the Technical Screening Criteria ("TSC"). Instead, enabling activities are activities that "contribute substantially" to activities that are TR-aligned (article 16 TR). Transitional activities are activities for which there are "no technologically and economically feasible low-carbon alternative" but which nonetheless support the transition to a climate-neutral economy (article 10 (2) TR). Classifying these two activities as 'environmentally sustainable' even though they do not meet the TSC demonstrates that even within the system of the TR itself, the binary nature of the classification system causes tension as it does not properly accommodate for more nuanced categorisations.

The second example is the incorporation of fossil gas-based and nuclear activities into the TR.[7]

These legislative choices reveal that the Commission is struggling with the restrictive nature of the TR. The legislative aim was that the TR should only include activities aligned with the Paris Agreement objectives. However, numerous activities represent positive progression toward sustainability while falling short of this threshold. Nonetheless, investments are channelled to these activities. However, the approach of the Commission to address this problem – diluting the criteria to accommodate activities that fail to meet the TR's original aim – risks undermining the credibility of the Taxonomy as a (strict) classification system for 'environmentally sustainable' activities.

3.4.3 Negative Effect on Other Legislation

The binary approach of the TR has a direct negative effect on other legislation in the EU SFF, in particular, the EuGBR and the SFDR. The EuGBR aims to overcome the fragmented and market-based landscape of sustainability labels. However, its effectiveness is restricted by the binary categorisation system of the TR. Only bonds that finance Taxonomy-aligned activities can use the label. However, due to the strictness of the TR, only a small fragment of the market qualifies for the label. In combination with the fact that the current PR does not include comprehensive sustainability disclosures for securities in general, this causes a situation in which, for a small segment of the market, there is detailed sustainability information available, whilst for the majority of the market, there is little or unharmonized sustainability information.

With the SFDR, a different challenge can be observed. The SFDR divides financial products into three categories, including two sustainable categories: investments with environmental or social objectives and sustainable investments. This structure misaligns with the binary approach of the TR. Moreover,

7 Criticism includes the pending case CJEU, Action brought on 7 October 2022, T-625/22, (Austria v European Commission), in which is demanded that the decision to qualify investments in fossil gas and nuclear energy as "environmentally sustainable" is annulled. See also: Fouquet D., "Taxonomy for Sustainable Finance: A Difficult Topic for Europe, a Worrying Development for Our Democratic Principles", *Renewable Energy Law and Policy Review* 2022, vol. 11(1), p. 5; Fouquet D., "The Healing Force of Renewables Calls for a Nuclear Free Taxonomy in Times of Aggression." *Renewable Energy Law and Policy Review* 2022, vol. 10(3/4), 2022, p. 1; Letter from Minister for Climate and Energy for the Netherlands, Federal Minister for Climate Action, Environment, Energy, Mobility, Innovation and Technology for Austria, Minister for Energy and Digital Development for Sweden, Minister for Climate, Energy and Utilities for Denmark, "Statement fossil gas-based activities in the EU Taxonomy", 31 January 2022, available at: https://www.government.nl/documents/letters/2022/01/31/statement-fossil-gas-based-activities-in-the-eu-taxonomy, accessed on 25 January 2025; Nicolás E.S., "EU gas and nuclear rules derided as 'biggest greenwash ever'", *euobserver* (newspaper), 14 January 2022, available at: https://euobserver.com/green-economy/ard798d6c5, accessed on: 25 January 2025.

the two sustainable categories from the SFDR operate independently from the TR. It is difficult to conceptualize how the TR could effectively be integrated into the SFDR under its current configuration, as the categorization in the SFDR reflects market demand for differentiation between sustainable and highly sustainable products, which the binary TR cannot accommodate. This disconnect between the SFDR and the TR diminishes the value of the TR as an interpretive tool for the comprehensive information disclosed under the SFDR, whereas an alternative approach could significantly enhance synergies between these regulatory instruments.

3.4.4 Undermines Incentives to Become More Sustainable

Whilst the primary objective of the TR is to enable investors to make well-informed investment decisions and reorient capital toward sustainable investments, another aim is to incentivise investee companies to make their business models more environmentally sustainable to attract more funding. However, the binary approach of the TR potentially undermines this aim. For businesses that can confidently determine that their activities will never qualify as environmentally sustainable, the TR does not create any incentives to even make incremental steps toward an improved sustainability position.[8] Similarly, although somewhat less problematic, there are no incentives in the TR to further improve the sustainability impact of an economic activity once it has qualified as environmentally sustainable.

3.5 Unnecessary Regulatory Burden

There is no doubt that the EU SFF imposes a heavy burden on businesses subject to the CSRD/ESRS and TR and on financial intermediaries and advisers required to comply with the SFDR. This is justified by the urgent need to address the current climate crisis, which calls for more sustainable investments and a regulatory framework to facilitate those. However, the EU SFF also creates unnecessary burdens, which makes compliance unnecessarily costly for businesses. The unnecessary regulatory burdens are caused by two distinct problems: unnecessary legislative complexity and internal misalignment. The primary example of unnecessary legislative complexity ('messy' legislation) are the CSRD and ESRS. The CSRD contains lengthy but legally insignificant descriptions, the ESRS are excessively long, sometimes repetitive, and difficult

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8 For example: European Federation of Pharmaceutical Industries and Associations, "How the EU can incentivise environmental sustainability of new medicines", 3 October 2024, available at: https://www.efpia.eu/news-events/the-efpia-view/blog-articles/how-the-eu-can-incentivise-environmental-sustainability-of-new-medicines/, accessed on:12 December 2024.

to navigate. Although the CSRD and ESRS are the primary examples of 'messy' legislation, all legislation that I analysed in this research could do with some editorial work to enhance clarity and usability. The problem of excessive reporting requirements under the CSRD/ESRS has also been signalled in Draghi's 'The Future of European Competitiveness', which emphasizes that the regulatory landscape must facilitate competitiveness and resilience,[9] and in the Budapest Declaration, wherein European Heads of State and Government have called for a simplification of the regulatory framework, in particular for SMEs, calling for a reduction of reporting requirements of at least 25%.[10]

The second problem that causes unnecessary regulatory burden is the misalignments that I discussed in paragraph 3.2. In particular, the Taxonomy diverges from the environmental disclosures to be made under the CSRD/ESRS, and the SFDR with its PAIs has its entire own disclosure framework that is unconnected to the CSRD/ESRS and TR disclosures. This means that a lot of redundant disclosure work has to be done, which could be avoided in a more coherent framework. Ultimately, these two problems increase compliance costs and make sustainable investments unnecessarily expensive, which decreases the effectiveness of the framework.

3.6 Conclusion

In general, the EU SFF is a fantastic step forward to enable investors to integrate sustainability considerations into their investment decisions. The framework addresses market inefficiencies by targeting information asymmetries that contribute to the underfunding of sustainable activities, implementing comprehensive disclosure requirements at multiple levels throughout the investment chain. The framework employs complementary regulatory strategies – procedural transparency through CSRD/ESRS, SFDR, and PR providing comprehensive neutral information that, in general, align to the double materiality principle, alongside normative thresholds in the TR and EuGBR offering standardized sustainability benchmarks. The double materiality principle ensures the investor is informed on all four dimensions of sustainability, namely positive and negative impact, risks and opportunities. This information is complemented by the normative qualification of what is con-

9 European Commission, The Draghi report: A competitiveness strategy for Europe (Part A): A competitiveness strategy for Europe, September 2024, available at: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en; European Commission, The Draghi report: In-depth analysis and recommendations (Part B): In-depth analysis and recommendations, September 2024 available at: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en.

10 European Council, Press Release, Budapest Declaration on the New European Competitiveness Deal, 8 November 2024, available at: https://www.consilium.europa.eu/en/press/press-releases/2024/11/08/the-budapest-declaration/, point 4.

sidered as sustainable – Taxonomy-alignment – which enables investors to interpret the sustainability impacts of investment decisions.

However, the framework also suffers from three fundamental flaws that potentially undermine its effectiveness. First, misalignments throughout the framework. This means that if an investor only relies on part of the information that is disclosed, for example, only on the prospectus or on the SFDR information, there is a risk that the information does not accurately represent the sustainability impact, risks and opportunities. Second, the binary nature of the Taxonomy creates the risk that the TR is too reductive to be genuinely informative for investors and potentially inhibits capital flows to sustainable activities that fall short of the strict criteria used in the regulation. Third, the combination of extensive yet non-aligned disclosure requirements imposes a regulatory burden that, while necessary for many aspects, is excessive in respects.

4 Answer to the Research Question – Part II

4.1 Introduction

To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities? In this section, I present my two main recommendations for improving the EU SFF to optimize the reorientation of capital toward sustainability objectives. These recommendations are based on the overarching flaws that I have identified in paragraph 3. They partially deviate from the recommendations that can be found in Chapters 3 – 5, which have a narrower focus, namely on the specific legislation that is analysed in those chapters. Moreover, I briefly discuss the main proposals from the Commissions' Omnibus package aimed at decreasing the regulatory burden of the CSRD that was published on 26 February 2025.

4.2 Alignment

4.2.1 Mandatory Elements throughout EU SFF

Two elements should be contained in all mandatory disclosures throughout the information chain: the double materiality principle and Taxonomy-alignment. The reason to include these two complementary elements in the initial, ongoing, and intermediary disclosures is simple: It is essential information that investors need to make *informed investment decisions that integrate sustainability considerations*. The double materiality principle encompasses the four

dimensions of sustainability information in relation to an economic activity or business: the positive and negative impact on sustainability matters and the financial risks and opportunities that arise due to sustainability matters. Next to being acquainted with these four dimensions, it is necessary to know how Taxonomy-aligned the activity is because it helps to interpret the sustainability impact of the activity.

4.2.2 What Aligns to What

Alignment of the double materiality principle and TR-alignment throughout the information chain has several layers:

1. Both the double materiality information and the Taxonomy-alignment are disclosures that ultimately are generated by the issuer. Here, the first alignment challenge lies: ideally, the metrics for reporting under the CSRD/ESRS are identical to the metrics used in the TSC for determining Taxonomy-alignment. Contrary to the other steps in the EU SFF, these two pieces are already relatively well aligned. Firstly, the ESRS follow roughly the same structure as the TR. Secondly, the TR information is integrated into the sustainability reporting via article 8 TR. Two more steps will enhance the alignment between the CSRD/ESRS and the TR. First, the sector-specific standards for the ESRS that are currently being developed should closely match the activity categorization of the TR. There does not need to be one sector-specific standard per activity in the TR, but it should be clear which TR activities – or NACE codes – are included in which standard and all TR activities should be covered. Substantively, the sector-specific standards should align with the disclosure metrics that are required under the TSC to prevent double reporting. Second, the generic DNSH in the TR, for which there is a very high likelihood that the business will have to use them, should be better reflected in the topical ESRS. In this way, a business that has complied with the material topical ESRS can easily determine whether it meets the generic DNSH under the relevant activities in the TR. Better aligning the ESRS to the TR additionally creates the opportunity to evaluate which ESRS disclosures are redundant and can be deleted to reduce the regulatory burden of annual sustainability reporting.
2. The second layer in which sustainability disclosures must be aligned is the initial disclosures that are regulated by the PR. This legislation lacks any mandatory sustainability disclosures. In Chapter 4, I have proposed several elements to include in the PR to enhance sustainability disclosures in prospectuses. However, at a minimum, the information in the prospectus should cover two aspects: the four areas of the materiality principle and how Taxonomy-aligned the activities which are being financed through the proceeds are. This information primarily builds on the information

that issuers generate and disclose under the CSRD/ESRS and the TR framework. However, the information to be disclosed under the PR information may not be identical to the ongoing disclosures. There are two important modifications between the first and second layers that need to be taken into account when drafting the sustainability disclosures for the PR. First, the double materiality information in the PR should be disclosed more concisely than in the ongoing disclosures – a summarized overview of the main impacts, risks, and opportunities would ensure that the information is accessible enough to be easily interpreted. Second, when securities are issued for more specific activities rather than general financing of the issuer, the sustainability information should be more narrowly focused on those specific activities. This information should also be based on the ongoing disclosures, as the CSRD/ESRS framework requires reporting not only on firm-level but also in disaggregated form. Regardless of how these sustainability disclosures in the PR would exactly be shaped; it is essential to maintain the integrity of the information. To achieve this, the metrics and qualifications used in the CSRD/ESRS and TR should be maintained in the PR, regardless of the specific criteria that are ultimately developed.

3. The third layer of alignment of sustainability disclosures concerns alignment between issuer level and intermediary level disclosures, specifically focusing on the SFDR. There are two distinct aspects which must be better harmonized. First of all, the SFDR must integrate the double materiality principle and the Taxonomy-alignment. Second, the individual disclosure requirements for the different types of financial products must be harmonized.

The current SFDR categorizes financial products into three groups: neutral (article 6), light green (article 8), and dark green (article 9). These categorizations are not based on the classification framework that is established by the TR. To improve alignment between issuer and intermediary disclosures, the current system should be replaced with a mechanism that integrates the classification system of the TR whereby the SFDR categories represent a degree of Taxonomy-alignment. What is challenging is that financial products often combine multiple individual investments with varying degrees of Taxonomy-alignment and include non-EU securities for which no Taxonomy-data is available. The legislator thus must find a mechanism to qualify the aggregated impact of multiple investments. One approach could be to establish quantitative thresholds, for example, that at least 50% of financial products' combined value must be Taxonomy-aligned to qualify as a dark-green product. This will become more feasible if initial disclosures provide a clear indication of how Taxonomy-aligned the individual investment is, as proposed under the last point.

The second improvement to the SFDR framework is that double materiality and TR-alignment should be mandatory for all product types, regardless of their category. The legislator should, therefore, take a few steps. First of all, the multiple Annexes and tables for the PAI disclosures and the pre-contractual disclosures for products 8 and 9 should be merged, simplified and made mandatory for all product types. Second, substantively, the disclosures should contain a straightforward manner to disclose the four aspects of the double materiality principle, with disclosures that are, on an aggregated level, based on CSRD/ESRS disclosures where possible. To maintain the integrity of the information, the metrics and qualifications used in the ESRS/CSRD and TR framework should be maintained in the SFDR disclosures. Third, the disclosure of aggregated Taxonomy-alignment should be included.

4.2.3 Pros

The three recommendations formulated in the previous paragraph directly address two of the fundamental flaws described in paragraph 3: the misalignment between disclosure requirements and unnecessary regulatory burdens. On the first point, the recommendations ensure consistent and reliable sustainability disclosures throughout the EU SFF, which contributes to a system where the investor is enabled to incorporate sustainability considerations into the investment decisions irrespective of whether they access all information disclosed to them on the basis of the EU SFF or information disclosed under a part of the system. Moreover, the opportunities for greenwashing are minimized as issuers and intermediaries have less freedom in designating securities or financial products as sustainable in the prospectus or in SFDR disclosures. Secondly, by aligning the disclosures, redundant and inconsistent disclosures under the different parts of the EU SFF are minimized, which reduces the regulatory burden that is faced by issuers and intermediaries. By minimizing these two flaws, the recommendation thus contributes to a more effective EU SFF that better enables investors to make informed investment decisions that integrate sustainability considerations and is more practical.

4.2.4 Cons

There is one major drawback to better aligning different parts of the EU SFF: it will affect the scope of investments that can qualify as 'light green' or 'dark green' under the SFDR. At the moment, intermediaries are free to develop their own methodology and reasons for categorizing financial products under either sustainable category. As discussed in Chapter 5, this has significant drawbacks, inter alia, that the authenticity of the categorisation is not sufficiently safeguarded and that there is an increased risk of greenwashing. Better alignment would take away both concerns because the designation as 'light green' or 'dark green' would become more rigid. However, this also means

that many activities may be classified as ‘promoting environmental or social characteristics’ (“E/S”), or having ‘sustainable investment as its objective’ (articles 8 and 9 SFDR respectively) on other grounds that a certain degree of Taxonomy-alignment, cannot be marketed as light or dark green. This can be a serious problem for activities for which no Taxonomy-alignment must be determined in the first place, for example, investments outside the EU. This could potentially mean that those activities receive less financing as they may not be marketed under article 8 or 9 SFDR. On the other hand, if the level of Taxonomy-alignment of the total value of the investments is less than 100%, there still could be room for non-Taxonomy-aligned investments within those product categories. Better aligning the issuer and intermediary disclosures will thus require the legislator to strike a balance between the need for financing for non-Taxonomy aligned activities and the reliability of the ‘light green’ and the ‘dark green’ categories under the SFDR

4.3 Gradual Taxonomy

4.3.1 Introduce Multiple Categories

To overcome the problems that are caused by the binary Taxonomy, the current system should be upgraded to encompass a more nuanced categorisation of sustainability impacts. Two potential approaches are a three- or a five-category model, as depicted below.

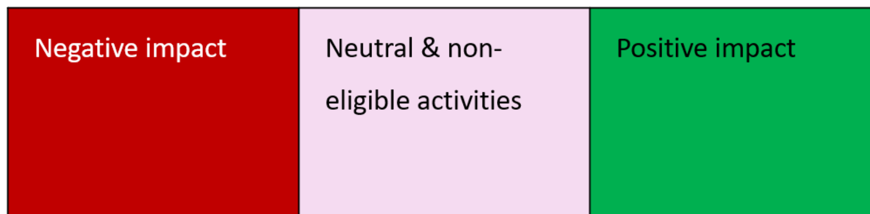

Figure 9: Three-category model. Source: Own image.

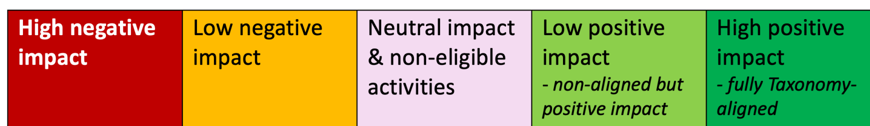

Figure 10: Five-category model. Source: Own image.

Whereas the three-category model aligns better with, for example, the proposal of the Platform on Sustainable Finance, the five-category model allows for more differentiation and recognizes that on both the negative and the positive side,

it is necessary to distinguish between sustainability impacts.[11] Implementing either system would require at least three major edits to the current TR. First, the TSC must be updated to contain more thresholds to differentiate between the different categories. Second, the DNSH criteria must be reviewed to determine how these relate to the different categories. It might be necessary, for example, to clarify that for the categories 'neutral', 'low positive impact' and 'high positive impact', no significant harm should be done to any of the other environmental objectives of the TR. Third, the scope of the TR should be expanded under this model to generically include all activities that are not specific under the current TR as 'neutral & non-eligible.'

4.3.2 Pros

The proposed models, and in particular the five-category model, offer four key advantages over the current binary Taxonomy. The five-category model addresses and, therefore, enhances the effectiveness of not only the TR but the EU SFF in its entirety.

The first reason to switch to the five-category model is that the current TR may not serve as an effective interpretative tool for sustainability impacts, which reduces its usability, since the binary nature of the TR renders it too reductive to be genuinely informative for investors. In particular, the five-category model overcomes this problem and provides a more nuanced and granular basis for comparing investment opportunities in terms of sustainability impact. At the same time, the five-category model is still an accessible and easy to interpret system.

Second, the five-category model addresses the current challenge for the legislator regarding activities for which there is a desire to encourage more financing, but which do not align with the current generally strict Taxonomy criteria. Multiple categories better cater to the need for financing for these types of activities. This is in particular so for transition financing – financing of activities which may not have a direct high positive impact, but which are necessary to reduce GHG emissions. This need is also a reason why a five-category model is to be preferred over the three-category model as proposed by the Platform on Sustainable Finance, which does not allow for differentiation within the negative or positive category.

Third, a gradual Taxonomy has positive effects on both the EuGBR and the SFDR. The main problem of the current EuGBR is that its scope is too limited, as only Taxonomy-aligned activities can carry the label. When all economic activities essentially have a label (ranging from 'high negative impact' to 'high positive impact'), this can be a reason to reflect on whether and how

11 Platform on Sustainable Finance, "The Extended Environmental Taxonomy: Final Report on Taxonomy extension options supporting a sustainable transition", *European Commission* March 2022.

the scope of the EuGBR could be broadened to include more investments. It could also be a reason to reflect on the added value of the EuGBR in general, especially if the gradual Taxonomy is introduced together with a better aligned EU SFF, in which, for example, the prospectus adequately reflects the double materiality principle and what Taxonomy-category the investment would fall into. For the SFDR, a gradual Taxonomy represents an opportunity for the legislator to create a more explicit link between Taxonomy-alignment and the SFDR product categories 'neutral,' 'light green,' and 'dark green' and make them more reliable. At the same time, it would be an opportunity to continue to reflect the demand for more differentiated labelling of (sustainable) investments at intermediary level.

The fourth advantage of a gradual Taxonomy over a binary one is that it creates incentives to become more sustainable, even for those activities that may never qualify as 'high positive impact'. This is especially so if the legislator creates opportunities to include 'neutral' activities (and possibly even a small amount of 'low negative impact' activities) in the 'light green' category of the SFDR. By stepping away from the all-or-nothing approach of the binary Taxonomy, businesses will be encouraged to make incremental improvements in their sustainability impact.

4.3.3 Cons

There are three major drawbacks for implementing a gradual Taxonomy. First, a gradual Taxonomy will increase the complexity of the EU SFF. This complexity has several dimensions. Primarily, the legislator will have to develop a nuanced system that distinguishes between three or five categories of sustainability impact. Creating multiple categories for sustainability impact will likely involve more than simply introducing multiple thresholds in the TSC. It is also likely to raise conceptual questions on how different parts of the TR relate to each other, in particular the TSC and the DNSH-criteria. For example, how should the gradual approach deal with situations in which an activity meets the thresholds in the TSC, but causes significant harm to one of the other environmental aims of the TR? Should the activity automatically be relegated to 'low negative impact' or 'high negative impact,' or should the gradual approach contain a proportionality assessment which would allow for 'neutral' or even 'low positive impact' categorisation in such a case? Next to the TR itself, the increased complexity will affect all legislation that incorporates TR information. As argued in paragraph 4.2, Taxonomy-alignment should be better integrated throughout the EU SFF. However, a more complex TR will require the legislator to balance carefully the increased complexity of a multiple-category model on the one hand and the need for straightforward legislation on the other hand.

Another problem of the gradual Taxonomy is that it increases the use of the TR throughout the EU SFF, which creates problems for those activities

that fall outside the TR framework. A gradual Taxonomy would mean that for securities issued inside the EU, there will be a Taxonomy indication available (ranging from 'high negative impact' to 'high positive impact'). When TR-alignment is better integrated in the EU SFF, in particular at intermediary level, this raises the question of how to deal with securities that have been issued outside of the EU. If those securities would be treated on par with 'non-eligible' European securities, this raises questions about how to integrate them into the SFDR system, especially when they have a non-EU sustainability label or have a high negative impact on sustainability matters. The legislator will also be facing the challenge of ensuring that neither non-EU securities are discriminated against, nor that EU securities are disadvantaged by having to indicate Taxonomy-alignment.

A third problem is that a gradual Taxonomy may have grave implications for those activities that are of 'high negative impact'. In their Report on Taxonomy extension options, the Platform on Sustainable Finance lists a number of concerns that fall under this problem. In particular, that high carbon intensity sectors are at a greater risk of being blacklisted, that these businesses may find difficulties in raising financing from banks and on markets, and that a mandatory negative categorisation effectively could mean the creation of stranded assets by law.[12] Given the current dependency on fossil fuel-intensive industries, these are legitimate concerns. Moreover, the legislator would need to carefully assess the wider economic implications, as the creation of stranded assets could have far-reaching effects on interconnected financial markets. Nonetheless, the need for reliable sustainability impact information persists, and the disclosure of sustainability impacts is already mandated within sustainability reporting under the CSRD/ESRS framework. The contribution of a gradual Taxonomy is that it would qualify this existing information through a normative spectrum of positive and negative impacts.

4.4 The Omnibus Proposal

On 26 February 2025, the Commission presented its proposals to reduce the regulatory burden of the CSRD/ESRS and TR in response to, *inter alia*, Draghi's 'The Future of European Competitiveness', which emphasises that the regulatory landscape must facilitate competitiveness and resilience,[13] and the Buda-

12 Platform on Sustainable Finance, "The Extended Environmental Taxonomy: Final Report on Taxonomy extension options supporting a sustainable transition", *European Commission* March 2022, p. 21-22.

13 European Commission, The Draghi report: A competitiveness strategy for Europe (Part A): A competitiveness strategy for Europe, September 2024, available at: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en; European Commission, The Draghi report: In-depth analysis and recommendations (Part B): In-depth analysis and

pest Declaration, wherein European Heads of State and Government have called for a simplification of the regulatory framework, in particular for SMEs.[14] These proposals, collectively referred to as the Omnibus package, are aimed at simplifying sustainability disclosure rules whilst keeping to the overall ambition of the European Green Deal.[15] The package contains a number of proposed actions, most importantly:

1. Limit the scope of the CSRD/ESRS to large businesses with over 1000 employees and a turnover exceeding EUR 50 million or a balance sheet exceeding EUR 25 million.[16]
2. Limit the scope of article 8 of the Taxonomy Regulation, which requires businesses to disclose Taxonomy alignment, to businesses with more than 1000 employees and a net turnover exceeding EUR 450 million.[17]
3. Remove the sector-specific sustainability reporting standards from the ESRS altogether.[18]

These radical proposals must be seen in the context of the changing political landscape in which the Russian war against Ukraine has driven up energy prices for EU businesses, and trade tensions have been rising since the election of US president Trump.[19]

While the Omnibus proposals undoubtedly will decrease the regulatory burden that is currently imposed by the EU SFF, they also risk undermining the entire framework. While procedurally easy, removing the sector-specific sustainability reporting standards altogether sacrifices the potential for enhanced synergy between the TR and the ESRS. Businesses that are required to assess their TR-alignment will need to generate this information anyway, rendering the elimination of sector-specific reporting requirements under the ESRS both unnecessary and counterproductive. Much more problematic, however, are the proposals to limit the scope of the CSRD/ESRS and the TR.

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recommendations, September 2024 available at: https://commission.europa.eu/topics/eu-competitiveness/draghi-report_en.

14 European Council, Press Release, Budapest Declaration on the New European Competitiveness Deal, 8 November 2024, available at: https://www.consilium.europa.eu/en/press/press-releases/2024/11/08/the-budapest-declaration/, point 4; calling for a reduction of reporting requirements of at least 25%.

15 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directives (EU) 2022/2464 and (EU) 2024/1760 as regards the dates from which Member States are to apply certain corporate sustainability reporting and due diligence requirements COM(2025) 80 final ("Omnibus-I COM(2025)80") p. 1-2; Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directives 2006/43/EC, 2013/34/EU, (EU) 2022/2464 and (EU) 2024/1760 as regards certain corporate sustainability reporting and due diligence requirements COM(2025) 81 final ("Omnibus-I COM(2025)81"), p. 1-2.

16 Omnibus-I COM(2025)80, p. 3-4.

17 Omnibus-I COM(2025)80, p. 4.

18 Omnibus-I COM(2025)81, p. 4, 15.

19 Omnibus-I COM(2025)80, p. 2.

By removing up to 80% of reporting businesses from the scope of the CSRD/ESRS and an even larger proportion from disclosing TR-alignment, the two critical information points needed for making an informed investment decision that incorporates sustainability considerations are limited to only a fraction of the issuers.[20] This will cut off the flow of sustainability information from the source and effectively weaken the intermediary disclosures, making it more difficult for FMPs and FAs to compile the information necessary for SFDR disclosures.

Drastically limiting the scope of the CSRD/ESRS and TR may seem like a cost-effective way to boost the European economy. However, this approach would also undermine the ability of investors to make informed investment decisions that incorporate sustainability considerations and thereby inhibit the flow of capital toward sustainable activities. As discussed in Chapter 2, the (mis)allocation of capital to non-sustainable activities may appear economically advantageous in the short-term. Businesses that externalize their environmental damage profit from their activities whilst externalizing the costs to society and future generations. Consequently, these businesses may categorically realize more financial profit than sustainable businesses that internalise their environmental costs, making them more competitive. However, from an L&E perspective in which welfare is defined as the "value of everything in society", this is a counterproductive approach to economic progress. While it may benefit individual businesses and their investors, society at large experiences economic losses from polluting activities. It is, therefore, surprising that the Commission proposes to limit the transparency mechanisms that enable investors and society at large to gain a better understanding of the environmental costs and benefits that individual businesses impose upon society. Instead of a simplistic deregulation approach, the Commission should consider how to enhance the effectiveness of the framework by better aligning the necessary disclosures and eliminating those that serve no purpose in light of the aims of the EU SFF.

4.5 Conclusion

The research question central to this thesis is *To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities?* I identified various smaller and larger potential points of improvement that would contribute to optimizing the EU SFF. However, the two fundamental and overarching reforms that I discussed in this paragraph are

20 Omnibus-I COM(2025)80, p. 3.

particularly important to consider, as they would have a major impact in enhancing the effectiveness of the entire framework.

First, the flow of information throughout the different parts of the EU SFF must become better aligned. This requires, at a minimum, the implementation of two disclosure requirements throughout the EU SFF: the double materiality principle and Taxonomy-alignment. Both elements are pivotal in enabling investors to make an informed investment decision that meaningfully integrates sustainability information. Second, the TR must be expanded to include more categories to better cater to both the information demand of investors and the financing demand of the industry. While these proposed modifications present certain legislative challenges and may intensify regulatory pressure in specific areas, the improved EU SFF should eliminate redundant reporting and decrease the general complexity of the framework that is caused by mismatched legislation. An additional benefit would thus be that the entire system would become more efficient for issuers, intermediaries, and investors.

5 Final Thoughts

The climate crisis is undeniably linked to our neoclassical economy, in which the idea of maximizing individual utility has legitimized the systematic exploitation of natural resources at the expense of collective welfare. It is therefore unsurprising that many thinkers across all disciplines question whether capitalism itself should be replaced with a system that has solidarity, integral ecology, and the common good as its core principles. However valid the critique of the current economic system may be, it should not preclude serious attempts to reform that same system. The EU SFF represents a serious attempt to contribute to reforming the current economic system: by mandating sustainability disclosures throughout the investment chain, the EU SFF enables all actors to consciously move away from exploitative and destructive economic activities and reallocating capital toward an economy that prioritizes sustainability and general well-being.