

Defence Tech, ESG and the Sustainable Finance Disclosure Regulation

It's fair to say that the world was a different place when the Sustainable Finance Disclosure Regulation (SFDR) was published in 2019.

In the last five years, the geopolitical environment has changed significantly, with energy security now taking precedence over net-zero, such that nuclear and natural gas are now considered a key part of the energy transition, and many investors' previous aversions to the defence sector being reversed, with national security and resilience taking centre stage.

“ESG” is now described by many as “Energy Security and Guns”

We quickly moved from a position where NATO forces were training Ukrainian volunteers in 2022, to Operation Hedgehog in 2025, where 10 Ukrainian drone operators took out two battalions in simulated exercises in Estonia. In order to attempt to plug the defence gap, according to the European Defence Agency, defence spending increased by 98% from 2020 to 2025.

While most of this defence spending will follow more traditional funding routes, there is now a recognition that defence and dual-use investments can be considered as “sustainable investments” for the purpose of SFDR. A link to the European Commission's notice on this matter can be found here: [ac79ebc7-d2f1-4e7a-a79c-71a06a5fdbf8_en](https://ec.europa.eu/commission/presscorner/detail/en/ac79ebc7-d2f1-4e7a-a79c-71a06a5fdbf8)



A quick reminder on SFDR

SFDR is the EU's framework that requires asset managers and other financial market participants to disclose how they integrate sustainability risks and impacts at both firm and product level, so investors can compare products and avoid greenwashing. It aims to increase transparency on how financial products consider sustainability risks and the adverse impacts of investments on environmental and social factors. Its intention was to channel private capital towards the transition to a net-zero, more sustainable economy.

Key to this, and of particular relevance to PortCo's, is that it requires granular information on investments to be passed up the investment chain to allow these goals to be met.

However, it was poorly drafted and, while it wasn't intended as a product classification regulation, as such, the market has fixated on this notion, with three tiers of product type:

Article 6: those with no specific ESG characteristics or objectives – typically, defence tech funds would fall within this category.

Article 8: those that *promote* environmental or social characteristics – not necessarily having ESG at their core but having some sort of ESG promotion, sometimes referred to as “light green” Funds risk tripping into this category by virtue of having a degree of ESG characteristic promotion.

Article 9: have sustainable investment as an explicit objective – within parameters, defence tech could feasibly fit within this category, but it is less likely.

Funds cannot be marketed as “sustainable” without evidence and standardised disclosures under this framework as they would risk a sanction for either greenwashing or green bleaching.

Defence tech and dual-use assets as "sustainable investments" under SFDR

As mentioned above, the European Commission issued a notice supporting investment in the European defence industry, saying that investments in defence can qualify as “sustainable investments” under SFDR if they both “*contribute to an objective*” (either social or environmental) and “*do no significant harm*”.

This clarification means that many Article 8 or 9 funds *can* allocated to defence tech, including dual-use, cyber, space and autonomy.

However, there are a number of practical challenges associated with this. SFDR is concerned with disclosure, which causes immediate challenges in a sector that is rightly concerned with secrecy. And the practical aspects of meeting ongoing reporting compliance are equally challenging.

Practical Challenges for Defence/Dual-use companies seeking investment from Article 8/9 SFDR Funds

Defence companies seeking capital from Article 8 SFDR funds face several intertwined challenges, mainly around providing granular, forward-looking ESG and PAI data (see below), demonstrating robust governance and human-rights safeguards, and addressing investor/reputational sensitivities around weapons exposure. These go beyond generic corporate disclosure and often require them to build new data, compliance and reporting infrastructure tailored to sustainable funds' expectations. These challenges disproportionately affect smaller defence-tech or dual-use firms, being faster moving environments where governance is less formalised.

Article 8 fund requirements and PAI data

Article 8 funds must disclose how they promote environmental or social characteristics and how they consider Principal Adverse Impacts (PAIs), including specific indicators relevant to weapons and human rights. Defence issuers therefore need to supply reliable data on factors such as controversial weapons exposure, civilian harm risk, and human-rights policies, which may not be captured by standard financial reporting systems.

Exclusions and weapons-related screening

Most Article 8 and Article 9 funds explicitly exclude controversial weapons (e.g. cluster munitions, anti-personnel mines, CBRN), and some use broader conventional weapons or defence-sector screens. Defence companies have to map their product mix and revenue streams to these screening criteria and provide evidence that they do not breach controversial-weapons prohibitions or clearly segment and report activities to allow investors to carve out ineligible business lines.

Governance, end-use, and due-diligence expectations

Investors that choose to include defence exposure increasingly expect strong governance, rigorous human-rights and end-use due diligence, and continuous controversy monitoring to manage reputational and regulatory risks. Meeting these expectations requires formal policies (e.g. on export controls, sanctions, customer vetting, end-use monitoring) and demonstrable processes, as well as incident reporting and remediation mechanisms that go beyond what is mandated by traditional defence-procurement rules.

Data availability and ESG ratings

Defence companies often suffer from limited or inconsistent coverage by ESG data providers, and their activities may be treated conservatively in scoring methodologies, creating an additional hurdle for Article 8 funds that rely on third-party data in their disclosures. To attract capital, issuers may need to fill data gaps proactively by publishing detailed sustainability reports, aligning with international standards on responsible business conduct, and engaging directly with ESG rating agencies to ensure the specifics of defence activities are properly reflected.

Regulatory and policy uncertainty

Notwithstanding the European Commission's notice on the possibility of defence tech being a “sustainable investment”, EU policymakers are still in the process of clarifying exactly how defence fits within the EU sustainable finance framework, including SFDR, which creates uncertainty for both investors and issuers.

Internal capacity and compliance burden

Building the capability to meet Article 8 investors' reporting needs can be resource-intensive, especially for smaller or earlier-stage defence, security and resilience companies. Challenges include limited internal ESG expertise, the need to interpret evolving regulatory language, and the administrative load of aligning multiple reporting frameworks (SFDR, CSRD, CSDDD and sector-specific rules) with existing defence-compliance structures.

Will SFDR 2.0 help?

Since SFDR was not particularly well received by the industry, it went through a review and re-draft, with the European Commission publishing a draft text of an updated Regulation at the end of 2025. This is currently under deliberation by the European Parliament and Council.

Politically speaking, the direction of travel is to make it compatible with defence and dual-use, but it is still a clumsy tool for defence tech specifically and only partially fit for purpose. Conceptually, it's out of date, and fits the old notions of ESG, rather than defence readiness; the Commission is effectively retrofitting defence into the social-sustainability box.

We also still have “sustainable” and “non-sustainable” buckets for disclosures, which sits awkwardly with the nature of lethal capability, even if justified as contributing to peace.

The onerous DNSH and PAI regimes are not tailored to weapon systems, export-control regimes or battlefield use-cases.

Finally, the data requirements will be more granular, which will increase the compliance cost and further disadvantage earlier-stage PortCo's.

Conclusion

The inclusion of defence and dual-use investments within the scope of “sustainable investment” under SFDR reflects a clear shift in political priorities, but the regulatory framework has yet to catch up with that reality. While capital is beginning to flow, the friction created by disclosure obligations, data requirements and conceptual misalignment means that SFDR remains an imperfect regime for supporting defence readiness. Unless SFDR 2.0 evolves beyond retrofitting defence into legacy ESG constructs, both investors and PortCo's will continue to navigate a system that acknowledges the necessity of defence but struggles to accommodate it in practice.

Fieldfisher's cross-practice industry-focused team has supported space and defence clients for over 30 years, including time spent in industry, giving us a deep understanding of the unique challenges and opportunities. We understand the nuances and the bigger picture, allowing us to deliver advice which is both legally sound and operationally useful. We support across the entire industry value chain – from investors to cutting-edge start-ups, regulators and Government procurement, global aerospace and defence manufacturers, satellite and launch operators, and all areas of the critical supporting infrastructure. With our experience working on all sides of the table, we help our clients efficiently navigate the complexity and compliance burdens of the space and defence industry.



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