The EU Taxonomy Regulation – Giving sustainable investing a good name

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In brief...

There is no denying that that the EU has lofty and commendable ambitions when it comes to sustainability. With its aims to decouple economic growth from resource use and make Europe the first climate neutral continent by 2050, sustainability is firmly on Europe's agenda.

Action plan: Financing sustainable growth

One of the many initiatives as part of the European Green Deal[1] 1 was the development of an Action Plan for Financing Sustainable Growth[2] (the Action Plan). One of the European Commission's main objectives in its Action Plan was to reorient capital flows towards a more sustainable economy. Action 1 of the Action Plan was to establish an EU classification system for sustainable activities, recognising that clear guidance on activities that qualify as contributing to environmental objectives would help inform investors about the investments that fund environmentally sustainable economic activities.

Taxonomy Regulation

On 12 July 2020, Regulation (EU) 2020/852[3] (the Taxonomy Regulation) came into force, bringing with it an exhaustive list of environmental objectives being:

- climate change mitigation;
- climate change adaptation;
- the sustainable use and protection of water and marine resources;
- the transition to a circular economy;
- pollution prevention and control; and
- the protection and restoration of biodiversity and ecosystems (together, the Environmental Objectives).

The Taxonomy Regulation enables market participants to determine whether an economic activity qualifies as environmentally sustainable, thereby facilitating cross border sustainable investment and discouraging the practice of greenwashing, which refers to the marketing a financial product as environmentally friendly, when in fact it isn't.

Article 3 (Criteria for environmentally sustainable economic activities) of the Taxonomy Regulation is the key provision when trying to determine the degree to which an investment is environmentally sustainable and provides that an economic activity shall qualify as environmentally sustainable where that economic activity:

- contributes substantially to one or more of the Environmental Objectives set out in Article 9 (Environmental objectives) with the requirements for what constitutes a "substantial contribution" in respect of each Environmental Objective set out in Articles 10 (Substantial contribution to climate change mitigation) to 16 (Enabling activities);
- does not significantly harm any of the Environmental Objectives in accordance with Article 17 (Significant harm to environmental objectives);
- is carried out in compliance with the minimum safeguards laid down in Article 18 (Minimum safeguards); and
- complies with certain technical screening criteria that the European Commission will establish and which will set out in greater detail the requirements:
  - for making a substantial contribution in respect of the relevant Environmental Objectives; and
  - for determining whether an activity causes significant harm to one or more of the Environmental Objectives.

The requirements for the technical screening criteria are further elaborated on in Article 19 (Requirements for technical screening criteria). Article 20 (Platform on Sustainable Finance) of the Taxonomy Regulation further mandates the establishment of a Platform on Sustainable Finance which is to be composed of various agencies, interest groups and experts and which will, among other things, advise the European Commission on the technical screening criteria, analyse aspects of the technical screening criteria and undertake certain monitoring and reporting roles.

Amendments to Regulation (EU) 2019/2088[4]

Regulation (EU) 2019/2088 on sustainability related disclosures in the financial services sector (the Disclosure Regulation) sets out rules on transparency with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts and the provision of sustainability related information with respect to financial products. Articles 5 to 7 of the Taxonomy Regulation incorporate a number of the Environmental Objectives' principles into the Disclosure Regulation, provide that references to "do no significant harm" in the Disclosure Regulation are to be interpreted in line with the Taxonomy Regulation and also provide that in certain circumstances it needs to be disclosed that specific investments do not in fact take into account the EU criteria for environmentally sustainable economic activities.

Article 25 of the Taxonomy Regulation also mandates the European Supervisory Authorities to develop draft regulatory technical standards to specify the details of the content and presentation of the information in relation to the principle of "do no significant harm" and also embeds the changes set out in Articles 5 to 7 of the Taxonomy Regulation into the Disclosure Regulation.

Conclusion

The Taxonomy Regulation enables market participants to determine with confidence whether an economic activity qualifies as environmentally sustainable, thereby facilitating cross border sustainable investment and discouraging greenwashing. The amendments to the Disclosure Regulation also provide that investors should be able to determine which and to what extent the Environmental Objectives are complied with, thus allowing them to direct capital flows towards a more sustainable economy and to reap the rewards (both financial and virtuous) of environmentally sustainable investing.

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[1]https://ec.europa.eu/info/strategy/priorities 2019 2024/european green deal_en
[2]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 on 18 March 2018
[3]REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
[3]REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability related disclosures in the financial services sector

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