Introducing the new sustainable finance measures of the EU Commission

Executive Summary

- On 21 April 2021, the EU Commission published a new package of measures to further promote sustainability in the financial system.
- Firstly, the measures include the highly-anticipated **EU Taxonomy Climate Delegated Act** which establishes the technical screening criteria to determine whether economic activities qualify as being aligned to the two environmental goals 'climate change mitigation' and 'climate change adaptation'.[1]
- Secondly, the EU Commission presented its proposal for a new **Corporate Sustainability Reporting Directive (CSRD)** which, once adopted, would significantly extend non-financial reporting obligations of commercial companies.
- Thirdly, the package includes six delegated acts on sustainability preferences, fiduciary duties and product governance relevant for MiFID investment firms, AIFMs, UCITS management companies and insurances.
- The sustainable finance package underlines the EU Commission's continued ambition to transform its financial policy towards sustainability and direct private capital towards its climate policy goals.

This GSK Update summarizes the measures introduced by the EU Commission in April 2021 as well as their target audience and potential impact.

I. EU Taxonomy Climate Delegated Act

The Taxonomy Regulation (EU) 2020/852 (**Taxonomy**) is a classification system for sustainable activities. While there is no legal requirement for economic activities to be taxonomy-aligned, the pressure towards such alignment is expected to increase. The EU Taxonomy Climate Delegated Act defines technical screening criteria applicable to the two first environmental objectives 'climate change mitigation' and 'climate change adaptation' under the Taxonomy. The technical screening criteria for the remaining four environmental objectives, i.e. 'sustainable use and protection of water and marine resources', 'transition to a circular economy', 'pollution and prevention control' and 'protection and restoration of biodiversity and ecosystems' will be published in 2022.

1) Who is concerned?

The EU Taxonomy Climate Delegated Act will apply to all entities subject to disclosure obligations under the Taxonomy, i.e. certain large public-interest entities and financial market participants.[2] In addition, all companies active in the climate-relevant sectors like real estate, energy, water, waste management, IT, manufacturing, agriculture/forestry or mobility whose direct or indirect investors or stakeholders are based within the European Union will be faced with the expectation to report on the taxonomy-alignment of their activities. Furthermore, UCITS management companies and AIFMs will be, at least indirectly, affected. In future, "ESG-funds" are expected to predominantly invest in taxonomy-aligned

[1] For further information, please refer to our GSK Update focusing on the real estate sector (May 2021): Taxonomy Regulation - Stricter sustainability requirements for real estate

[2] For further information, please refer to our GSK Update (February 2021): New Sustainability Reporting Obligations under the Taxonomy Regulation

assets in order to comply with investors' "sustainability preferences" under the new MiFID II-regime.

2) What is it about?

The EU Taxonomy Climate Delegated Act provides detailed technical screening criteria on a sector-by-sector basis. It focuses on sectors covering the large majority of carbon emissions in the European Union. The criteria determine which activities can be considered to make a substantial contribution to one of the first two environmental objectives (climate change mitigation and climate change adaptation), and to do no significant harm to the respective five other environmental objectives.

3) When does it apply?

The EU Taxonomy Climate Delegated Act applies as of **1 January 2022**. Consequently, it will already be relevant for financial disclosure obligations in relation to the financial year 2021.
However, this is still subject to the condition that neither the European Parliament nor the Council reject the delegated act within the scrutiny period of four months (which can be extended by additional two months).

II. Corporate Sustainability Reporting Directive (CSRD)

The proposed CSRD aims to update and significantly extend the non-financial reporting obligations originally introduced by the Non-Financial Reporting Directive 2014/95/EU (**NFDR**)[3]. The NFDR was transposed into the Luxembourg legal framework in 2016.

1) Who is concerned?

Currently, the NFDR applies only to certain large public interest entities, such as issuers whose securities are traded on an EU regulated market with more than 500 employees, EU-based credit institutions and insurance undertakings. The proposed CSRD would significantly extend the scope and apply to all large undertakings[4], all entities whose transferable securities are listed on an EU regulated market and eventually even to small and medium-sized undertakings[5].

2) What is it about?

The proposed CSRD would extend the sustainability reporting obligations by introducing, among others, the requirement to report on sustainability targets, on the due diligence process implemented with regard to sustainability matters and on actual or potential impacts on the value chain. The CSDR further envisages common sustainability reporting standards to be adopted as delegated acts of the EU Commission by 31 October 2022. The NFDR, on the other hand, currently only provides for non-binding reporting guidelines. Another key change under the proposed CSRD would be the mandatory assurance of sustainability reporting by an auditor.

3) When does it apply?

The proposal requires the adoption by the European Parliament. Member states will then need to transpose the CSRD provisions into national laws. The current proposal envisages the application to financial years starting on or after **1 January 2023**.

III. Delegated Acts following SFDR

The EU Commission finally published six delegated acts amending existing EU regulations and relating to the ESG disclosure obligations under the Sustainable Finance Disclosure Regulation (EU) 2019/2088 (**SFDR**).

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[3] For further information, please refer to our GSK Update (March 2020): Non-Financial and ESG Reporting: A New Era of Sustainability Reporting?

[4] Large undertakings/groups exceed on their balance sheet dates at least two of the three criteria: (a) balance sheet total: EUR 20 million;(b) net turnover: EUR 40 million; (c) average number of employees during the financial year: 250.

[5] Small undertakings/groups do not exceed on their balance sheet dates at least two of the three criteria: (a) balance sheet total: EUR 4 million;(b) net turnover: EUR 700,000; (c) average number of employees during the financial year: 10.

1) Who is concerned?

The delegated acts are addressed to UCITS management companies, AIFMs, MiFID investment firms and insurance companies/intermediaries and insurance distributors.

2) What is it about?

The delegated acts concern, among others:

- Fiduciary duties of fund managers, insurance companies and MiFID investment firms in connection with the assessment of sustainability risks;
- Sustainability factors and sustainability-related objectives to be considered by product manufacturers and advisers in connection with the product oversight and governance process; and
- sustainability preferences to be considered by advisers when assessing a client's suitability for the investment in financial/insurance products.

Especially the consideration of "sustainability preferences" and its implementation within suitability assessments will be of fundamental importance for issuers and distributors of financial products, as "sustainability preferences", by definition, only cover those financial products investing in (environmentally) sustainable investments or that consider principal adverse impacts on sustainability factors.

3) When does it apply?

The delegated acts are expected to apply as of October 2022.

IV. What we offer

GSK Stockmann offers a variety of services in connection with sustainable finance generally and non-financial and ESG disclosure in particular, such as:

- Helping you determine and navigate your sustainability-related disclosure obligations,
- Assisting you with the analysis of your assets and services,
- Assisting you with your non-financial reports,
- Helping you find products and solutions to benefit from your taxonomy-aligned services,
- Helping you set up governance structures and policies to achieve your ESG goals,
- Training your management and staff with our tailor-made ESG academy.

Our sustainable finance experts in Luxembourg and Germany are happy to help your business navigate this fast-paced topic.

V. Conclusion

With this package of sustainability measures, the EU Commission continues to push private capital flows towards sustainability. Entities in scope of the disclosure obligations under the Taxonomy now have some clarity on the technical screening criteria they need to apply. However, actors in the climate-relevant sectors such as real estate still face the even greater challenge of transforming their businesses in the real economy towards sustainability. Meanwhile, by further increasing sustainability duties of key financial market participants, the EU Commission aims to ensure that demand for sustainable products and sustainability reporting will continue to be high. The proposal for a new corporate sustainability reporting directive underlines that the EU's legislative efforts in promoting sustainability are far from over and more is yet to come.

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