European Commission June 2023 Sustainable Finance Package

Matheson

June 2023

The European Commission ("**Commission**") has published a number of legislative proposals and supporting documents with a view to further developing the EU sustainable finance framework. Importantly, the package does not introduce any new disclosure or reporting requirements beyond those already set out in the Sustainable Finance Disclosure Regulation ("**SFDR**") or the Corporate Sustainability Reporting Directive ("**CSRD**"). The package includes proposals to add economic activities to the EU Taxonomy and new rules for ESG rating providers, intended to increase transparency on the market for sustainable investments. The Commission has issued documents supporting the legislative initiatives as part of the package, which are aimed at making the sustainable finance framework easier to use, so that the framework can continue to contribute effectively to the European Green Deal objectives. The legislative proposals included in the package are:

- a proposed regulation on the transparency and integrity of ESG ratings activities; and
- proposed delegated acts introducing technical screening criteria ("**TSC**") for the non-climate environmental objectives in the EU Taxonomy Regulation and targeted amendments to the EU Taxonomy Climate Delegated Act, which expands on the economic activities contributing to climate change mitigation and adaptation not included so far.

The package includes the following supporting documents:

- a communication on a sustainable finance framework that works on the ground, which summarises the most recent measures and initiatives adopted by the Commission to support stakeholders in their implementation efforts, simplifying complex elements of the framework and addressing the most urgent usability issues. The next steps outlined in the communication include a public consultation assessing the Sustainable Finance Disclosure Regulation ("**SFDR**"), which will be launched in autumn 2023;
- staff working document on enhancing the usability of the EU Taxonomy and the overall EU sustainable finance framework;
- commission notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links with the SFDR (FAQs). The FAQs aim to provide some clarifications on how FMPs should consider the requirements for compliance with minimum safeguards under Article 18 of the EU Taxonomy Regulation and to clarify the status of investments in Taxonomy-aligned investments as "sustainable investments" under the SFDR; and

- recommendation on transition finance, aiming to provide guidance and practical examples for companies and the financial sector. The recommendation is non-binding and does not impose any new obligations and intended to support awareness and the update of transition finance by market players.

The key aspects of the legislative proposals included in the package are summarised below.

Proposed Regulation on ESG Ratings Providers

The Commission committed in its renewed sustainable finance strategy published in July 2021 to take action to improve the reliability, comparability and transparency of ESG ratings. The Commission's proposed regulation on ESG Ratings Providers aims to improve transparency of ESG ratings' characteristics and methodologies, ensure increased clarity on the operations of ESG rating providers and prevent risks of conflicts of interest. The general objective of the initiative is to improve the quality of ESG ratings to enable investors to make better informed investment decision with regard to sustainability objectives. The proposal is intended to ensure the quality and reliability of ESG rating providers' services to protect investors and ensure market integrity.

Under the proposed regulation, ESG rating providers operating in the EU would have to seek authorisation from the European Securities and Markets Authority ("**ESMA**"). The legislation also contains rules on the provision of ESG ratings in the EU by third country ESG rating providers. The regulation will apply six months after its entry into force and there are transitional provisions for ESG ratings providers which provide their services at the date of entry into force of the regulation and for new entrants that are categorised as small and medium-sized undertakings.

EU Taxonomy Technical Screening Criteria

The Commission has approved a new set of TSC for economic activities contributing towards one or more of the four remaining environmental objectives set out in the Taxonomy Regulation (in addition to climate change mitigation and climate change adaptation, in relation to which TSC have already been published). The four environmental objectives addressed by the new TSC are:

- sustainable use and protection or water and marine resources;
- move towards a circular economy;
- pollution control and prevention; and
- protection and restoration of ecosystems and biodiversity.

These four environmental objectives were due to apply from 1 January 2023. The first two environmental objectives - climate change mitigation and climate change adaptation - have applied since 1 January 2022.

The Commission has also adopted targeted amendments to the EU Taxonomy Climate Delegated Act, which expand on economic activities contributing to climate change mitigation and adaptation not included so far – in particular the manufacturing and transport sectors. The inclusion of more economic activities covering all six environmental objectives and consequently more sectors and companies, is intended to increase the usability and potential of the EU Taxonomy in scaling up sustainable investments in the EU.

Comment

The expansion of the EU Taxonomy should lead to increased data availability in the market and facilitate financial market participants ("**FMPs**") in meeting their disclosure obligations under the SFDR, although it will take time for this data to become publicly available. FMPs will also welcome the creation of a more transparent and reliable framework for ESG ratings, although the increased compliance costs likely to be incurred by such providers may in turn lead to increased costs for those availing of their services.

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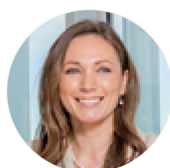

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