EU Sustainable Finance legal framework and its effects on sustainable investments

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6 June 2023

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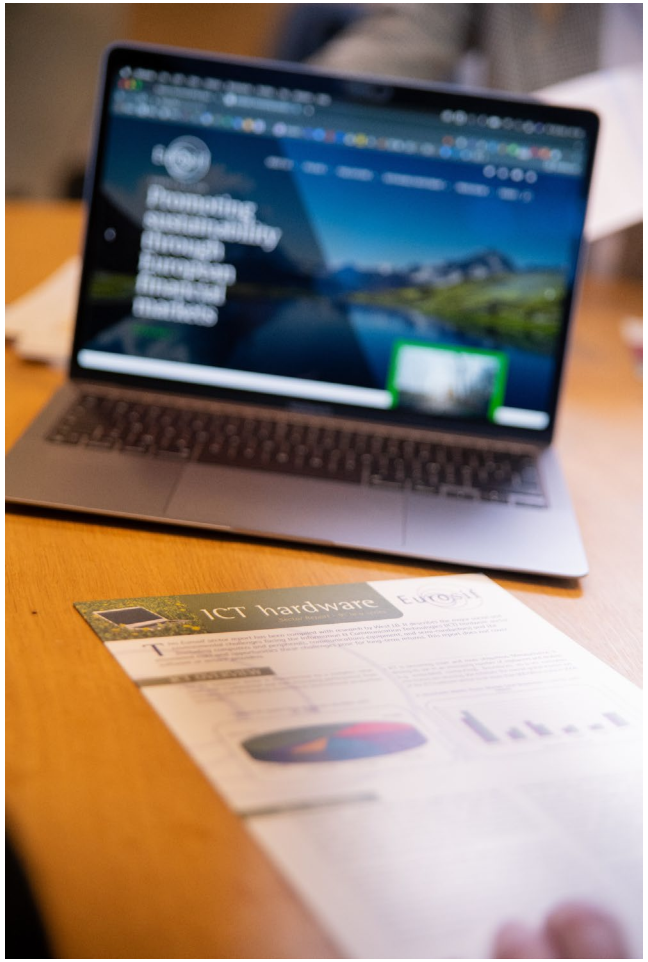
PROMOTING SUSTAINABILITY THROUGH
EUROPEAN FINANCIAL MARKETS

About Eurosif

The European Sustainable Investment Forum



In a nutshell:

- The leading pan-European association promoting sustainable finance at EU level.
- Membership is comprised of Europe-based national Sustainable Investment Fora (SIFs).
- Most of national SIFs have a broad and diverse membership including asset managers, institutional investors, index providers and ESG research & analytics providers. Some SIFs are government funded.
- Eurosif and its members are committed to the growth and integrity of meaningful sustainable investment flows and support the ambition of European policymakers in enabling a fully transparent sustainable investment market through appropriate and well-designed regulation and industry practice.

EU Sustainable Finance framework

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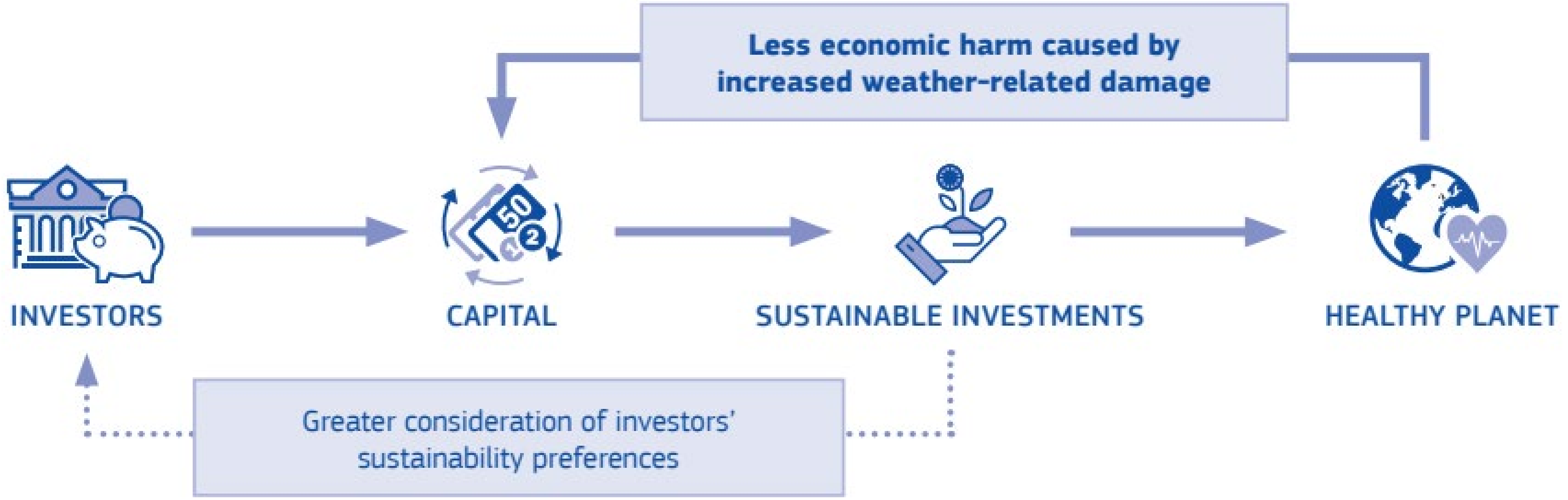
- In its 2018 Action Plan on Financing Sustainable Growth, the European Commission (EC) noted “as we are increasingly faced with the catastrophic and unpredictable consequences of climate change and resource depletion, urgent action is needed to adapt public policies to this new reality”.

- To address this defining challenge, EC placed the financial sector at the centre of reforms aiming for:

  1. To reorient capital flows towards sustainable investment in order to achieve sustainable and inclusive growth;
  2. To manage financial risks stemming from climate change, resource depletion, environmental degradation and social issues
  3. To foster transparency and long-termism in financial and economic activity.

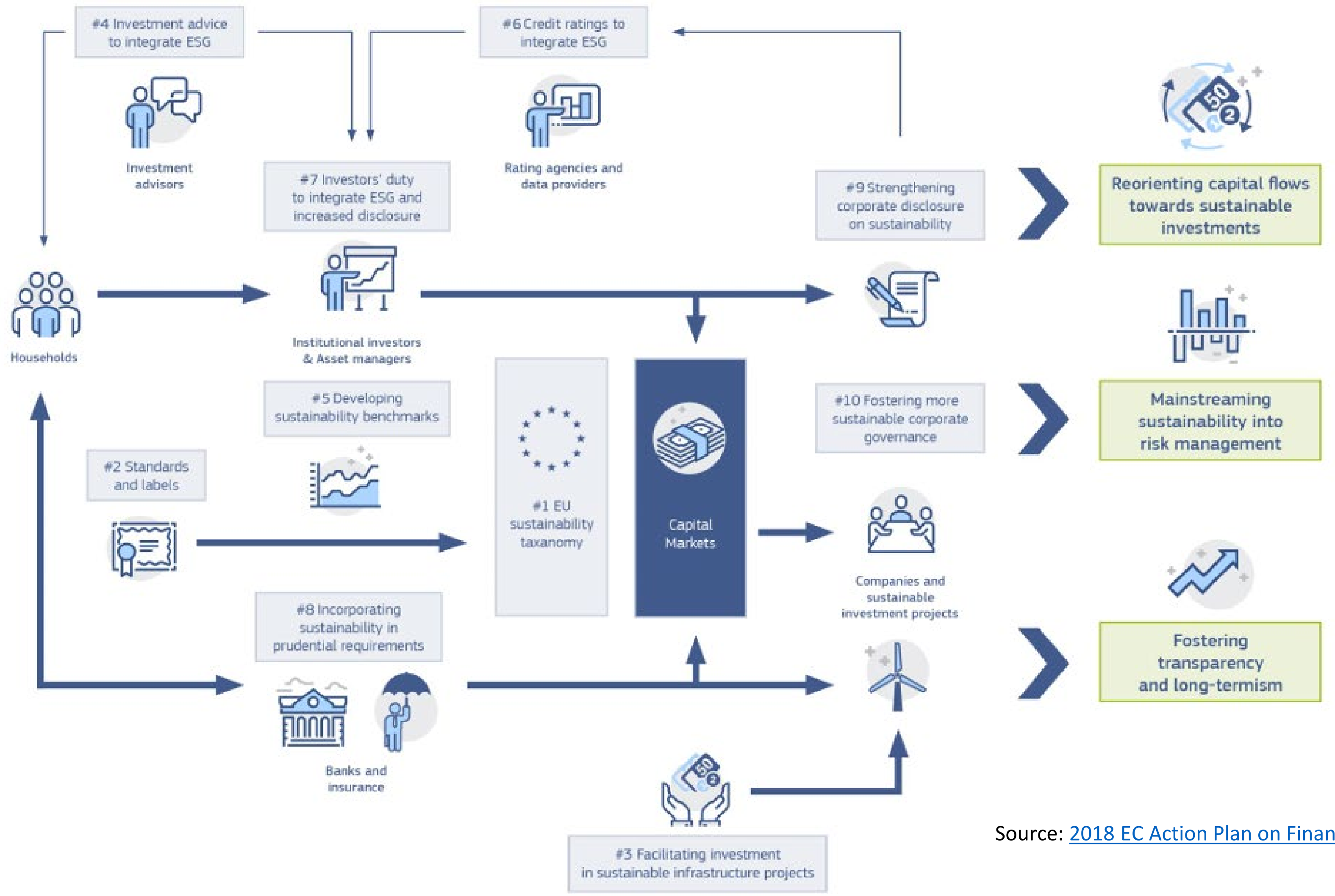
- The scale of the investment challenge is beyond the capacity of the public sector alone. The financial sector has a key role to play in reaching those goals.

EU Sustainable Finance framework



Source: [2018 EC Action Plan on Financing Sustainable Growth]

EU Sustainable Finance framework



Source: [2018 EC Action Plan on Financing Sustainable Growth]

EU Sustainable Finance framework

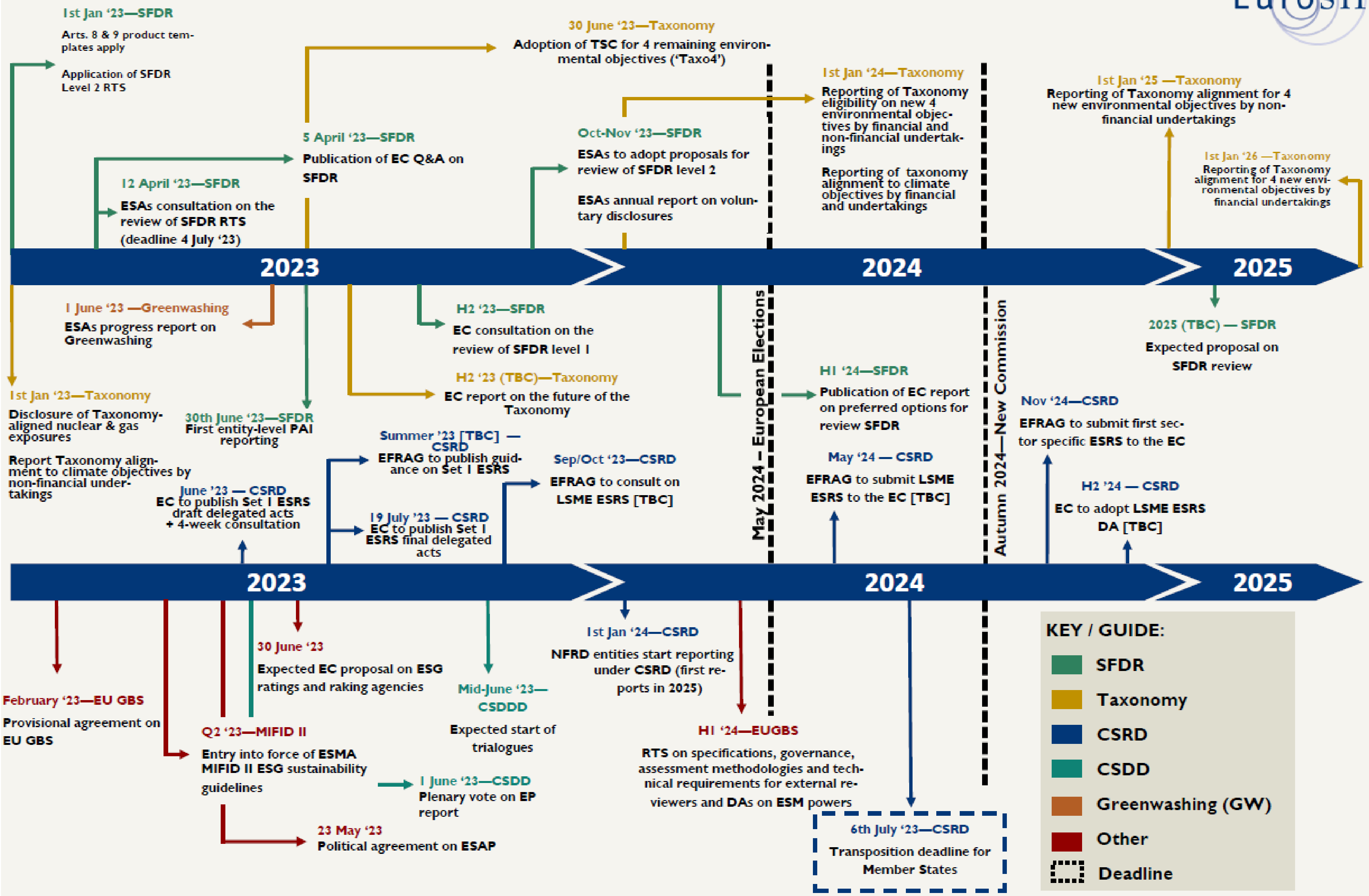
- On 6 July 2021, EC adopted the Renewed Sustainable Finance Strategy reaffirming its commitments, however shifting focus more towards financing a transition towards sustainability.

- **Context**
  - ✓ The EU Green Deal objectives of climate neutrality by 2050 and 55% emissions' reduction by 2030
  - ✓ The scale and far-reaching impact of climate change and environmental degradation are increasingly recognised as material source of risks
  - ✓ COVID-19 outbreak and recovery phase show the need to increase resilience of our societies and have a comprehensive overview of sustainability (including social aspects)

- **Aim**: A comprehensive and ambitious action plan with clear deadlines to reach the 2030 and 2050 targets

- **Actions:**
  - ✓ Accelerating the transition in the real economy and boosting sustainable investments in the recovery context.
  - ✓ Improving resilience and mainstreaming sustainability risks.
  - ✓ Empowering citizens, entrepreneurs and the retail investors.
  - ✓ Putting sustainability and long-termism at the heart of corporate and investment decision-making.
  - ✓ Moving sustainable finance beyond climate objectives.
  - ✓ Unleashing the potential of ESG data.
  - ✓ Creating global opportunities and coordinated actions.

EU SUSTAINABLE FINANCE REGULATORY OVERVIEW



The Sustainable Finance Disclosures Regulation (SFDR)

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- Applying as of March 2021, the Sustainable Finance Disclosure Regulation (SFDR), was among the first actions under the 2018 sustainable finance action plan.

- Together with the EU Taxonomy, it creates a **new sustainability-related disclosure framework for financial market participants and financial advisers** with regards to the **integration of sustainability risks** and the **consideration of adverse sustainability impacts** in investment processes.

- The SFDR requires financial market participants and financial advisors to disclose:

    - how they integrate sustainability risks into their investments / advice;

    - whether, and if so, how they consider the principal adverse impacts or negative externalities of their investment decisions/advice on the environment or society.

- The obligation to disclose information with regard to adverse impacts is on a ‘comply or explain’ basis for smaller firms, but it is mandatory for financial market participants with more than 500 employees.

The Sustainable Finance Disclosures Regulation (SFDR)

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- Disclosures comprise **entity-level and product-level disclosures**. The former must be reported on the company website while the latter must be integrated in the product pre-contractual information, on the website and in the on-going disclosures.

- Products qualifying under **Article 9 or Article 8**, meaning respectively products pursuing sustainable investment as their objective or products with ESG characteristics, must disclose the EU Taxonomy-alignment of their underlying sustainable investments.

- The Regulatory Technical Standards (RTS) were adopted in April 2022 with some revisions applied in Feb 2023. Final consolidated version is available here.

- The ESAs have published multiple Q&As on the interpretation of SFDR:
  - ✓ July 2021
    - Correction
  - ✓ May 2022
  - ✓ November 2022
  - ✓ April 2023
    - Amendments to previous Q&As

The Sustainable Finance Disclosures Regulation (SFDR)

Latest developments

- December 2022: SFDR Level 1 review announced by Commissioner McGuinness.
    - The European Commission is starting a preparatory work paving the way for a future review of the SFDR Regulation. For that aim, the Commission is organising meetings and workshops with the industry and other stakeholder groups gathering feedback for the best way forward.
    - A public consultation is planned in Q3 2023. A legislative proposal, however, cannot be expected before 2025, meaning after the European elections in 2024.

The Sustainable Finance Disclosures Regulation (SFDR)

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Latest developments

- April 2023: ESAs consultation on the review for the PAIs and other amendments to the SFDR level 2.
  - Published on 12 April and open for consultation until 4 July 2023.

  ➢ **Key takeways:**

  - The consultation focuses on extending the list of social PAI indicators and refining the contents of other indicators
  - However, the ESAs also consult on additional matters, including:
    1. Improvement to disclosures related to how sustainable investments do not significantly harm environmental or social objectives
    2. Simplifications of the pre-contractual and periodic documents' disclosure templates
    3. Technical adjustment on e.g. the treatment of derivatives or definition of equivalent information

EU Taxonomy

- The EU Taxonomy is a classification system that helps companies and investors identify "environmentally sustainable" economic activities to make sustainable investment decisions.

- Environmentally sustainable economic activities are described as those which "make a substantial contribution to at least one of the EU's climate and environmental objectives, while at the same time not significantly harming any of these objectives and meeting minimum safeguards."

- The climate and environmental climate objectives are:
  - 1. Climate change mitigation
  - 2. Climate change adaptation
  - 3. The sustainable use and protection of water and marine resources
  - 4. The transition to a circular economy
  - 5. Pollution prevention and control
  - 6. The protection and restoration of biodiversity and ecosystems

EU Taxonomy

- The Commission is establishing the actual list of environmentally sustainable activities by defining technical screening criteria (TSC) for each environmental objective through delegated acts:
  - June 2021: Climate Delegated Act
  - July 2021: Taxonomy Disclosures Delegated Act
  - March 2022: Complementary Climate Delegated Act

Latest developments

The Commission published two delegated acts for the 4 remaining environmental objectives ('Taxo4'). They were open for consultation until 3 May 2023

- April 2023: [draft] Environmental Delegated Act
- April 2023 [draft] Delegated Act Amending the Taxonomy Climate Delegated Act

The Corporate Sustainability Reporting Directive (CSRD)

- Establishes reporting rules for companies on sustainability-related matters (ESG).
- Ensures that investors and other stakeholders have access to the information they need to assess investment risks arising from climate change and other sustainability issues.
- Introduces the European Sustainability Reporting Standards (ESRS).
- Adopted in November 2022.
- The first companies will have to apply the new rules for the first time in the 2024 financial year, for reports published in 2025.

The European Sustainability Reporting Standards (ESRS)

- A reporting framework under which companies under the CSRD scope can report their sustainability-related information from a double-materiality perspective.

- The objective of the ESRS is to harmonise information reported by companies to increase comparability so investors can make sound investment decisions and direct capital flows in alignment with the green transition.

- The European Commission is about to publish the draft Delegated Acts, which will be open for comments for 4 weeks. The final Delegated Act will be published around mid-July.

The European Sustainability Reporting Standards (ESRS)

Latest developments

- Due to political pressures, the European Commission (EC) has made substantial adjustments to the first set of the European Sustainability Reporting Standards (ESRS), reducing their ambition level:

  - All ESRS and disclosure requirements to be subject to materiality assessment (apart from ESRS 2 TBC & optional disclosures), including climate, own-workforce, SFDR, EU climate benchmarks and Pillar III-related disclosures.

  - Certain disclosures, in particular scope 3 GHG emissions, biodiversity and social, to be phased in over time, some for all companies in scope, some for companies with less than 750 employees.

  - Increased number of disclosures made voluntary compared to EFRAG proposals and additional flexibility by raised thresholds and changing definitions.

Reducing the ambition of the ESRS as compared to EFRAG proposals risks undermining the effectiveness of the CSRD and the implementation of the EU sustainable finance strategy.

The Corporate Sustainability Due Diligence Directive (CSDD)

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- The CSDD will establish a framework through which companies in scope must **identify, prevent, mitigate, and account** for their adverse human rights and environmental impacts.

- The directive seeks to foster integration of sustainability considerations in governance models and management systems within companies to make their business models more sustainable and aligned with the green transition.

- To that end, the text will establish due diligence obligations to foster **sustainable and responsible corporate behaviour** and to anchor **human rights and environmental considerations** in companies' operations and corporate governance.

Latest developments: The file has now finalised the negotiation phases in the European Parliament and will be entering in trialogues around mid-June, where the three co-legislators will agree on a final text.

CSDD: Benefits of an effective due diligence implementation

- Companies that exercise due diligence in their supply chains are **more competitive**: Lower employee fluctuation, higher productivity, better strategic risk management, improved reputation…

- **Better access to investment**: Companies wishing to access private funding for the green transition will have to meet due diligence criteria. Investors and banks are increasingly demanding information on sustainability and due diligence.

- **A level-playing field for domestic producers**: Companies producing in the EU have higher costs than their competitors using manufacturing outside of Europe, where labour and environmental standards are not the same. Introducing due diligence obligations would alleviate this disadvantage.


Thank you!
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