

The Taxonomy Regulation – the Framework to Facilitate Sustainable Investment in the EU

On 22 June 2020, 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 (the Taxonomy Regulation) was published in the Official Journal of the European Union. It contributes to the legal framework aimed at ensuring better protection of the environment. The Taxonomy Regulation is an integral part of the EU strategy to attain the environmental objectives, which will be central to all major policies in the years to come.

The immediate objective of the Regulation is to set uniform criteria for classification of investments as “sustainable”. However, the Taxonomy Regulation has much wider application within the EU policies than what its subject-matter and scope would suggest. It sets out the EU environmental priorities, as well as the fundamental principles underlying the process of implementing them, while there is no obstacle for the criteria relating to the sustainability of investment to be used also for purposes of mechanisms beyond the disclosure obligations of certain groups of persons pursuant to the Regulation. Certain acts adopted after 22 June 2020 have already referred to the standards laid down in the Taxonomy Regulation, which implies that its significance could only increase in future.

It should be noted that the criteria, being set out in a regulation, have direct horizontal effect and apply to all persons within the EU and prevail over the national legislation of Member States. The Regulation entered into force on the twentieth day following that of its publication in the Official Journal of the EU, i.e. on 12 July 2020 but, for the time being, it is binding only on the authorities of the EU and the Member States.

As already mentioned, the Regulation introduces obligations for both the EU and Member States to set out environmental requirements to financial market participants and issuers of financial products or corporate bonds.

Secondly, the specific obligations laid down in the Regulation are addressed to financial market participants who make available financial instruments within the meaning of Article 2 of 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.

Thirdly, the requirements set out in the Taxonomy Regulation also apply to public-interest

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companies with more than 500 employees or parent companies of large groups which qualify as a public interest entity.

In fact, the Taxonomy Regulation obligates these groups of companies to comply with the requirements for an investment to qualify as “environmentally sustainable”. Thus the standards of all Member States are aligned and more transparency is ensured as to which investments actually contribute to the attainment of the EU environmental objectives. Transparency is achieved through the introduction of specific obligations for the three groups of addressees of the Regulation as follows:

- Member States are required to make sure that the criteria become standards in all requirements to financial market participants or issuers of financial products or corporate bonds which are made available on the market as “environmentally sustainable”;
- Financial market participants and issuers of financial products or corporate bonds disclose information on the environmental objective or environmental objectives set out in the Taxonomy Regulation to which the investment underlying the financial product contributes; they should also provide a description of how and to what extent the investments are in economic activities that qualify as environmentally sustainable;
- This rule applies also to financial products that promote environmental characteristics, i.e. all financial products which incentivise investment in environmental sectors of the economy;
- Public-interest companies with more than 500 employees and parent companies of large groups which qualify as a public interest entity are required to publish information in a non-financial statement or a consolidated non-financial statement.

Having clarified the addressees of the Regulation and their obligations, we should explain how it is determined which activities qualify as environmentally sustainable. In this connection, the Taxonomy Regulation sets out a requirement consisting of four distinct criteria to be met cumulatively. Economic activities should:

- Contribute substantially to any one of the environmental objectives set out in the Regulation;
- Not significantly harm any of these objectives;

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- Be carried out in compliance with the minimum safeguards of human rights, including the fundamental conventions of the Un International Labour Organisation;
- Comply with the technical screening criteria for each of the specific objectives as set out in delegated acts adopted by the European Commission.

The six objectives are as follows:

1. Climate change mitigation;
2. Climate change adaptation;
3. Sustainable use and protection of water and marine resources;
4. Transition to a circular economy;
5. Pollution prevention and control;
6. Protection and restoration of biodiversity and ecosystems.

The second criterion (to make sure that the economic activity does not significantly harm any of the objectives) covers some specific indicators which are specified in the Regulation and will be further developed in the EU legislation.

The third criterion requires prevention of substantial harm to the human rights principles, including the protection of economic and social rights.

Finally, the fourth criterion needs to be specified in delegated acts of the European Commission, one for each of the six environmental objectives. These delegated acts will set out the parameters to assess the compliance with the environmental sustainability requirements. The first two acts (relating to objectives 1 and 2) had to be adopted by 31 December 2020, while the deadline for the other two is the end of this year. So far, the European Commission has approved only one draft of a general delegated regulation on the first two objectives and the legislative process for its adoption is currently under way. It is only after the delegated act concerning the relevant objective is adopted that the Taxonomy Regulation will be fully applied regarding that objective.

The draft of the delegated regulation was published on 6 April 2021. It sets out some specific criteria to check whether activities qualify as environmentally sustainable. In this connection, it makes reference to some existing standards, e.g. activities in the field of construction should comply with the energy efficiency rules set out in Directive 2010/31/EU of the

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European Parliament and of the Council of 19 May 2010 on the energy performance of buildings. However, the criteria go beyond energy performance to include air circulation, the effect of the building on global warming throughout its life cycle, and the opportunities for reuse of the building materials after the end of the life cycle. Many rules are already in place in various sustainable construction systems, such as DGNB in Germany, LEED in the United States, BREEAM in the United Kingdom, HQE in France, and CASBEE in Japan. In this sense, the delegated act is intended to bring together the experience gained in sustainable economic activities, systematise it and give clear guidance for the assessment of projects seeking certification as sustainable. If the delegated act is adopted, it could be expected that the disclosure obligations regarding the first two objectives will become binding as from 1 January 2022. The obligations regarding the other two objectives will become binding when the other delegated acts are adopted.

The Taxonomy Regulation is related to many other EU environmental initiatives, such as the eco-labelling rules. Furthermore, the “do no harm” principle is the underlying principle of Regulation (EU) 2021/241 of the European Parliament and of the Council of 12 February 2021 establishing the Recovery and Resilience Facility, where the observance of this principle is a requirement for the approval of the projects which Member States propose in their recovery and resilience plans. This principle is also set out in the documents of the Horizon Europe Framework Research Programme. Notwithstanding the delay in the adoption of the relevant delegated acts provided for in the Taxonomy Regulation, its framework for economic activities to qualify as environmentally sustainable will become even more relevant in future.