# 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. International Bulletin, November 2020.

On 22 June this year, 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, known as the Taxonomy Regulation and hereinafter referred to as the Regulation, was published in the Official Journal of the European Union (EU), coming into force 20 days after its publication on 12 July.

Taxonomy is one of the key pieces within the EU Action Plan on financing sustainable growth, published in 2018. This Plan takes into account the lines agreed in (1) the 2030 Agenda for Sustainable Development adopted by the United Nations in September 2015, which centres on the Sustainable Development Goals (SDGs) covering the economic, social and environmental dimensions and in (2) the Paris Agreement adopted through the United Nations Framework Convention on Climate Change and approved by the EU in October 2016, which aims to keep the increase in global average temperature below 2°C and to continue efforts to limit it to 1.5°C compared with pre-industrial levels.

In order to have financial products or corporate bonds that help channel private investment towards sustainable economic activities, it is essential to establish a taxonomy, in other words, a clear and detailed European classification system that creates a common language for all actors in the financial system (financial market participants and economic operators), setting the criteria for determining whether an economic activity is sustainable in a way that enables investors to understand the extent to which certain investments contribute to achieving sustainable objectives.

It is nevertheless important to note that this Regulation focuses on investments which finance economic activities that can be considered environmentally sustainable. The taxonomy relating to other sustainability objectives, including social objectives, might be developed later.

Furthermore, the harmonisation of criteria seeks to make it possible to compare products with these characteristics and thus favour cross-border investments, fight "greenwashing" and allow the development of a future labelling system for financial products or corporate bonds that are marketed as environmentally sustainable.

On the other hand, with regard to the environmental objectives included in this Regulation, it should be noted that the provisions relating to the climate change objectives will first be developed, being applicable from 1 January 2022, while the remaining environmental objectives will be developed later and will be applicable from 1 January 2023.

**Scope of application**

The Regulation applies to:

– **Member States and the European Union**, when adopting measures setting requirements for financial market participants or issuers in respect of financial products or corporate bonds that are offered as environmentally sustainable.

– **Financial market participants**, as defined in Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector (the Disclosure Regulation), when including a description of how and to what extent the investments underlying these products finance economic activities considered environmentally sustainable in the pre-contractual and periodic information on the financial products that they market. In this regard, it should be noted that in the area of the securities market, this rule is mandatory for entities that provide discretionary portfolio management and/or financial advisory services, as well as for collective investment schemes managers.

– **Undertakings subject to the obligation to publish non-financial information** in accordance with Articles 19a and 29a of Directive 2013/34/EU, when publishing information on how and to what extent the company's activities are linked to economic activities considered environmentally sustainable in their non-financial statement or consolidated non-financial statement.

**Criteria applicable to environmentally sustainable economic activities**

Environmentally sustainable investment is defined as investment that finances one or more economic activities that can be considered to be sustainable in environmental terms. The Regulation establishes that an economic activity will be considered environmentally sustainable when:

1) **it contributes substantially to one or more of the environmental objectives** established in the Regulation;
2) **it does not significantly harm** other environmental objectives. Assessment of this must take into account the environmental impact of both the activity itself and of the products and services generated by that activity throughout their life cycles (their production, use and end of life);
3) **it is carried out in compliance with minimum safeguards**, what means an alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights;
4) **it complies with the technical screening criteria**, which are the basis for determining when an economic activity contributes substantially or causes significant harm to each of the environmental objectives established in the Regulation.

**Environmental objectives**

The Regulation includes six environmental objectives:

a) **Climate change mitigation**

Activities that contribute substantially to achieving the goal set forth in the Paris Agreement mentioned above will qualify.

In the case of economic activities for which there is no technologically or economically feasible low-carbon alternative, they are considered to make a substantial contribution to climate change mitigation if they support the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1.5°C above pre-industrial levels, by phasing out greenhouse gas emissions and provided that this activity has levels of greenhouse gas emissions that correspond to the best performance in the sector or industry, does not hamper the development and implementation of low-carbon alternatives and does not lead to a lock-in of carbon-intensive assets. The taxonomy defines them as **transitional activities.**

However, an economic activity is considered to cause significant harm to this objective if it leads to significant greenhouse gas emissions. The Regulation establishes that the technical screening criteria must ensure that electricity generation activities using solid fossil fuels do not qualify as environmentally sustainable economic activities.

b) **Climate change adaptation**

Activities will qualify if they include adaptation solutions to prevent or substantially reduce possible present and future adverse effects deriving from the climate on said activity and its environment (people, nature or assets).

Conversely, when an activity causes an increase in the adverse effects of the current climate and the expected future climate, on itself or on people, nature or assets, it is considered to cause significant harm to this objective.

c) **The sustainable use and protection of water and marine resources**

Activities will qualify if they contribute substantially to achieving the good status of bodies of water (both surface water and groundwater as well as marine waters) or preventing their deterioration when they are already in good status. Issues related to both urban and industrial waste water discharges are discussed here (note the growing concern about pollutants such as pharmaceuticals and microplastics); the protection of water intended for human consumption; the protection of aquatic ecosystems and the sustainable use of water; and ensuring the sustainable use and good status of marine waters.

Accordingly, activity that is detrimental to the good status or ecological potential of bodies of water or the good ecological status of marine waters is considered to cause significant harm to this objective.

d) **The transition to a circular economy,** in particular waste prevention, re-use and recycling

To determine the economic activities that contribute substantially to this objective, consideration is given to issues such as the efficient use of natural resources; increasing the durability, reparability, upgradability or reusability of products; increasing the recyclability of products and their materials; the substantial reduction of hazardous substances and the substitution of substances of very high concern and the prevention or reduction of waste generation.

When an activity generates significant inefficiencies in the use of materials or in the direct or indirect use of natural resources in one or more phases of the product life cycle, particularly in terms of the durability, reparability, upgradability, reusability or recyclability of products, leads to a significant increase in the generation, incineration or disposal of waste (except for the incineration of non-recyclable hazardous waste) or if its long-term waste disposal may cause significant long-term harm to the environment, it will be deemed to cause significant harm to this objective.

e) **Pollution prevention and control**

This concerns activities that contribute substantially to the protection against environmental pollution by preventing or, where that is not possible, reducing pollutant emissions to the atmosphere, water or land, other than greenhouse gases; improving air, water or soil quality levels in areas where the economic activity takes place while minimising adverse effects on human health and the environment or the risk of generating them;

the prevention or minimisation of any adverse effect on human health and the environment caused by the production, use or disposal of chemical products and the cleaning up of discarded waste and any other contamination.

An activity will be deemed to cause significant harm to the objective if it results in a significant increase in emissions of pollutants to the atmosphere (other than greenhouse gases), water or soil, compared with the situation before the activity started.

f) **The protection and restoration of biodiversity and ecosystems**

Qualifying activities are those that contribute substantially to protecting, conserving or restoring biodiversity, achieving the good condition of ecosystems or protecting ecosystems that are already in good condition. This can be done through conservation of nature and biodiversity in terrestrial, marine and other aquatic ecosystems, sustainable land use and management, sustainable agricultural practices and sustainable forest management.

Conversely, when the activity is significantly detrimental to the good condition and resilience of ecosystems or to the conservation status of habitats and species, it is considered to cause significant harm to the objective.

Finally, an economic activity can be said to contribute substantially to one or more of the environmental objectives directly while also qualifying as what the taxonomy defines as an **enabling activity**, that is an activity that enables other activities to make a substantial contribution to one or more of these objectives. For this, an activity must meet two requirements – (a) it must not lead to a lock-in of assets that undermine long-term environmental goals, taking into account the economic lifetime of those assets and (b) it must have a substantial positive environmental impact on the basis of life-cycle considerations.

**Technical screening criteria**

Technical selection criteria will be established by the European Commission through delegated acts. They will be quantitative and, where this is not possible, qualitative. Where appropriate they should be based on existing European labelling and certification systems and methodologies and use such sustainability indicators as may be established in accordance with the Disclosure Regulation. Other issues to be taken into account are the life cycle of the activity and the environmental impact not only of the activity but also of the products or services generated by it, the risk of assets becoming stranded as a result of the transition to a more sustainable economy and the risk of creating incentives incompatible with sustainable investment, covering all relevant economic activities in a given sector and ensuring that such activities are treated in the same way if they contribute equally to the he environmental objectives of the Regulation’s environmental objectives.

It should be noted that the provisions relating to the climate change objectives will first be developed, being applicable from 1 January 2022, while the remaining environmental objectives will be developed later and will be applicable from 1 January 2023.

It is important to note that the Commission will regularly review the technical screening criteria and may amend them in line with scientific and technological developments. In particular, the Commission will review the technical screening criteria for transitional activities at least every three years to ensure that they remain on a credible transition pathway consistent with a climate-neutral economy.

In order to assist the Commission in the process of developing, studying and reviewing the technical screening criteria and advise it on other related aspects, the Regulation provides for the setting up of a **Platform on Sustainable Finance** comprising experts representing both the public and private sectors as well as experts representing civil society.

The Regulation also ensures the continuity of the **Member State Expert Group on Sustainable Finance**, giving it formal status. Inter alia, the Expert Group will advise the Commission on the appropriateness of the technical screening criteria and the approach taken by the Platform with regard to the development of those criteria. This group will also serve as a channel for the exchange of views between Member States and the Commission, in particular with regard to the main results of the Platform, such as new screening criteria and important updates to them.

**Taxonomy, the Disclosure Regulation and Directive 2013/34/EU**

The Taxonomy Regulation also completes some aspects of the Disclosure Regulation, which includes, among others, the requirements related to pre-contractual disclosure and information in the periodic reports that must be provided in relation to financial products that either have as their objective sustainable investments (known as Article 9 products) or promote environmental or social characteristics (known as Article 8 products).

Pursuant to the content of the taxonomy, the information provided to investors in the case of Article 9 financial products, both ex ante and ex post, must enable them to understand the specific objective(s) to which the environmentally sustainable economic activities contribute and how they are financed, as well as what proportion of the investments underlying the product goes to sustainable environmental activities, specifying the proportions invested in enabling and transitional activities. Information relating to the principle of not causing significant harm shall also be provided. In the case of Article 8 products, the Regulation establishes that these requirements are to apply *mutatis mutandis*.

Where part (for Article 8 products) or all (for financial products other than those covered by the Disclosure Regulation) of a product portfolio is invested in economic activities that do not take into account the EU criteria for environmentally sustainable economic activities, the pre-contractual information is required to state this expressly.

These changes include new mandates for the European Supervisory Authorities to jointly develop regulatory technical standards that develop the aforesaid requirements.

The Taxonomy Regulation also in effect amends Directive 2013/34/EU by requiring certain large companies that are obliged to publish non-financial information in accordance with the provisions of said Directive, to stipulate the proportion of their turnover that comes from products or services related to economic activities that qualify as environmentally sustainable under the Taxonomy Regulation and the proportion of their total capital expenditure and operating expenditure relating to this type of economic activities in their non-financial statements or consolidated non-financial statements. This requirement must be developed through delegated acts. Extending this requirement to smaller companies is considered disproportionately burdensome, however they may publish such information on a voluntary basis.

**Regulation review and future developments**

The application of this Regulation should be reviewed regularly in order to assess the following, inter alia: the progress with regard to the development of technical screening criteria for environmentally sustainable economic activities, the possible need to revise and complement those criteria for determining whether an economic activity qualifies as environmentally sustainable and the effectiveness of the classification system for environmentally sustainable economic activities in channelling private investment into such activities, and the further development of that classification system, including the expansion of its scope beyond environmentally sustainable economic activities, in order to cover activities that significantly harm the environment, as well as other sustainability objectives, including social objectives.

Links of interest:

Regulation (EU) 2020/852 of the European Parliament and of the Council of June 18, 2020 on the establishment of a framework to facilitate sustainable investments

OECD Guidelines for Multinational Enterprises, 2011 Edition (latest version available)

United Nations Guiding Principles on Business and Human Rights

Platform on Sustainable Finance

Member States expert group on sustainable finance