UNDERSTANDING EVOLVING GLOBAL SUSTAINABILITY REQUIREMENTS - A PRIMER FOR US, UK AND OTHER NON-EU COMPANIES (UPDATED)

US, UK and other non-EU companies with operations in the European Union should be aware of ongoing EU efforts to legislate around sustainability. That awareness is important, in part, because the efforts represent the global direction of travel for disclosure standards tied to sustainability, for both companies as well as financial market participants, but more importantly because, as I have highlighted in previous briefing notes,[1] many of these efforts have extra-territorial reach. This is by no means hypothetical, in view of the fact that the Corporate Sustainability Reporting Directive ("CSRD") entered into force in January and the Corporate Sustainability Due Diligence Directive ("CSDDD") is winding its way through the legislative process.

At the heart of the growing web of EU mandated regulatory requirements (some applicable to companies, others to financial market participants) is the green taxonomy, the most ambitious roadmap in the world to meet climate and energy targets for 2030, by directing investment towards sustainable projects and activities. The taxonomy, based at its core on a set of four overarching conditions and six environmental objectives, sets out a complex definition of sustainability and what products can be marketed as sustainable. It does so through the common classification of sustainable economic activities deemed to contribute to environmental objectives via the Taxonomy Regulation and related Delegated and Implementing Acts.

Taxonomy is designed to increase transparency in the financial markets and reduce greenwashing by calling for disclosure of information about the environmental performance of assets and economic activities of financial and non-financial enterprises. The resulting taxonomy-compliant transparency in respect of corporate environmental performance also facilitates green finance.

I set out below, in this update to my March 5 briefing note, a lexicon of relevant concepts (terminology, legislation, and Delegated and Implementing Acts) as well as an update on recent developments.

Lexicon of EU Sustainability Concepts

General

Delegated and Implementing Acts: secondary legislation from the European Commission (the "Commission"), which in the sustainability area will set out technical screening criteria that define thresholds and specific requirements for activities to be considered to be contributing significantly to an **environmental objective**. These instruments form a critical part of the Taxonomy Regulation. To date, there are the following Taxonomy Delegated Acts:

- Taxonomy Environmental Delegated Act adopted June 27 (not yet published)
- Taxonomy Complementary Climate Delegated Act (2022/1214) published July 15, 2022
- Taxonomy Disclosure Delegated Act (2021/2178) published December 10, 2021
- Taxonomy Climate Delegated Act (2021/2139) published December 9, 2021

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[1] *See, e.g.,* the update on the Corporate Sustainability Reporting Directive, available here.

In addition, the CSRD empowers the Commission to adopt implementing and delegated acts to specify how competent authorities and market participants are to comply with the CSRD. The Commission published the first such delegated act on July 31 – these are the European Sustainability Reporting Standards ("ESRSs").

DNSH: the acronym for "does not significantly harm" any of the environmental objectives.

EFRAG, previously known as the European Financial Reporting Advisory Group: tasked with developing and promoting European views in the field of corporate reporting. In its sustainability reporting activities, EFRAG provides technical advice to the Commission in the form of draft ESRSs.

Environmental objectives (set out in Article 9 of the Taxonomy Regulation):

- climate change mitigation (in accordance with Article 10);
- climate change adaptation (in accordance with Article 11);
- sustainable use and protection of water and marine resources (in accordance with Article 12);
- transition to a circular economy (in accordance with Article 13);
- pollution prevention and control (in accordance with Article 14); and
- protection and restoration of biodiversity and ecosystems (in accordance with Article 15).

EU policy to commit companies to respect human rights and the environment in their global value chains: sets out the principles underlying the CSDDD.

European Green Deal: sets out a series of actions to transform the European Union into a modern, resource-efficient and competitive economy by achieving net-zero by 2050, economic growth decoupled from resource use, and no person or place left behind.

European Sustainable Finance Agenda: part of the broader effort to connect finance with the specific needs of the European and global economy for the benefit of the planet and society. Specifically, the agenda aims to reorient capital flows towards sustainable investment to achieve sustainable and inclusive growth; manage financial risk flowing from climate change; and foster transparency and long-termism.

Extra-territorial impact: the CSRD disclosure requirements will apply (*see* my November 20, 2022 briefing note for the phase-in dates) to:

- all "large undertakings" or "large groups" (whether or not listed on an EU regulated market), which encompasses EU companies (either an EU company or an EU subsidiary of a non-EU parent company) or EU groups on a consolidated basis, in all cases meeting *any two of the following three* criteria: as of the most recent balance sheet date: (i) more than €40 million of annual net revenue, (ii) more than €20 million of total assets, and (iii) average numbers of employees in excess of 250. Note: this could include a large EU subsidiary of a non-EU parent company and an EU parent undertaking of a large group that on a consolidated basis satisfies at least two of the three EU nexus criteria. All undertakings that are parent undertakings of large groups should report at the group level;

- companies (wherever organized) listed on an EU regulated market[2], including SMEs that are not micro-enterprises;
- EU credit institutions;
- EU insurance undertakings; and
- other companies designated as public-interest entities by national authorities.

Finally, groups with non-EU parent companies will be required to comply with certain requirements (with reporting based on the entire group, from the perspective of the parent) if:

- the group, on a consolidated basis, generated EU net revenue of more than €150 million in each of the last two consecutive financial years; *and*
- the group has at least one EU subsidiary that meets the requirements for an EU public-interest entity (*i.e.,* a "large undertaking," or EU regulated market listing (other than a micro-enterprise)); or a branch that generated more than €40 million in revenue in the preceding financial year.

The International Sustainable Standards Board ("ISSB"): *see* my April 13, 2022 briefing note, available here.

Minimum safeguards: set out under the Taxonomy Regulation to ensure that companies that hold themselves out as engaging in sustainable activities meet certain minimum standards in respect of human rights, bribery, taxation and fair competition. Under the Taxonomy Regulation, adherence to minimum standards is one of the four conditions for an economic activity to qualify as environmentally sustainable. These minimum safeguards cut across all of the EU sustainable finance regulations, the SFDR, the CSRD and the CSDDD. Essentially the minimum safeguards are intended to prevent green investments that otherwise meet sustainability standards from being marketed as sustainable if they violate the broader standards covered by the minimum safeguards.

It is noteworthy that minimum safeguards explicitly do not supersede more stringent business conduct standards set out in:

- The OECD Guidelines for multinational enterprises ("OECD-G")
- The UN Guiding Principles for Business and Human Rights ("UNGP")
- The ILO Declaration on Fundamental Principles and Rights at Work
- The UN International Bill of Human Rights

The Platform's October 2022 Final Report on Minimum Safeguards provides guidance on how the minimum safeguards are to flow through the SFDR, CSRD and CSDDD, on substantive topics and compliance. The guidance is non-binding. By virtue of the references to the SFDR, the five mandatory social PAIs set out in the SFDR are carried over.[3] With the

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[2] Listed securities include equity as well as debt securities, and depositary receipts in respect of equity or debt (*see* MiFID (2004/39/EC)). EU regulated markets would not include multilateral trading facilities in the European Union.

[3] Financial market participants are required under the SFDR to disclose the PAI of investment decisions on sustainability outcomes, including environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery. Of the 18 PAI indicators, five are relevant to minimum safeguards: violations of UNGP and OECD-G; lack of process to monitor UNGP and OECD-G compliance; unadjusted gender pay gap; board gender diversity; and

CSDDD still pending, and the CSRD recently approved, their implementation is uncertain and, therefore, the impact of the minimum safeguards on that legislation is evolving.

The Final Report breaks down compliance, based on the status under the CSRD, as between in-scope EU companies and in-scope non-EU companies, as well as for SMEs and banks/insurance companies, in each case with alternative tests (meeting one of two criteria of non-compliance) for each of the four core categories of human rights, corruption, taxation and fair competition. For example, in the case of minimum safeguards tied to human rights:

- **for an in-scope EU company**, (i) has it failed to establish an adequate human rights due diligence ("HRDD") process per the UNGP or OECD-G or (ii) are there signals that the company did not adequately implement HRDD and/or did it abuse human rights; and
- **for an in-scope non-EU company**, (i) has it failed to implement an adequate HRDD that follows the six steps of the UNGPs (as audit/assurance of these disclosures will be voluntary, an additional check on implementation is necessary, namely an assessment based, for example, on the World Benchmarking Alliance benchmarks) or (ii) are there signals that the company did not adequately implement HRDD and/or did it abuse human rights?

Non-Financial Reporting Directive (October 22, 2014 – 2014/95) ("NFRD"): the predecessor to the CSRD.

Platform on Sustainable Finance (the "Platform"): set up by the Commission as a permanent expert group to assist in developing sustainable finance policies, particularly the further development of the EU taxonomy. Among its priorities, the Platform is to provide advice on the technical screening criteria for environmental objectives, called for by Article 19 of the Taxonomy Regulation. The Platform had issued a report on methodology in March 2022 and a supplemental report (dated October 2022) in November.

Taxonomy Climate Delegated Act: sets out technical screening criteria for economic activities having the potential to contribute to climate change mitigation and climate change adaptation, these being the first two environmental objectives set out in the Taxonomy Regulation.

Taxonomy Complementary Climate Delegated Act: sets out technical screening criteria for activities in the gas and nuclear energy sector.

Taxonomy Disclosure Delegated Act, supplementing the Taxonomy Regulation: specifies the content, methodology and presentation of information for both financial and non-financial companies on the share of their respective business, investments or lending activities that are **aligned** with the Taxonomy.

- Non-financial companies are to disclose the share of their revenue, capital expenditure and operational expenditure (Performance KPIs) associated with environmentally sustainable economic activities as defined in the Taxonomy Regulation and the first

exposure to manufacture of controversial weapons (anti-personnel mines, cluster munitions, chemical weapons and biological weapons).

Taxonomy Delegated Act, as well as any future Delegated Acts on other environmental objectives.

- Financial institutions, mainly large banks, asset managers, investment firms and insurance/reinsurance companies, are to disclose the share of environmentally sustainable economic activities in the total assets they finance or invest in.

This Delegated Act defines, among other concepts,

- **Taxonomy-aligned economic activity**, which is an economic activity that complies with Article 3 of the Taxonomy Regulation.
- **Taxonomy-eligible economic activity**, which is an activity described in Delegated Acts adopted pursuant to the Taxonomy Regulation (subparts of Articles 10-15), regardless of whether or not the activity meets the screening criteria in those Delegated Acts. A **Taxonomy-non-eligible economic activity** is any activity not described in the Delegated Acts pursuant to the Taxonomy Regulation (subparts of Articles 10-15).

Taxonomy Environmental Delegated Act adopted by the Commission on June 27 (and yet to be finalized): sets out technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes no significant harm to any of the other environmental objectives. (*See* additional details below.)

Taxonomy Regulation (June 18, 2020 – 2020/852): establishes the common classification of sustainable economic activities deemed to contribute to environmental objectives. The Taxonomy classification is used in the CSRD and the SFDR. (*See generally* my January 6, 2022 briefing note, available here.) As noted in the introduction, the key to understanding the taxonomy construct is to follow the four criteria for environmentally sustainable economic activities and the six environmental objectives.

Article 3 sets out that whether or not an investment is environmentally sustainable, the four relevant criteria being whether the underlying activity:

- **contributes substantially** to one or more of the six environmental objectives set out in Article 9 (in accordance with Articles 10-16) – where **substantial contribution** means directly enabling other activities to make a substantial contribution to one or more of the objectives, provided the economic activity does not lead to lock-in of assets that undermine the long-term environmental goals and has a substantial positive environmental impact on the basis of life-cycle considerations (Article 16);
- does not significantly harm ("DNSH") any of the other environmental objectives set out in Article 9 (in accordance with Article 17);
- is carried out in compliance with minimum safeguards set out in Article 18; and
- complies with screening criteria established by the Commission (as contemplated by Articles 10-15, and meeting the requirements of Article 19).

The Taxonomy will have other applications in the future.

A visual representation of the Taxonomy is available on the Taxonomy Compass.

EU Corporate Disclosure

The **Corporate Sustainability Reporting Directive** (2022/2464): amends the NFRD as well as the Audit Directive (2006/43), the Transparency Directive (2004/109) and the Accounting Directive (2013/34). (*See* my November 20, 2022 briefing note, available here.) The CSRD entered into force January 5, and its rules will be phased in beginning January 1, 2024 for certain large EU and EU-listed companies (with reporting in 2025 on 2024 data), and for all in-scope companies by January 1, 2028.

The CSRD covers a range of disclosable information (the first five being carryovers from the NFRD):

- environmental matters;
- social matters and treatment of employees;
- respect for human rights;
- anti-corruption and bribery;
- diversity on company boards (in terms of age, gender, educational and professional background);
- "sustainability matters," which encompasses environmental, social and human rights, and governance factors, including the factors set out in the SFDR, which would pick up anti-corruption and anti-bribery matters; and
- "key intangible resources," which encompasses resources without physical substance on which the business model fundamental depends that are a source of value creation.

The key disclosure topics are:

- business model and strategy;
- time-bound targets related to sustainability;
- the role of the board and management regarding sustainability matters;
- policies relating to sustainability;
- incentive arrangements linked to sustainability;
- the due diligence process in respect of sustainability matters and, where applicable, in line with EU due diligence requirements;
- the principal adverse effects connected to the reporting company and its value chain;
- the principal risks related to sustainability matters;
- actions taken to prevent, mitigate, remediate or bring to an end actual or potential adverse impacts; and
- indicators relevant to the foregoing disclosures.

The specific disclosure requirements applicable under the CSRD are set out in the ESRSs, which were developed by EFRAG and were adopted by the Commission as a Delegated Act on July 31. The ESRSs now go to the European Parliament and the Council for scrutiny – both bodies may accept or reject, but cannot amend, them. (For more details, *see* Recent Developments below.)

The ESRSs cover general principles of sustainability reporting (ESRS 1), general disclosure principles (ESRS 2) and themed topics, including:

- climate change (ESRS E1);
- pollution (ESRS E2);

- water and marine resources (ESRS E3);
- biodiversity and ecosystems (ESRS E4);
- resource use and circular economy (ESRS E5);
- business conduct (ESRS G1);
- own workers (ESRS S1):
- workers in the value chain (ESRS S2);
- affected communities (ESRS S3); and
- consumer end users (ESRS S4).

The text of the standards, set out in Annex 1 to the Delegated Act, is available here and definitions of relevant terms are set out in Annex 2 to the Delegated Act (available here). These ESRSs are sector-agnostic. The Commission is required to adopt sector-specific standards by June 2024.

Among the most significant of the aspects of the ESRSs are the perspective of "double materiality," requiring reporting companies to report both on their impact on the people and the environment (known as "impact materiality"), and on how social and environmental issues give rise to financial risks and opportunities (affecting financial position, financial performance and cash flows over the short, medium and long term) for the reporting company (known as "financial materiality").

EU Financial Services Sector Disclosure Requirements

Sustainable Finance Disclosure Regulation (November 27, 2019 - 2019/2088) ("SFDR") applied from March 10, 2021 (with certain requirements to be phased in). It introduced disclosure requirements for financial market participants that fit within existing disclosure regimes, and established the concept of a "sustainability risk," which it defines as an ESG "event or condition that, if it occurs, could cause a negative material impact on the value of the investment."

In brief, the SFDR (as supplemented by the April 6, 2022 Delegated Act) sets out sustainability disclosure obligations:

- for market participants (asset managers, institutional investors and other entities that offer financial products while managing client money, which it refers to as "financial market participants"), as well as financial advisers in all investment processes, and for financial products that pursue objectives of sustainable investing; and
- as to adverse impacts of investment decisions on sustainability factors (referred to as "principal adverse impacts" or "PAIs") at entity and financial product levels. Among other things, financial market participants are to disclose the indicators related to PAIs of their investment decisions on sustainability factors and the actions taken/planned to be taken to avoid or reduce the PAIs identified. Financial market participants also are required to describe their policies to identify and prioritise PAIs on sustainability factors and how those policies are kept up to date and applied.

The Delegated Act (April 6, 2022 - 2022/1288), supplementing the SFDR, sets out technical standards specifying:

- the details of the content and presentation of the information in relation to the principle of DNSH;

- the content, methodologies and presentation of information in relation to sustainability indicators and PAIs; and
- the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports.

The indicators of PAIs of investment decisions on sustainability factors are:

- GHG emissions;
- Carbon footprint;
- GHG intensity of investees;
- Exposure to fossil fuel sector;
- Share of non-renewable energy consumption/production;
- Energy consumption intensity;
- Negative impact on biodiversity;
- Emissions to water;
- Hazardous waste and radioactive waste ratio;
- Violations of UNGP and OECD-G;
- Lack of process to monitor UNGP and OECD-G compliance;
- Unadjusted gender pay gap;
- Board gender diversity;
- Exposure to manufacture of controversial weapons;
- GHG intensity;
- Investees subject to social violations;
- Exposure to fossil fuels through real estate; and
- Exposure to energy-inefficient real estate.

In November 2022, the European Supervisory Authorities ("ESAs," being the European Banking Authority ("EBA"), ESMA and the European Insurance and Occupational Pensions Authority ("EIOPA")) published their Q&A on the SFDR Delegated Regulation. The Commission had published a separate Q&A on SFDR matters.

Regulation to establish a framework to facilitate sustainable investing: sets out the criteria for determining whether an economic activity qualifies as environmentally sustainable, for purposes of the SFDR.

EU Corporate Sustainability Due Diligence

The **Corporate Sustainability Due Diligence Directive** (Council approval December 1, 2022 - 2019/1937), including its Annex (*see* my previous briefing note, available here), establishes a duty of due diligence for companies within its scope. The core elements of the corporate duty are to ensure that companies active in the European Union contribute to sustainable development and the sustainability transition of economies and societies by respecting human rights and the environment, through the identification, prevention and mitigation, bringing to an end, remediation and minimisation, and where necessary, prioritisation, of potential or actual adverse human rights and environmental impacts connected with their own operations, and the operations of subsidiaries and value chains, and

ensuring that those affected by a failure to respect this duty have access to justice and legal remedies.

CSDDD obligations are tied to the OECD Due Diligence Guidance for Responsible Business Conduct, and thus include:

- integrating due diligence into policies and management systems;
- identifying and assessing adverse human rights and environmental impacts;
- preventing, ceasing or minimising actual and potential adverse human rights and environmental impacts;
- verifying, monitoring and assessing the effectiveness of measures;
- communicating; and
- providing remediation.

On December 1, 2022, the European Council cleared the way (having adopted its "general approach") for the Council presidency to begin negotiations with the European Parliament over the terms of the CSDDD. Separately, the Committee on Economic and Monetary Affairs of the European Parliament proposed to the Committee on Legal Affairs to expand the scope of the CSDDD to include institutional investors and asset managers, which would have obligations under the directive in respect of their investee companies. The Commission published its proposed directive on February 23. On June 1, the European Parliament adopted its own set of amendments (*see* Recent Developments, below).

The CSDDD is now under negotiation among the European Parliament, the Commission and the Council.

Global Standards

ISSB

In June, the ISSB formally issued its inaugural corporate disclosure standards – IFRS S1 (General Requirements for Disclosure of Sustainability-related Financial Information) and IFRS S2 (Climate-related Disclosures) (collectively, the "Standards"). The Standards respond to longstanding demands from investors and other stakeholders for consistent, comprehensive and comparable, decision-useful information to enable them to gain an understanding of a company's performance and prospects from a sustainability standpoint. In the words of the ISSB, these Standards establish a global baseline for sustainability disclosure – a common language for disclosing the effects of climate-related risks and opportunities on a company's "prospects." Ultimately, the Standards are designed to provide users of corporate financial reporting with information relevant to investment decisions in the subject reporting companies. (For more details, *see* my June 28 briefing note, available here.)

Recent Developments

Corporate Disclosure

As noted above, 12 ESRSs, which represent the common standards for the CSRD, were approved by the Commission on July 31(*see also* Commission Q&A). There is now a two-month, extendible to a four-month, period for the European Parliament and the Council to scrutinize the ESRSs.

The Commission has asked EFRAG to prepare additional nonbinding guidance, among other things, on materiality assessments (*see* EFRAG press release). The Commission will also put in place a mechanism to provide formal interpretations of the standards. EFRAG has

indicated that it will shortly host a portal for technical questions that companies or other stakeholders may have about the application of ESRSs. Where appropriate, the Commission will consider providing guidance on questions concerning legal interpretation of the ESRSs.

The Commission made a few key modifications to the draft standards submitted by EFRAG, including:

Materiality: all standards and all disclosure requirements and data points within each standard will be subject to materiality assessment, with the exception of the disclosure requirements specified in the "General disclosures" standard. This differs from the EFRAG proposal only insofar as EFRAG proposed three other exceptions to the general principle of materiality (climate standard; datapoints derived from the SFDR, the Benchmarks Regulation and the "pillar 3" disclosure requirements of the Capital Requirements Regulation; and, in the case of undertakings with more than 250 employees, certain datapoints regarding the undertaking's own workforce). Disclosure requirements subject to materiality are not, however, voluntary. The information in question must be disclosed if it is material, and the undertaking's materiality assessment process is subject to external assurance in accordance with the provisions of the CSRD.

If a reporting entity concludes that climate change is not a material topic and, therefore, that it does not report in accordance with that standard, it is to provide a detailed explanation of the conclusions of its materiality assessment with regard to climate change. This provision was included, according to the Commission, "in recognition of the widespread and systemic effects of climate change on the economy as a whole."

If a reporting entity concludes that a datapoint deriving from the SFDR, the Benchmarks Regulation or the "pillar 3" disclosure requirements under the Capital Requirements Regulation is not material, it must explicitly state that the datapoint in question is "not material." It must also provide a table with all such datapoints, indicating where they are to be found in its sustainability statement or stating "not material," as appropriate. According to the Commission, these provisions aim to facilitate the compliance of financial market participants, benchmarks administrators and financial institutions with their own disclosure obligations respectively under the SFDR, the Benchmarks Regulation and the Capital Requirements Regulation.

Phase-in: Undertakings with fewer than 750 employees may omit: scope 3 GHG emissions data and the disclosure requirements specified in the standard on "own workforce" in the first year that they apply the standards; and the disclosure requirements specified in the standards on biodiversity and on value-chain workers, affected communities, and consumers and end-users in the first two years that they apply the standards.

All undertakings may omit the following information in the first year that they apply the standards: anticipated financial effects related to non-climate environmental issues (pollution, water, biodiversity, and resource use); and certain datapoints related to their own workforce (social protection, persons with disabilities, work-related ill-health, and work-life balance).

Certain voluntary disclosures: The Commission has converted a number of the mandatory datapoints proposed by EFRAG into voluntary datapoints. This includes, for example: biodiversity transition plans; certain indicators about "non-employees" in the undertaking's own workforce and an explanation of why the reporting entity may consider a particular sustainability topic not to be material.

Further flexibility: there are additional flexibilities in the disclosure requirements on the financial effects arising from sustainability risks and on engagement with stakeholders, and in the methodology to use for the materiality assessment process. The Commission also has modified datapoints regarding corruption and bribery and regarding the protection of whistle-blowers that might be considered to have infringed on the right not to self-incriminate.

Interoperability: the Commission and EFRAG have continued to engage closely with the ISSB and the Global Reporting Initiative (GRI) to ensure a interoperability with the ESRSs, and further modifications to the draft ESRS have been made in light of that engagement.

Due Diligence Obligations

Parliament weighed in with its amendments on the CSDDD on June 1. Changes to the Commission version includes the scope of the directive (split between EU and non-EU companies), the scope of the diligence obligations, including the scope of non-subsidiaries whose impact a covered company must monitor, and the phase-in of the effectiveness of the obligations (from three to five years after entry into force).

Covered companies (under amended article 2, as proposed by the European Parliament) would include:

- EU-based companies with more than 250 employees on average and net worldwide turnover of more than €40 million; and EU-based companies that did not reach the foregoing thresholds but whose ultimate EU-based parent company had at least 500 employees and a net worldwide turnover of more than €150 million; and
- Non-EU companies (regardless of number of employees) if they have net worldwide turnover of more than €150 million, of which at least €40 million was generated in the European Union; and non-EU companies that did not reach the foregoing threshold but whose ultimate parent company had more than 500 employees on average and net worldwide turnover of more than €150 million, of which at least €40 million was generated in the European Union, including in either case turnover generated by third parties with whom the company and/or its subsidiaries has entered into a vertical agreement in the European Union in return for royalties

The proposed sector-specific thresholds would be eliminated.

All covered companies (and not just larger ones, as proposed by the Commission) would be required to adopt and implement a transition plan, compatible with reporting obligations under the CSRD, to ensure that the business strategy and the business model are aligned with: the transition to a sustainable economy, limiting global warming to 1.5°C and the objective of achieving climate neutrality, including 2030 climate targets and 2050 climate neutrality targets (under the European Climate Law). The plan would be required to address:

- resilience of the business model and strategy to risks related to climate matters;
- opportunities related to climate matters;
- where appropriate, an identification and explanation of decarbonization levers within operations and value chain, including the exposure to coal-, oil- and gas-related activities;
- how the business model and strategy take account of the interests of affected stakeholders and the impacts of the company on climate change;

- how the strategy has been implemented and will be implemented with regard to climate matters, including related financial and investment plans;
- the time-bound targets related to climate change set for Scope 1, Scope 2 and, where relevant, Scope 3 GHG emissions, including, where appropriate, absolute emission reduction targets for GHG for 2030 and in five-year steps up to 2050 based on conclusive scientific evidence, and a description of the progress the company has made toward achieving those targets; and
- a description of the role of the administrative, management and supervisory bodies with regard to climate matters.

Sustainable Finance

As noted above, on June 27, the Commission approved a new set of Taxonomy criteria via the Environmental Delegated Act for economic activities making a substantial contribution to one or more of the non-climate environmental objectives, namely:

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

The Commission also adopted on June 27 amendments to the Climate Delegated Act covering the environmental objectives of climate change mitigation and adaptation.

The Environmental Delegated Act now goes to the European Parliament and the Council for scrutiny – both bodies may accept or reject, but cannot amend, it.

ESG ratings providers: on June 13, the Commission proposed new rules for ESG ratings providers operating in the European Union that are disclosed publicly or that are distributed to regulated financial institutions in the European Union (Regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities – 2023/0177).

Fund names/greenwashing: in November 2022, the European Securities and Markets Authority ("ESMA") published a Consultation aimed at developing guidelines for the use of names of funds with ESG or sustainability-related terms. These guidelines are not intended to interfere with the requirements of the SFDR or the Taxonomy Regulation. The objective of the guidelines is to counter the risk of greenwashing by funds.

Separately, the ESAs published a Call for Evidence ("CfE") to better understand greenwashing across the entire EU financial services sector. For this purpose, the term "greenwashing" comprehends sustainability-related claims relating to all aspects of ESG (*i.e.*, environmental, social and governance dimensions). The CfE recognizes that the drivers of greenwashing are multifaceted and may include demand for sustainability-related products, data-related issues, the need to build expertise and skills, challenges in the application of new rules, inconsistent interpretations of the legal regime and financial literacy gaps.

Green Deal Industrial Plan

On February 1, the Commission announced the Green Deal Industrial Plan to support the EU transition to net-zero and support the competitiveness of the EU net-zero industry. It is based on four pillars:

- a predictable and simplified regulatory environment (including a new Net-Zero Industry Act ("NZIA") and a Critical Raw Materials Act ("CRM Act"), as well as reform of the market for electricity);
- speeding up investment and access to finance, including amending temporary state aid rules and increasing thresholds for notification of green investments;
- enhancing skills; and
- open trade for resilient supply chains.

The plan was first announced by President von der Leyen at Davos, and is Europe's answer to the buy-American provisions of the Inflation Reduction Act (*see* my November 26, 2022 briefing note, available here) by incentivizing EU clean tech and industrial innovation to stay in Europe.

On March 16, the Commission published its proposed NZIA, as a key element of the Green Deal Industrial Plan (*see also* Commission Update and Fact Sheet). The NZIA is intended to strengthen European manufacturing capacity of net-zero technologies and overcome barriers to scaling up manufacturing capacity in Europe, thereby increasing the competitiveness of the EU's net-zero technology industrial base and improving the EU's energy resilience. The NZIA is based on six pillars, including setting enabling conditions, accelerating carbon capture, facilitating access to markets, enhancing skills and fostering innovation.

The NZIA covers products, components and equipment necessary for manufacturing net-zero technologies. It distinguishes between net-zero technologies and strategic net-zero technologies, the latter making a significant contribution to decarbonisation by 2030 and being commercially available or soon to enter the market. All net-zero technologies benefit from the NZIA, but strategic net-zero technologies are eligible for additional benefits.

The NZIA is before the European Parliament and Council for consideration.

On March 16, the Commission also published its proposed CRT Act, designed to ensure EU access to a secure and sustainable supply of critical raw materials. The text of the proposed regulation was accompanied by a Commission Communication.

Renewable Hydrogen

In February, the Commission adopted two Delegated Acts to define what constitutes renewable hydrogen, as required under the Renewable Energy Directive (2018/2001). These definitions are necessary for renewable fuels of non-biological origin (RFNBOs) to be counted towards renewable energy targets. Hydrogen plays an important role in the European Green Deal and the REPowerEU plan, as upscaling the use of renewable hydrogen, ammonia and other derivatives are expected to accelerate the decarbonization of the EU economy and reduce dependence on Russian imports of fossil fuels. The Delegated Acts must be approved by the European Parliament and the Council.

On March 16, concurrently with the publication of the NZIA proposal, the Commission announced a plan to stimulate and support investment in sustainable hydrogen production through a European Hydrogen Bank (see also Commission Fact Sheet).

Concluding Thoughts

That there are multiple Directives, Regulations and Delegated Acts, including significant modifications to one Directive (the NFRD amended by the CSRD), are a testament to the complexity as well as the scope and ambition of the EU's sustainability initiatives. While the proposed SEC climate rulemaking release is a single document, focused only on climate and

only on disclosures by SEC reporting companies (in effect, listed companies), the EU effort is far broader. First, the effort targets disclosure across a far broader range of ESG themes; second, the effort covers far more than listed companies; and, third, the effort focuses not only on corporate obligations but also on financial market participant obligations.

The benefit of the EU approach is that it integrates, though that common classification system, the entire ecosystem of players that have a role in transitioning to net-zero. This is a dynamic area, with multiple moving pieces. In some cases, the changes are broadening coverage (*e.g.,* the CSRD modifications to the NFRD) and in others retrenching somewhat (*e.g.,* the scope of the CSDDD and the director duty of care thereunder).

All to say that close attention to legislative and regulatory developments remains necessary. To add to the complexity, recall that Directives (in contrast to Regulations) are not self-implementing and require transposition into national law, which has the potential to create more onerous obligations across Member States.

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