



AN INTRODUCTION TO EUROPEAN ESG REGULATION & IMPLEMENTATION

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AGENDA

- European Green Deal
- EU Action Plan on sustainable finance
- European disclosure regulation for financial products
- EU Taxonomy
- CSR Directive



EUROPEAN GREEN DEAL

EU GREEN DEAL AND SUSTAINABLE FINANCE – HOW DID WE GET HERE?



EU GREEN DEAL - OVERVIEW

- The EU Green Deal – a legislative and regulatory action plan with the overarching objective of the EU becoming the first climate neutral continent by 2050
- Key focus areas :
 - Climate action
 - Clean energy
 - Sustainable industry
 - Buildings and renovations
 - Sustainable mobility
 - Eliminating pollution
 - Farm to Fork
 - Preserving biodiversity
 - Research and Development (**R&D**)
 - Preventing unfair competition from carbon leakage



GREEN DEAL INITIATIVES



Climate Action

- **Key objective:** Climate neutrality by 2050
 - European Climate Law (Regulation (EU) 2021/1119)
- 2030 Greenhouse Gas Emissions Target:
 - *Fit For 55 Package*, including:
 - Emissions Trading System
 - Efforts Sharing Regulation
 - Renewable Energy Directive (revised in July 21)
 - Energy Efficiency Directive
 - Energy Taxation Directive
 - Alternative Fuels Infrastructure Regulation

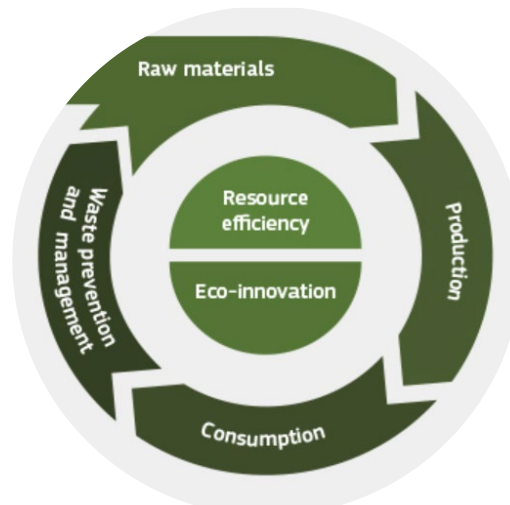
Clean Energy

- Reduce energy use and consumption
 - Clean Planet for All Strategy
 - Offshore Renewable Energy Strategy
 - Hydrogen Strategy
- Clean Energy for all Europeans package
 - Package of eight legislative acts:
 - Energy Performance in Buildings Directive
 - Renewable Energy Directive
 - Energy Efficiency Directive
 - Governance of the Energy Union Regulation
 - Electricity Regulation
 - Electricity Directive
 - Risk Preparedness Regulation
 - ACER Regulation

GREEN DEAL INITIATIVES

Sustainable Industry

- Circular Economy Action Plan
 - Increase reusability, reparability and/or recyclability:
 - Waste Shipment Regulation
 - Packaging Directive
 - EcoDesign Directive
 - Regulation on persistent organic pollutants
 - New regulation on sustainable batteries (2020/0353(COD))
- EU Industrial Strategy:
 - Strengthen single market
 - Increase global competitiveness
 - Enhance strategic autonomy



Buildings and renovations

- The Renovation Wave
 - Reduce energy consumption and move towards decarbonization of heating and cooling
 - Focus on worst performing buildings and public buildings
 - Energy Performance Buildings Directive
 - Energy Efficiency Directive
 - Construction Products Regulation
 - Proposal on Building Renovation Passports
 - European Bauhaus

GREEN DEAL INITIATIVES

Sustainable mobility

- Target of 90% cut in transport emission by 2050
- Strategy for Sustainable and Smart Mobility:
 - 2030, 2035 and 2050 Targets
 - Proposals and review of legislation:
 - Energy Performance of Buildings Directive
 - Directive on the Deployment of Alternative Fuel Infrastructure
 - CO2 emissions (post-Euro 6/VI emission standards)

Eliminating Pollution

- Zero Pollution Action Plan :
 - Chemical Strategy for Sustainability
 - Review of REACH and other chemicals regulation
 - action plan for water, air and soil
 - Ambient Air Quality Directive
 - Implementation Report on the Environmental Noise Directive
 - Bathing Water Directive
 - Drinking Water Directive
 - limit pollution from large industrial installations
 - Industrial Emissions Directive
 - Mercury Regulation

GREEN DEAL INITIATIVES



Farm to Fork

- Farm to fork strategy
 - €10 billion on research and innovation on food, bioeconomy, natural resources, agriculture, fisheries, aquaculture and the environment
 - Legislative framework for sustainable food systems
 - Sustainable Use of Pesticides Directive
 - Feed Additives Regulation
 - Complements Strategy to Reduce Methane Emissions

R&D

- R&D key to achieve Green deal objectives:
 - 35% of Horizon Europe's EUR 95.5 Billion budget will be spent on R&D

Preserving biodiversity

- EU Biodiversity Strategy 2030
 - Conserve and restore ecosystems
 - Birds and Habitats Directive
 - EU Forest Strategy
 - Synergizes with Farm to Fork strategy
 - €20 billion in public and private funding

Carbon Leakage

- Carbon Border Adjustment Mechanism
 - Ensures price of imports reflects their carbon impact
 - Prevent unfair competition

FINANCING THE EU GREEN DEAL

- European Green Deal Investment Plan
 - €1 trillion worth of public and private investment over the next decade:
 - EU budget and the EU Emissions Trading System
 - InvestEU Programme
- Just Transition Mechanism
- Sustainable Finance
 - Taxonomy



EU ACTION PLAN, DISCLOSURE, & TAXONOMY

BACKGROUND – INTERNATIONAL DEVELOPMENTS

- **UN Principles for responsible Investment (UN PRI)**
 - 2006 Initiative of the UN with large institutional investors
 - Six principles for responsible investments
 - Principle 1: “We will incorporate ESG issues into investment analysis and decision making processes”
- **UN sustainable development Goals (“SDG”, “Agenda 2030”)**
 - came into force on 01 January 2016
 - 17 political goals for the UN (peace, end poverty, education, etc.)
- **Paris Agreement**
 - Agreement of 197 states dated 12 December 2015
 - Goal: reduction of global warming to 1,5° Celsius

EU ACTION PLAN ON SUSTAINABLE FINANCE

- EU response to the UN SDG and the Paris Climate Protection Agreement, dated 08 March 2018
- *“Reorienting private capital to more sustainable investments requires a comprehensive shift in how the financial system works.”*
- 10 Actions to reorient capital flows, manage risks from climate change and foster transparency
- Actions 1: **Classification** for sustainable activities: *“A unified EU classification system – or taxonomy - will provide clarity on which activities can be considered 'sustainable'.”* (**EU Taxonomy**)
- Action 9: **Transparency**: *“Transparency of asset managers and institutional investors on sustainability issues is a basic prerequisite for financial market participants to adequately assess their management of sustainability risks.”* (**EU Sustainable Finance Disclosure Regulation**)

TRANSPARENCY – EU SFDR

EU Regulation on sustainability-related disclosures in the financial services sector (27 November 2019 (EU 2019/2088))

Subdivision of investments funds and other investment products into three groups:

- **"Art. 8-Products"** : Products with ESG characteristics in their investment strategy - *"among other characteristics, environmental or social characteristics are promoted"*
- **"Art. 9-Products"**: Impact Investment Products - *" a financial product has sustainable investment as its objective".*
- **"Art. 6-Products"**: (no ESG characteristics) – *„where financial market participants deem sustainability risks not to be relevant, a clear and concise explanation of the reasons therefor is required“*
- Subdivision between 6,8 and 9-Products difficult and/or still disputed
- Classification has a significant influence on scope of disclosure obligations
- **"Green washing"** must be avoided!

CLASSIFICATION – EU TAXONOMY

Establishment of a framework to facilitate sustainable investment (18 June 2020 (EU 2020/852))

- The regulation does not contain a definition of sustainable activities/investments.
- It contains only principle-based objectives that an activity/investment should benefit or not harm, e.g.:
 - climate protection
 - sustainable use and protection of water and marine resources
 - transition to a circular economy
- The actual classification takes place in the so-called “Level II” measures.
- Entry into force of essential provisions of the Regulation on 01 January 2022 or 01 January 2023.
- The Level II measures are currently still in the draft stage.

CLASSIFICATION – EU TAXONOMY

Criteria for environmentally sustainable economic activities:

- Economic activity contributes substantially to one or more environmental objective, and
- does not significantly harm any of the environmental objectives, and
- is compliant with minimum safeguards (International Bill of Human Rights, etc.), and
- complies with technical screening criteria (TSC).

CLASSIFICATION – EU TAXONOMY

- Environmental objectives: Climate change mitigation, climate change adaption, protection of water and marine resources, transition to a circular economy, pollution prevention and control, protection and restoration of biodiversity and ecosystems.
- As of Jan. 1, 2022, the EU taxonomy will only come into force with regard to the objectives climate change mitigation and climate change adaptation. The other goals will not be effective before 01 Jan. 2023.

TAXONOMY AND TRANSPARENCY – PRACTICAL ISSUES

- The self-imposed deadlines for the introduction of the new ESG regulations are often not met. Legal requirements for classification and transparency come into force gradually at different points in time.
- Financial market participants must implement documentation in their products, even if specifications are still missing / only available in draft form.
- The regulation alternates between attention to detail on the one hand, and legal gray areas on the other.
- Example: Investor information for Art. 8 and Art. 9 products must contain a separate appendix in which the ESG-related information is described in a detailed question and answer scheme. At the same time, it is still unclear, which percentage of a fund's assets must meet ESG-characteristics in order to qualify under Art. 8 of the SFDR.

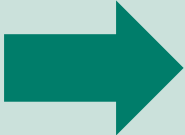



CSR DIRECTIVE

1. BACKGROUND

- A wide array of stakeholders from regulators to financial analysts use ESG criteria to evaluate the environmental and social impacts of a business
- Non-financial reporting by German companies has long been a voluntary matter
- The first framework has been set out by the CSR Directive Implementation Act of the European Union 2014 (“CSR Act”), which the German legislator has implemented into domestic law (Sec. 289a ff. German Commercial Code (HGB))
- As of fiscal year 2017, non-financial reporting is mandatory

2. REFORM OF THE CSR DIRECTIVE (1/4)

	Current situation	Future
Scope	<p>Companies that satisfies all of three conditions:</p> <ol style="list-style-type: none">1. Large company (that exceed at least two of the following three criteria: a balance sheet total of €20m; a net turnover of €40m; an average number of employees during the financial year of more than 250)2. Oriented towards the capital market3. An average number of employees during the financial year of more than 500 <div> This covers approximately 11,700 large companies and groups across the EU</div>	<p>The scope will cover:</p> <ul style="list-style-type: none">• All large companies (that exceed at least two of the following three criteria: a balance sheet total of €20m or a net turnover of €40m or an average number of employees during the financial year of more than 250)• All companies listed on EU regulated markets, with the sole exception of listed micro-companies (although listed small and medium-sized companies would fall within the scope) <div> This would cover nearly 49,000 companies and groups across the EU</div>

2. REFORM OF THE CSR DIRECTIVE (2/4)

	Current situation	Future
Topics to report on	<ul style="list-style-type: none">• Providing of a brief description of the business model and disclosures on non-financial issues such as environmental, social and employee-related matters, respect for human rights, anti-corruption, bribery matters and diversity on corporate boards• Several national and international guidelines exists which can be used for the preparation of the non-financial report (e.q. GRI, SASB, IIRC, etc)• Guidelines are not mandatory; it is legally required to indicate within the report which guideline was applied, or why no guideline was used for the report	<ul style="list-style-type: none">• Specification of the content of sustainability-related information referring to the EU-coined term ESG and adoption of EU sustainability reporting standards• CSR Directive will put an end to the current non-mandatory standards• Requirement to report according to mandatory EU sustainability reporting standards. The Commission will adopt delegated acts to provide for such reporting standards based on the technical advice provided by the European Financial Reporting Advisory Group (EFRAG)• Requirement to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan

2. REFORM OF THE CSR DIRECTIVE (3/4)

	Current situation	Future
Reporting	<ul style="list-style-type: none">• The reporting company may include its non-financial report in the management report or prepare a separate non-financial report to be published on their website	<ul style="list-style-type: none">• The reporting company may include its non-financial report in the management report or prepare a separate non-financial report to be published on their website
Audit	<ul style="list-style-type: none">• No obligation to externally audit the content of the reported non-financial information; however, if the management report has not been added with a non-financial report or if a separate non-financial report has not been published or if individual disclosures are missing therein, the management report is incomplete and the auditor may restrict or deny the audit opinion	<ul style="list-style-type: none">• Implementation of a general EU-wide audit and assurance requirement

2. REFORM OF THE CSR DIRECTIVE (4/4)

	Current situation	Future
Penalties	<ul style="list-style-type: none">• False non-financial reporting is punishable by imprisonment or a fine	<ul style="list-style-type: none">• Implementation of further sanctions:<ul style="list-style-type: none">– a public statement outlining the nature of the violation and indicating the responsible person/entity;– a cease-and-desist order against the responsible person/entity; and– administrative pecuniary sanctions

3. CURRENT STATUS OF THE LEGISLATIVE PROCEDURE

- Associations and professionals had the opportunity to state their opinion on the proposed directive until June 4, 2021
- Next, the European Parliament will start its work on the proposal (first, second reading)
- Directive is proposed to be effective for financial years beginning as of 1 January 2023

THANK YOU / QUESTIONS?

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