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SUSTAINABLE FINANCE – A REGULATORY OVERVIEW

WHITEPAPER

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"A deep re-engineering of the financial system is necessary for investments to become more sustainable and for the system to promote truly sustainable development from an economic, social and environmental perspective. This implies finding ways to integrate sustainability into the EU's regulatory and financial policy framework and to mobilise and orient more private capital flows towards sustainable investments."

European Commission, Mid-Term Review of the Capital Markets Union Action Plan, 8th June 2017

1. EU ACTION PLAN AND GREEN DEAL

01

Sustainability has been at the top of the legal policy agenda of European financial market regulation for quite some time. This has been the case at least since the EU Commission adopted its Action Plan on Financing Sustainable Growth[1] (hereinafter "**Action Plan**") in March 2018. The task, which the financial industry will now also be called upon to tackle, is enormous: according to the EU Commission's estimates, between EUR 180 billion and EUR 270 billion will have to be invested each year to achieve the 2 °C target set out in the Paris Climate Change Agreement.[2] This investment requirement cannot be met through sole reliance on public budgets.[3]

02

The EU therefore wants to **redirect private capital flows** so that they can be used to finance sustainable projects (see below 2).[4] The regulatory toolbox to achieve this goal consists of an EU-wide classification (taxonomy), the introduction of labels for sustainable products (e.g. green bonds), the consideration of ESG preferences in financial advice, and uniform standards for climate benchmarks (see below 2).

03

The Action Plan also calls for embedding financial risks arising from climate change, resource scarcity, environmental degradation, and social problems into the **risk management** of credit institutions, asset managers, insurance companies, and rating agencies (see 3 and 5 below).[5]

04

Finally, the EU aims to promote transparency on how sustainability issues are addressed in **corporate reporting and corporate governance** (see below 4).[6]

05

The Action Plan has been given a political boost by the EU Commission's **European Green Deal** published in December 2019, which significantly increases the EU's climate and environmental policy ambitions. For example, greenhouse gas emissions in Europe are to be reduced by at least 55% by 2030, rather than 40% as previously planned, to ensure that Europe becomes climate neutral by 2050.[7] To finance the Green Deal, the EU Commission presented the European Green Deal Investment Plan in January 2020, which aims to mobilize at least €1 trillion for sustainable investments over the next decade.[8]

06

As part of the Green Deal, the EU Commission published its new Strategy for Financing the Transition to a Sustainable Economy in July 2021 (hereinafter "**New SF Strategy**").[9] It highlights four areas in which

additional measures are needed to enable the financial system to support the transformation to a sustainable economy:

- Financing the transition to a sustainable economy;
- Inclusion through greater consideration of citizens and SMEs and improving their access to sustainable financing;
- Strengthening the resilience of the financial sector to climate and environmental risks and combating greenwashing;
- Expand global efforts to promote a sustainable economy.

07

Finally, the EU Commission presented a **Green Deal Industrial Plan for the Net Zero Age** on February 1, 2023.[10] The plan intends to improve the competitiveness of European climate-neutral industry – particularly against the backdrop of the US Inflation Reduction Act – and at the same time accelerate the transition to climate neutrality.

08 The plan is based on four pillars:

- A predictable, coherent and simple regulatory environment for industry to enable the rapid build-up of production capacity for a carbon neutral economy;
- Faster access to sufficient financial resources for green investments;
- Promoting skills needed by the European workforce for the green transformation;
- Open trade for resilient supply chains

GOALS OF THE ACTION PLAN

Diversion of private capital into sustainable investments

- Taxonomy
- Identifiers (incl. Green Bonds)
- Financial advice
- Benchmarks

Promoting transparency and sustainability

- Disclosure / Accounting
- Corporate governance

Embedding of sustainability into risk management

- Ratings
- Institutional investors and asset managers
- Banks and insurance companies

2. REDIRECTING PRIVATE CAPITAL TO SUSTAINABLE INVESTMENTS

09 To achieve a reorientation of private capital flows toward sustainable investments, the European legislator is taking the financial industry to task. It must now ask investors about their sustainability preferences and offer them sustainable financial products.[11] To create the regulatory framework for this, the EU has on the one hand enacted new "sustainability financial market laws"; on the other hand, it is building on existing regulations (MiFID II, IDD).

10 Specifically, the EU Commission has initiated the following four legislative projects since May 2018, most of which have already been implemented:

1. development of an EU classification system for sustainable activities (Taxonomy Regulation) – finally adopted and published at level 1[12] and partially finally adopted and published at level 2;[13]

2. introduction of sustainability-related transparency obligations for financial market participants and financial advisors (Sustainable Finance Disclosure Regulation – SFDR) – finally adopted and published at levels 1 and final version adopted and published at level 2;[14]

3. creation of uniform reference values for CO_2 benchmarks – finally adopted and published at level 1 and 2;[15]

4. integration of sustainability in the client advisory process (Delegated Regulation (EU) 2021/1253[16] and Delegated Directive (EU) 2021/1269[17] – MiFID II – as well as Delegated Regulation (EU) 2021/1257[18] – IDD) finally adopted and published.

11 An important regulatory reference point in European legal texts is the acronym ESG. ESG stands for the terms Environmental, Social, and (Corporate) Governance, and thus describes the three possible sustainability goals towards which a sustainable investment can be directed.[19]

2.1 WHAT IS A SUSTAINABLE FINANCIAL PRODUCT?

12 The central concept of the European regulatory efforts are "*sustainable investments*". The term appears in both the Taxonomy Regulation and the SFDR. However, the term "sustainable investment" is broader in the SFDR than in the Taxonomy Regulation and therefore it is not defined uniformly.

13 One reason for this is that the Taxonomy Regulation – unlike the SFDR – was initially only intended to regulate "environmentally sustainable investments", i.e. "green" investments. And even in this subsection of ESG (E), the Taxonomy Regulation so far only offers evaluation criteria at Level 2 for the environmental goals of "climate change mitigation" and "climate change adaptation". For Taxonomy standards on the social (S) sustainability category, there are only initial proposals from a group of experts, the *Platform on Sustainable Finance* (PoSF) set up by the EU Commission.[20] Sustainable corporate governance (G) is completely omitted from the Taxonomy Regulation for the time being.[21]

14 Moreover, the Taxonomy Regulation sets stricter requirements for an "environmentally sustainable investment" than the SFDR:

> According to the Taxonomy Regulation, this requires an investment in one or more economic activities that are considered environmentally sustainable under the Taxonomy Regulation.[22] Economic activity is only environmentally sustainable if it makes a **substantial contribution** to the achievement of an environmental objective.[23] The conditions under which this is the case are specified in the Delegated Regulations on Level 2 of the Taxonomy Regulation. For the environmental objectives of "climate change mitigation" and "climate change adaptation", Level 2 regulations have already entered into force with initial amendments (see in more detail below 2.1.2).[24]

15 A "sustainable investment" within the meaning of the SFDR, on the other hand, is an investment in an economic activity that **contributes to** the achievement of an environmental objective or social objective (without having to be "substantial").[25] In this respect, no reference is made to the environmental objectives and evaluation criteria of the Taxonomy Regulation.[26]

16 Accordingly, **sustainable investments as defined by the Taxonomy Regulation** are **a subset of sustainable investments as defined by the SFDR**.[27] In the view of the European Supervisory Authorities (ESAs), financial products can therefore include environmentally sustainable investments as defined by the SFDR without being Taxonomy-compliant.[28] This has implications for the design of financial products (see in more detail below 2.2.1).

17 The common thread running through both definitions is that the investment must have a positive impact on sustainable economic activity to be recognized as sustainable. In both variants, the investment must also not significantly harm any sustainability objectives (Do no significant harm principle – **DNSH**). Furthermore, the companies in which investments are made must apply good governance practices, in particular with regard to sound management structures, employee relations, employee compensation and tax compliance (see in more detail below 2.1.2).

2.1.1 Taxonomy Regulation and SFDR – a Complex Interplay

18 The **Taxonomy Regulation aims** to establish a uniform classification of environmental sustainability for financial market participants within the EU.[29] It is designed as a **framework regulation** for the sustainability regulation of the European financial markets.

19 The Taxonomy Regulation is not only addressed to the financial market participants, but also to the **Member States**: They are obliged to apply the taxonomy laid down in the regulation when they set requirements in relation to financial products designated as "environmentally sustainable".[30] This involves minimum standards, seals or comparable labels for "green" financial products. Because the EU Commission expects an increase in national standards for such financial products, it fears a fragmentation into different national sustainability concepts. Therefore, the Commission is working to prevent this by installing a uniform European sustainability Taxonomy.[31]

20 In contrast, the goal of the **SFDR is to** reduce **information asymmetries** in the relationships between investors and financial market participants regarding sustainability risks and criteria.[32]

21 The SFDR does not pursue product regulation in terms of content. It is concerned with product transparency. Put simply, where a financial product is advertised as sustainable, its supplier should provide information on how sustainable the product really is.

Focus Application Area:
Financial market participants – Financial advisors – Financial products

22 The Taxonomy Regulation applies to all financial market participants, regardless of whether they offer sustainable financial products or not.[33] For the term "financial market participant", the Taxonomy Regulation refers to the corresponding definition in the SFDR.[34] According to this definition, financial market participants are, among others, credit institutions that provide financial portfolio management.[35] During legislative negotiations, the European Parliament (EP), wanted to extend the term "financial market participant" in the SFDR to all CRR credit institutions in general – regardless of whether they provide financial portfolio management or not.[36] In the end, however, the EP was unable to get its way.

23 The **SFDR** addresses financial market participants as well as financial advisors. **"Financial advisors"** are

- Insurance intermediaries providing insurance advice for IBIP (Insurance Based Investment Products),
- Insurance companies that provide insurance advice for IBIP,
- Credit institutions/investment firms that provide investment advice,
- AIFM/OGAW management companies providing investment advice.

24 The scope of the Taxonomy Regulation and the SFDR extends to **"financial products"**. For the definition of "financial product", the Taxonomy Regulation refers to the corresponding term in the SFDR.[37] Accordingly, a financial product is:

- a portfolio that is the subject of financial portfolio management,
- an AIF,
- an IBIP,
- a pension product / pension scheme,
- a UCITS,
- a Europe-wide private pension product (PEPP).

25 According to the SFDR, the term "financial product" does not include debt instruments such as corporate bonds or securitized derivatives (certificates).

26 In contrast, the EP had proposed to extend the concept of financial product in the Taxonomy Regulation to all issues subject to a prospectus requirement under the Prospectus Directive (2003/71/EC) and the EU Prospectus Regulation (Regulation 2017/1129).[38] Warrants and certificates subject to prospectus would also have been included in this definition of "financial product". However, the EP was not able to prevail with this position either.

SUSTAINABLE INVESTMENT AND SUSTAINABLE ECONOMIC ACTIVITY

2.1.2 Sustainable Investment and Sustainable Economic Activity

27 Central terms of the sustainability Taxonomy are

- the environmentally sustainable investment and
- the environmentally sustainable economic activity.

28 The **Taxonomy Regulation** is currently limited to determining whether or not an economic activity is environmentally sustainable (see 2.1 above).[39]

29 An investment is environmentally sustainable if it finances one or more economic activities that are considered environmentally sustainable under the Taxonomy Regulation.[40]

30 To be considered environmentally sustainable, an **economic activity** must first **contribute substantially** to one of the following environmental objectives:[41]

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; and
6. the protection and restoration of biodiversity and ecosystems.

31 Moreover, the economic activity must **not significantly harm** the environmental objectives.[42] Finally, the economic activity must be carried out in compliance with a **minimum level of protection of** human and labor rights.[43]

32 The Taxonomy Regulation specifies the meaning of "substantial contribution" for each environmental objective individually.[44] Contributions can be made in different ways. First of all, economic activities that are fully in line with the respective environmental objective, e.g. carbon-free energy production, make a substantial contribution.[45] In addition, economic activities that directly enable other activities to make a substantial contribution to the environmental goals (so-called enabling activities) can also make a substantial contribution.[46] For climate change mitigation,

there is also a third category, of so-called transitional activities.[47] These are economic activities for which there is currently no technologically and economically feasible low-carbon alternative and which support the transition to a climate-neutral economy. Thus, economic activities can also substantially contribute to climate change mitigation if they entail particularly low carbon emissions, at least compared to the other economic activities in the sector.

33 Another prerequisite for an economic activity to be recognized as ecologically sustainable is that it does not significantly harm any other environmental objective (so-called *Do no significant harm principle* – **DNSH**). Thus, while an environmentally sustainable activity does not have to contribute to every environmental objective, it also mustn't significantly harm other environmental objectives. To this end, the Taxonomy Regulation defines limits which must be observed regarding other environmental objectives.[48]

34 In addition, companies which conduct ecologically sustainable economic activities must observe **minimum safeguards** for internationally recognized human and labor rights.[49] Appropriate procedures must be in place to ensure that global agreements such as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including international labor protection agreements, are observed. For environmental sustainability, compliance procedures must thus be established at the corporate level to ensure adherence to these minimum safeguards. The PoSF has presented a report with recommendations which explain the resulting requirements.[50] Based on the OECD Guiding Principles and the UN Guiding Principles, the report identifies four core areas: (i) human rights, including workers' rights, (ii) bribery/corruption, (iii) taxation, and (iv) fair competition. For these core areas, the PoSF develops indicators that suggest a violation of the minimum standards. Companies must establish a *Human Rights Due Diligence* process (**HRDD**) in order to reliably identify such violations. HRDD is a multi-step process, of which steps 2–6 must be repeated on a regular basis so that a cycle is established: (1) adoption and embedding of a commitment to HRDD into policies and procedures, (2) identification and assessment of adverse impacts through stakeholder engagement, (3) taking actions to cease, prevent, mitigate, and remediate adverse impacts (4) tracking the implementation of these actions and its results, (5) communicating publicly on the approach to HRDD, and actions taken to avoid and address adverse impacts, and (6) providing or cooperating in remediation, including establishing or participating in grievance mechanisms where individuals and groups can raise concerns about adverse impacts. Thus, the mere absence of identified violations in the core areas mentioned above does not per se justify the assumption that the minimum standards have been met. Rather, companies must also demonstrate that the HRDD which they describe is being carried out. At least in

the first few years of applying minimum safeguards, however, regulators should take into account that such a process must first be established.

35 The first two requirements ("substantial contribution" and DNSH requirements) are concretized by technical evaluation criteria.[51] The goal of these standards is to develop uniform and unambiguous technical criteria to ensure comparability. As a result, however, the technical evaluation criteria are increasingly becoming the bottleneck for a comprehensive application of the Taxonomy Regulation, as their legislative development is proceeding only gradually and is highly complex.

36 Based on the recommendations of the Technical Expert Group on Sustainable Finance (**TEG**), a first delegated regulation with more than 480 pages of annexes came into force on January 1, 2022, containing the **taxonomy methodology which must be implemented at Level 2** for the environmental objectives "climate change mitigation" and "climate change adaptation" (**Climate Delegated Act**).[52] The EU Commission's FAQs, which were published in draft form on December 19, 2022, serve as an interpretative aid to the often complex regulations.[53]

37 The Climate Delegated Act covers about 70 economic activities which are conducted by about 40% of listed companies in sectors accounting for almost 80% of direct greenhouse gas emissions in Europe. It first sets out technical evaluation criteria which define different forms of substantial contributions to climate change mitigation or climate change adaptation and gives DSNH-criteria. The covered sectors include forestry; environmental protection and renaturation; manufacturing; energy production; water, wastewater & waste; transport; real estate; information & communication; and research & development. The evaluation criteria thus contain a kind of checklist that can be used to determine whether and when one of these economic activities can be considered environmentally sustainable. The Climate Delegated Act was expanded by a politically highly controversial Supplementary Climate Delegated Act[54] , which includes the operation of nuclear power plants and modern gas-fired power plants as sustainable transitional activities in the climate Taxonomy if certain conditions are met. It can probably be seen as a compromise that economic activities related to nuclear and gas power plants must be disclosed separately, so that they are at least easily recognizable. In the end, the EP did not use its right to veto the Supplementary Climate Delegated Regulation, even though its committees had initially spoken out against it. However, Austria has already filed a lawsuit against the Supplementary Regulation. Several environmental associations have also expressed their concerns and threatened to file a lawsuit.

38 The PoSF submitted its final report on technical standards for the remaining four environmental objectives of the Taxonomy Regulation, on March 30, 2022.[55] To this report, PoSF submitted a supplementary report in

November 2022, providing the methodology for identifying enabling economic activities and evaluation criteria for additional economic activities.[56] The draft Delegated Regulation containing the technical evaluation criteria for these environmental objectives (**Environmental Delegated Act**) and an additional extension of the Climate Delegated Act were planned for the first half of 2022, but have not yet been published.

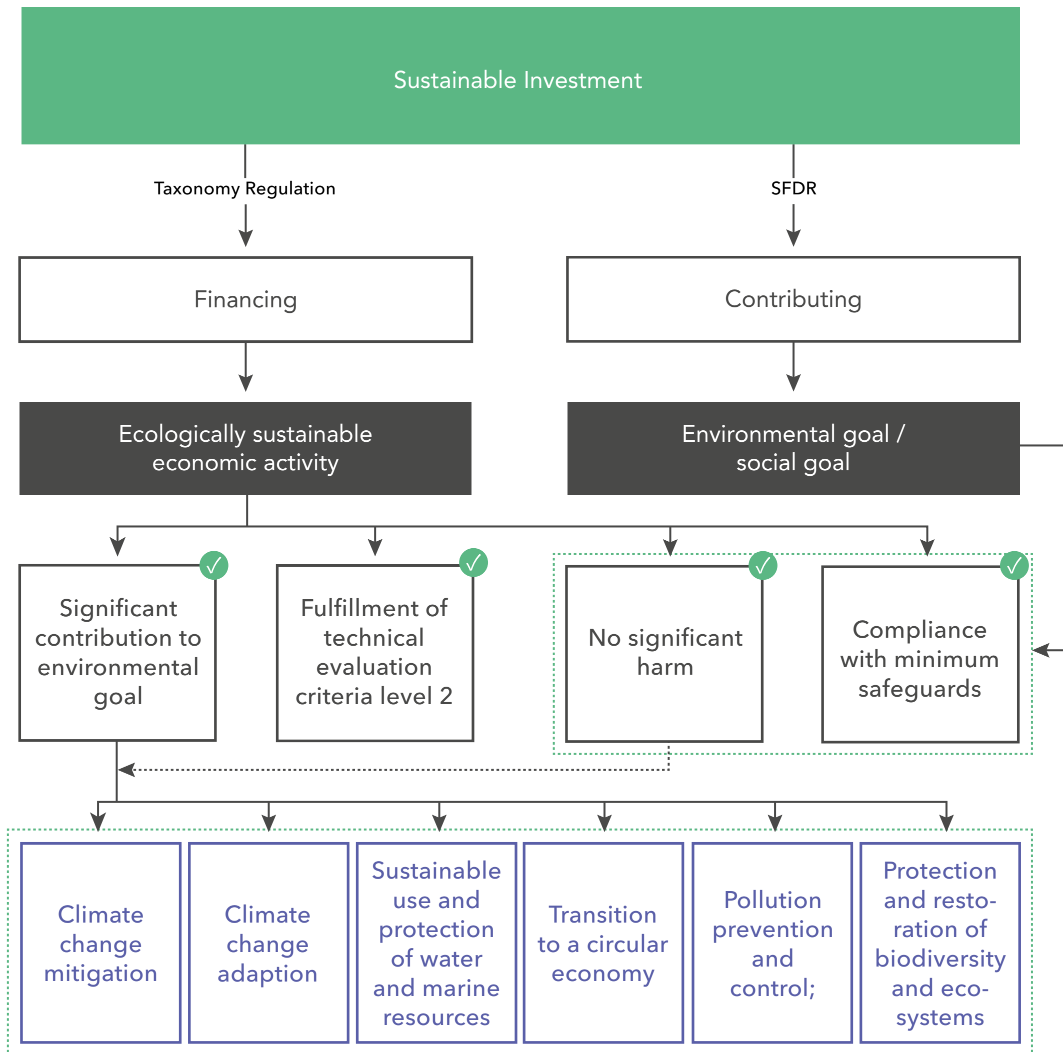
39 The Taxonomy's standards on whether an economic activity qualifies as environmentally sustainable must be used to determine the extent to which an **investment** is **environmentally sustainable**.[57]

40 In order to visualize the contents of the Taxonomy and make them easier to understand, the EU Commission has developed the **EU Taxonomy Compass**, an online tool that maps the overall framework of the Taxonomy criteria as well as the Taxonomy-eligible economic activities, which will be updated regularly.[58]

41 The **SFDR**, on the other hand, takes a somewhat different approach. For **environmental objectives** (variant 1), Art. 2 No. 17 SFDR contains a non-exhaustive list of key indicators against which the contribution of an investment to environmental objectives can be measured, without, however, providing a separate definition of environmental objectives. For **social objectives** (variant 2), there is also a non-exhaustive list. In contrast, such key indicators are missing in the Taxonomy Regulation. The other requirements are also similar, according to the SFDR, the investments must not significantly harm any of these objectives (**DNSH principle**). Furthermore, the companies in which investments are made must apply good corporate governance practices, in particular with regard to sound management structures, employee relations, employee compensation and tax compliance. However, despite similarities with the Taxonomy Regulation, the SFDR uses different terminology in some cases, so that complete consistency with the Taxonomy Regulation is not ensured.

42 The European Supervisory Authorities therefore criticize that an (environmentally) sustainable investment in the sense of the Taxonomy Regulation is not necessarily congruent with an (environmentally) sustainable investment in the sense of the SFDR, as the definition of sustainable investment in Art. 2 No. 17 SFDR does not directly. Reference the Taxonomy Regulation. As far as possible, this potential discrepancy should be reduced by the regulatory technical standards of the European supervisory authorities.[59] In this context, interactions are generally intended by the legislator. For example, the obligation to separately identify the share of nuclear and gas-fired power plants under the Supplementary Climate Delegated Regulation for the Taxonomy Regulation has led the ESAs to propose a corresponding amendment to the RTS for the SFDR at the request of the EU Commission.[60]

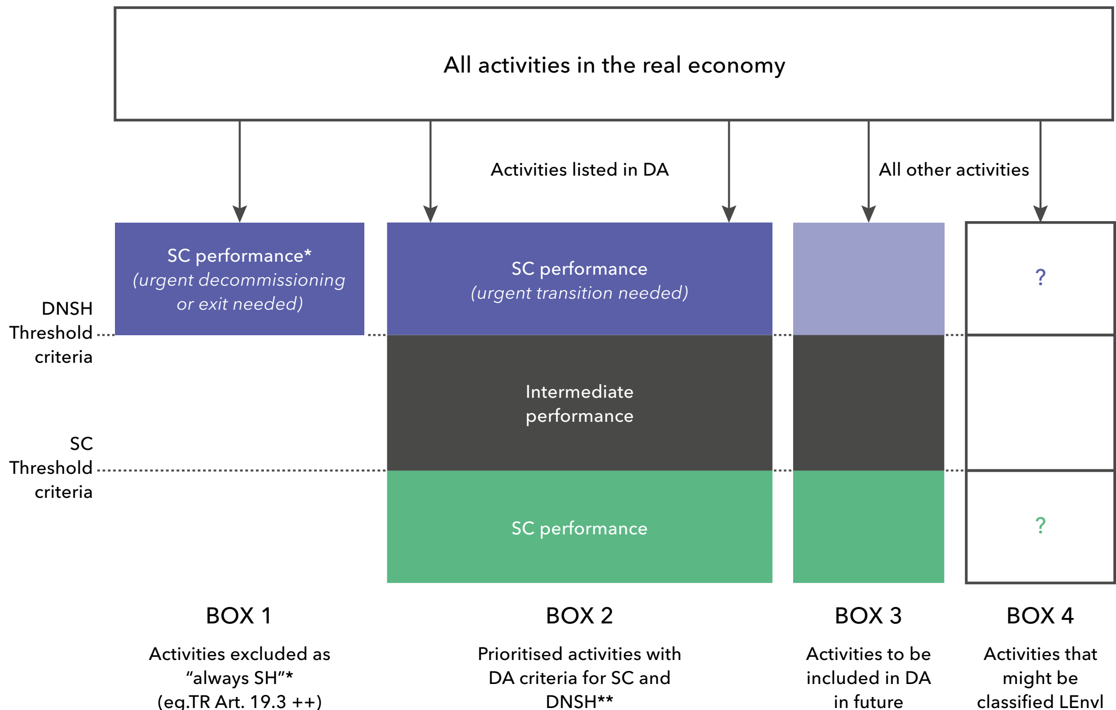
43 The different terminology of the Taxonomy Regulation and SFDR is illustrated in the following overview:



Extension of the Taxonomy

44

To counter the accusation that the binary orientation of the Taxonomy hinders the urgently needed support of the transformation process, the PoSF published its Final Report on Taxonomy extension options supporting a sustainable transition (**Taxonomy Traffic Light**) in March 2022.[61] The report starts from the assessment that the taxonomy is conceptually too inflexible. It divides economic activities "binarily" into taxonomy-compliant or non-taxonomy-compliant and places high demands on reaching the threshold for taxonomy compliance. Decidedly environmentally harmful activities, for which either no transition is possible and which therefore have to be terminated as soon as possible or which urgently require a (possible) transition, have so far been disregarded, as have economic activities that are in an intermediate stage towards taxonomy conformity or those economic activities that have only minor environmental impacts from the outset. In order to provide more differentiation in this respect, each economic activity in the EU area should in future be assigned to one of the following four boxes:[62]



* economic activities for which no technological possibility of improving their environmental performance to avoid SH exists across all objectives.

** In some cases, the DNSH criteria may not have been set for a certain activity & environmental objective, e.g. an activity may have an SC criteria for Climate Change Adaptation but that activity may have no DNSH criteria for Climate Change Mitigation in the DA.

Quelle: Platform on Sustainable Finance

- Box 1 represents activities that are excluded from the green Taxonomy as they violate the DNSH-principle and are by their nature unable to transition.
- Box 2 contains all economic activities for which technical screening criteria have already been developed. The new provision is that these economic activities are to be divided into three performance levels: Sustainable (i.e., "green") economic activities continue to be those that make a *substantial contribution* to one of the environmental objectives and *do not significantly harm* any environmental objective. Economic activities that do not make a substantial contribution but also do not significantly harm any environmental objective will belong to a new intermediate ("yellow") performance level (*intermediate performance*). All economic activities that harm an environmental objective fall into the lowest ("red") performance level (*significantly harmful performance*).
- Box 3 represents environmentally impactful (positive or negative) activities that have the potential to make a substantial contribution to one of the environmental objectives but are not yet included in the Taxonomy. They are expected to be included in the green Taxonomy in future Delegated Acts.
- Box 4 contains the remaining economic activities that have only a minor impact on the six environmental objectives covered by the Taxonomy (*no significant impact*).

45

Until this expansion of the taxonomy is implemented, the voluntary "Transition Finance Principles" proposed by the International PoSF in November 2022 for decarbonization can provide guidance.[63] The report develops nine principles for both goal setting and implementation for companies and investors. For target-setting, it is important that (1) the 1.5° target is the benchmark, (2) the targets are ambitious, especially in terms of near-term action, (3) the targets cover all activities, and (4) are compatible with other environmental and social goals. Care must be taken to ensure that implementation (5) is based on a comprehensive plan, (6) is firmly embedded in internal governance, (7) includes external engagement, (8) is publicly reported on, and (9) is standardized and credibly verified.

Social Taxonomy

46

In February 2022, the PoSF also published its Final Report on Social Taxonomy.[64] The PoSF takes three groups of stakeholders – workers, end users, and society – into account, and in this way arrives at three main objectives: (1) adequate working conditions along the value chain, (2) adequate living standards and well-being of end users, and (2) inclusive and sustainable society and communities. For each of these three main objectives, further sub-objectives are defined:

- **Appropriate working conditions along the value chain:** adequate wages, occupational health and safety, social security, discrimination-free working environment, human rights along the value chain, etc.

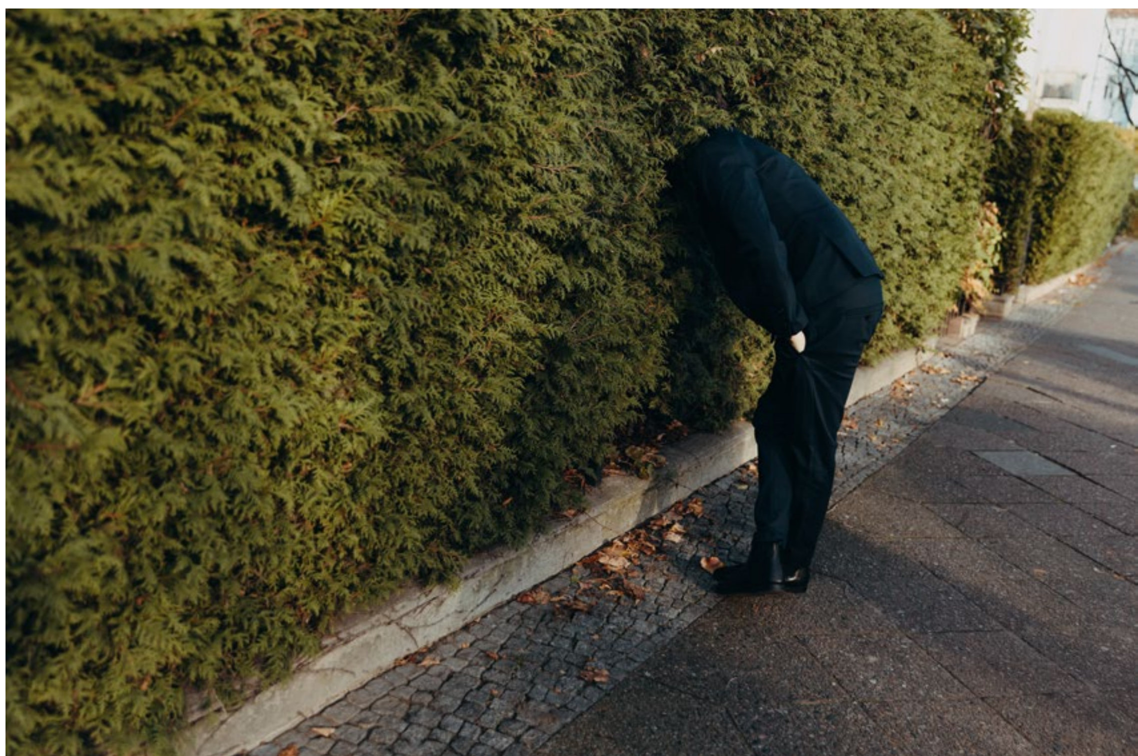
- **Adequate standard of living and well-being of end users:** product safety, quality health and long-term care insurance, improving access to quality food, water, and housing, improving educational opportunities, data protection, and others.

- **Inclusive and sustainable society and communities:** Promoting equity and inclusive growth through improved infrastructure, childcare, inclusion of people with disabilities; creating sustainable livelihoods, for example thorugh consultations with indigenous people; respecting human rights.

47

The further method of Social Taxonomy corresponds to the environmental taxonomy. An activity is only socially sustainable if (1) the activity contributes substantially to a (sub-)objective, (2) the activity does not significantly harm other (sub-)objectives (which should also include environmental objectives) and (3) the company observes the minimum safeguards which are provided for in Art. 18 Taxonomy Regulation. When determining the substantial contribution to a social objective, activities in particularly vulnerable sectors (e.g. mining with regard to job security) are to be considered in particular. In addition, activities must create additional value. This means that the typically inherent benefit of certain economic activities, e.g., pharmaceutical companies, should not be sufficient, but should be supplemented by an additional benefit, e.g., discounted distribution of medicines. The final report gives first indications in which direction a Social Taxonomy could develop, but also points out the problems in quantifying concrete criteria.

48 The reports of the PoSF on the extension of the taxonomy or on the Social Taxonomy will be included in a report of the Commission, which, according to the requirements of the Taxonomy Regulation, should have been published no later than December 31, 2021.[65] Unofficially, however, it has been announced that the development of a Social Taxonomy is currently not a priority for the EU Commission, especially since the methodological difficulties have not yet been satisfactorily resolved.



STANDARDS AND LABELS

2.1.3 Standards and Labels: Green Bonds and EU Ecolabel

Green Bonds, TLAC/MREL Bonds and Green Loans

49 Building on the Taxonomy, the Action Plan envisages the creation of uniform EU standards and labels for sustainable financial products.[66] A Europe-wide standard for so-called "green bonds" is to serve as a prototype.[67] To this end, the TEG submitted a report for an "EU Green Bond Standard" in June 2019.[68] The report contains a total of ten recommendations and conclusions, the implementation of which will have to be decided by the EU Commission. The TEG proposes that the EU Commission adopt a pan-European Green Bond Standard, the application of which should be voluntary. Building on these proposals, the EU Commission presented a draft regulation on European Green Bonds (**EuGB**) in July 2021.[69] As a voluntary "gold standard" for green bonds, this is to be open to all bond issuers, including private companies, public institutions and issuers based outside the EU.

50 According to this standard, issuers of green bonds, if they wish to use the designation "European Green Bonds" or "EuGB", must meet certain uniform requirements

- Bond proceeds must be used entirely for fixed assets, capital expenditures, or operating expenses that meet Taxonomy requirements or will meet such requirements within a specified period of time as set forth in an appropriate Taxonomy adjustment plan.

- The use of proceeds must be made transparent by means of detailed reporting requirements, including the completion of a factsheet specified in Annex I, annual reports and a post-issuance review. To ensure compliance with the requirements of the EuGB standard, including the taxonomy orientation of the use of proceeds, the bonds must be audited by external experts.

- External valuers providing services to issuers under the EuGB standard must be registered with and supervised by ESMA.

51 The final version of the regulation was not adopted at the end of 2022, as initially announced, because the trilogue negotiations have not yet been concluded. According to reports, open points of discussion include, in particular, an extension of the transparency requirements to include environmentally sustainable bonds that do not qualify as EuGBs,

and the introduction of a flexibility component in the taxonomy-compliant use of funds.[70]

52 In addition, the European Green Deal Investment Plan also aims to mobilize at least EUR 1 trillion for sustainable investment over the next decade (see 1. above). As part of the European Green Deal Investment Plan, the EU Commission committed to developing a renewed sustainable finance strategy that will also rely on green bonds as a means of financing sustainable growth.

53 Accordingly, the EU Commission issued Green Bonds as part of the instrument to finance a sustainable recovery of the EU from the pandemic. In total, the EU Commission has raised 12 billion euros through this. This sum is to be used exclusively for investments within the EU that are green and sustainable.[71]

54 As part of its ongoing review[72] of the quality of own funds and eligible liabilities, the EBA has for the first time also included in an update report a chapter with considerations on own funds or instruments for eligible liabilities with ESG characteristics, so-called **ESG capital bonds for TLAC and MREL purposes**.[73] Among other things, the EBA provides an overview of the risks identified in this context as well as the differences identified in the relevant clauses. The report also includes considerations on the interplay between the clauses used for ESG bonds and the eligibility criteria for own funds and eligible liabilities.

55 In its New SF Strategy, the EU Commission has highlighted the importance of private households and SMEs for the transformation process if they are given access to sustainable financing in the form of **sustainable loans (Green Loans)**.[74] With the help of Green Loans, households and SMEs could improve the energy efficiency of their buildings, switch to environmentally friendly heating sources or zero-emission vehicles. The EU Commission has therefore asked the EBA for an opinion on November 22, 2022, to address the following aspects:

- A definition of green credits based on the Taxonomy,
- possible support instruments for so-called green retail loans and green mortgages,
- the lending process,
- pre-contractual information,
- the consultation of the borrower,
- the necessary information by the credit institution,
- the advertising,
- the product control and
- consumer protection.

56 The EBA is to submit its opinion by December 29, 2023.

Ecolabel

57 In addition to green bonds, other financial products are also to be able to acquire a specific sustainability label. To this end, as part of the voluntary labeling system already in place under Regulation (EC) No. 66/2010 (Ecolabel Regulation), an EU Ecolabel is to be awarded to certain retail financial products that invest to a high degree in environmentally sustainable economic activities as defined by EU Taxonomy. The Ecolabel allows consumers to be reliably informed about the environmental impact of the labeled product.

58 The Joint Research Centre (JRC) presented an updated report in March 2021, which includes criteria for the use of an EU Ecolabel for retail financial products and a draft decision on the establishment of Ecolabel criteria for retail financial products by the EU Commission.[75] The JRC report proposes to include two types of financial services – and thus indirectly: two types of financial products – in the scope of the EU Ecolabel[76]: (1) the management of retail investment funds and unit-linked life insurance covered by the PRIIPs Regulation, and (2) the management of a time deposit or savings product[77], where the money deposited is used to fund projects and activities that (in addition to interest) also achieve environmental benefits.[78] Specifically for the latter product group, the JRC report develops criteria that a bank or savings bank must comply with if it wants to use the Ecolabel for a savings product:

1. **investment in green economic activities**[79]
   At least 70% of the deposits shall be invested in green loans or green bonds. The applicant must report annually on the status of implementation of the projects financed. The funds held as deposits and those extended as loans shall be kept strictly separate or traceable within the accounts of the credit institution in order to limit their use for other purposes and to enable traceability of the deposited funds of individual retail customers and their contribution to the total value of the green loans granted.

2. **exclusions based on environmental aspects**[80]
   Deposits may not be extended as loans to companies or used for project financing if the company generates more than 5% of its sales from a business activity that is excluded due to negative environmental impacts.

3. **exclusions based on social and governance aspects.**[81]
   Furthermore, the deposits may not be extended for loans to companies that fall under the exclusions based on social and governance aspects. These include, for example, the protection of international human rights, the prohibition of forced and child labor, the protection of minorities and indigenous communities, and compliance with local regulations against corruption, bribery and extortion. Furthermore, tobacco and arms production fall under the exclusion criterion.

4. **information for retail investors**[82]
   The information to be provided annually to retail investors must include, among other things, a detailed listing of the projects and green economic activities for which loans have been extended, including their implementation status.

5. **information that appears on or above the Ecolabel**[83]
   The use of the EU Ecolabel shall be in accordance with the instructions of the EU Ecolabel Guidelines.

2.2 WHAT TRANSPARENCY OBLIGATIONS ARE ISSUERS AND INTERMEDIARIES SUBJECT TO?

59

From the perspective of the EU Commission, transparency plays a central role in the enforcement of sustainability factors in the financial sector.[84] The SFDR therefore provides for extensive transparency obligations for issuers and intermediaries, which are also aligned with the requirements of the Taxonomy Regulation.

2.2.1 SFDR

60 The SFDR contains numerous transparency requirements, most of which are directed at both financial market participants and financial advisors, but some of which are directed only at financial market participants. These transparency obligations are product-related (see 2.1.2 above for the substantive specification by the Taxonomy Regulation) or company-related.

Art. 8 and Art. 9 products

61 The SFDR differentiates between cases where a financial product merely promotes sustainable characteristics (Art. 8 SFDR) and cases where the product has sustainable investment as its objective (Art. 9 SFDR).

62 In the latter case, i.e. in the case of an **"Art. 9 product"** (*deep green*), the financial market participant must include information in the pre-contractual product information on how the intended objective of a sustainable investment is to be achieved.[85] This requirement is interlinked with the Taxonomy Regulation in such a way that this information must include a description of how and to what extent the investments underlying the financial product are investments in environmentally sustainable economic activities pursuant to Art. 3 Taxonomy Regulation. In this description, the share of investments in environmentally sustainable economic activities selected for the financial product, including details on the shares of so-called enabling activities and transition activities, shall be indicated as a percentage of all investments selected for the financial product.[86] This means that the pre-contractual information on an Art. 9 product must indicate the extent to which the sustainable investments targeted by the product are Taxonomy-compliant.

63 In its July 2021 Q&A on the SFDR, the EU Commission made it clear that a financial product only qualifies as an Art. 9 product if it contains approximately 100% taxonomy-compliant investments or investments that are sustainable within the meaning of Art. 2 No. 17 SFDR.[87]

64 An **"Art. 8 product"** (*light green*) is characterized by promotion of ecological or social characteristics. This is a catch-all term that is intended to cover products that are not specifically geared towards sustainable investments, but which, according to the provider, take sustainability aspects into account in other ways when making investment decisions. This applies regardless of the actual sustainability profile of the financial product. According to the EU Commission, the term "promotion" within the meaning of Art. 8 SFDR includes, among other things, direct or indirect claims, information, reporting, disclosures that give the impression that the investments pursued with the financial product in question also take into account environmental or social characteristics in relation to

the investment strategies or objectives. This may include pre-contractual information, periodic reports as well as marketing communications or descriptions of investment strategies, seals of approval, and the use of product names or designations in memoranda or offering documents or fact sheets.[88] BaFin has endorsed this view in its September 2022 Q&A.[89]

65 Since an Art. 8 product does not require any (direct or indirect) investment in a sustainable economic activity, the provider is comparatively free in how it takes environmental or social characteristics into account. For this purpose, he can in particular make use of a recognized investment strategy, such as a best-in-class approach or the definition of minimum exclusions (e.g. from "brown" economic activities).

Information media: Pre-contractual information/website/periodic reports

66 Financial market participants and financial advisors must provide information on product characteristics, their handling of adverse effects on sustainability factors and sustainability indicators against which the "sustainability performance" of the respective financial product is to be measured in three different ways:

- pre-contractual information in a document provided for under the distinct law relevant to the financial product (Art. 6 (3) SFDR). For a UCITS, this is e.g. the sales prospectus, for individual asset management the information document according to Section 63 (7) WpHG (= Art. 24 (2) MiFID II);
- Website of the financial market participant/financial advisor (Art. 10 SFDR);
- periodic reports (Art. 11 SFDR).

SFDR Delegated Act

67 On April 6, 2022, the EU Commission adopted a Delegated Act which serves as a single rulebook that combines all transparency obligations for financial market participants, financial advisors and financial products with a sustainability link (SFDR Delegated Act).[90] The SFDR Delegated Act builds in large parts on the "Final Report and draft RTS on disclosures under SFDR", which the three European supervisory authorities (EBA, EIOPA and ESMA – ESAs) had published on February 2, 2021.[91] The regulation entered into force on January 1, 2023.[92]

68 The SFDR Delegated Act specifies the disclosure requirements under the SFDR on the following **company-related** aspects:

- Information on compliance with the Do no significant harm (DNSH) principle (Art. 2 No. 17 SFDR), which intersects with the indicators for adverse impacts on sustainability factors (principal adverse impacts – PAI) – which also must be disclosed (**PAI statement**) (Art. 4 par. 1 – 5 SFDR) (Art. 4 et seq. SFDR Delegated Act). The ESAs thus wish to supplement the DNSH criteria from the Taxonomy, with social and governance aspects.
- Statement on the website regarding the adverse impact of investment decisions on sustainability factors related to climate and other environmental impacts (Art. 4 par. 6 SFDR) and adverse impacts in social and labor affairs, respect for human rights, anti-corruption and anti-bribery (Art. 4 par. 7 SFDR) (**Sustainability Policy**).

69 Furthermore, the SFDR Delegated Act substantiates the **product-related** transparency obligations of the SFDR.

70 The SFDR Delegated Act focuses product transparency on the description of the ESG characteristics of the products, i.e. in the case of a product under Art. 9 SFDR the sustainable investment objective and in the case of a product under Art. 8 SFDR the social or environmental characteristics which the product promotes. In this context, the financial market participant must explain in **pre-contractual information** how the product achieves its respective ESG objectives and which investment strategy is used for this purpose (Art. 14 et seq. SFDR Delegated Regulation). On its **website**, the financial market participant must disclose detailed information her methodology, her data sources, and her monitoring criteria (Art. 23 et seq. SFDR Delegated Regulation). The financial market participant must evaluate the extent to which the product has achieved its environmental or social characteristics or sustainable investment objectives in **periodic reports** (attainment) (Art. 50 et seq. SFDR-DelVO).

2.2.2 Taxonomy Regulation

71 The Taxonomy Regulation does not contain any independent transparency obligations for financial market participants. Instead, it specifies the content of existing product-related transparency obligations under the SFDR.[93] The SFDR is supplemented accordingly by the Taxonomy Regulation.[94] Thus, the SFDR and Taxonomy regulation avoid overlapping regulatory standards. However, this does not change challenging fact that financial market participants must precisely disclose the extent to which the financial products they issue meet the Taxonomy criteria for determining environmental sustainability.

72 The Taxonomy-related parts of the SFDR Delegated Regulation provide for specific transparency requirements for products that make environmentally sustainable investments as defined by the Taxonomy. Art. 9 products (*deep green*) investing in environmentally sustainable economic activities (= Art. 5 Taxonomy Regulation products) and Art. 8 products (*light green*) investing in environmentally sustainable economic activities (= Art. 6 Taxonomy Regulation products) must, in addition to the information described above (par. 2.2.1), also indicate the share of investments in taxonomy-compliant activities by means of a pie chart.

73 **Example:** A fund with EUR 200 million assets under management invests

1. EUR 100 million in shares and bonds of companies whose economic activities are 10% Taxonomy-compliant and thus "green" (weighted Taxonomy-compliant investments = EUR 10 million),
2. EUR 10 million in green bonds in accordance with the EU Green Bond Standard (Taxonomy-compliant investment = EUR 10 million),
3. EUR 20 million in green bonds financing 50% Taxonomy-compliant activities (weighted Taxonomy-compliant investments = EUR 10 million), and
4. EUR 70 million in companies without Taxonomy-compliant economic activity.

74 Thus, a Taxonomy level of 15% is applied to this fund (EUR 30 million Taxonomy-compliant investments in relation to EUR 200 million total investments).

2.2.3 Overview

75 Further details can be found in the following overview:

Financial market participants & financial advisors	Financial market participants	Medium
Strategy for incorporating sustainability risks into investment decisions and product advice		Website (Art. 3 SFDR) / pre-contractual information (Art. 6 I lit. a SFDR)
Consideration of adverse impacts of investment decisions on sustainability factors. Art. 5 SFDR Delegated Act Summary; Art. 6 SFDR Delegated Act Description Impacts; Art. 7 SFDR Delegated Act Measures for identification and prioritization; Art. 8 SFDR Delegated Act Engagement Policy; Art. 9 Compliance with International Standards.		Website (Art. 4 SFDR and Art. 4 et seq. SFDR Delegated Act)
Consideration of sustainability risks in remuneration policy		Website (Art. 5 SFDR)
Impact of sustainability risks on product returns		Pre-contractual information (Art. 6 I lit. b SFDR)
	Consideration of adverse sustainability impacts at the level of the financial product	Pre-contractual information (Art. 7 SFDR)
	Promotion of ecological or social characteristics by the financial product, index as reference value if applicable	Pre-contractual information / website / regular reports
	Product with environmental / social characteristics (Art. 8 SFDR and Art. 14ff. SFDR Delegated Act):	

Financial market participants & financial advisors	Financial market participants	Medium
	Disclosure of information in the format and according to the requirements of Annex II to the SFDR Delegated Act Reference to information in Annex II to the SFDR Delegated Act in the main part of the pre-contractual information. Introductory statement with information, Whether (a) financial product is intended to promote sustainable investment; Whether (b) financial product promotes environmental or social characteris-tics without aiming for sustainable investment.	Pre-contractual information
	(a) Summary (b) No sustainable investment objective (c) Environmental or social characteristics of the financial product (d) Investment strategy (e) Proportion of investments (f) Monitoring (g) Methods (h) Data sources and processing (i) Limitation of methods and data (j) Due diligence (k) Engagement policy (l) Indication of the specific reference benchmark.	Website

Financial market participants & financial advisors	Financial market participants	Medium
	Disclosure of information in the format and according to the requirements of Annex IV to the SFDR Delegated Act	Periodic reports
	Product with environmental / social characteristics (Art. 9 SFDR and Art. 18 ff. SFDR-DelVO):	
	Disclosure of information in the format and according to the requirements of Annex III to the SFDR-DelVO Reference to information in Annex III to the SFDR-DelVO in the main part of the VVI. Introductory statement with information that financial product has a sustainable investment objective	Pre-contractual information
	(a) Summary (b) No significant detriment to sustainable investment objective (c) Sustainable investment objective (d) Investment strategy (e) Proportion of investments (f) Monitoring (g) Methods (h) Data sources and processing (i) Limitation of methods and data (j) Due diligence (k) Engagement policy (l) Achievement of sustainable investment objective.	Website
	Disclosure of information in the format and according to the requirements of Annex V to the SFDR Delegated Act	Periodic reports

76 The transparency requirements applicable to financial market participants must also be met by managers of **private equity, venture capital and private debt funds**. This applies regardless of whether the manager has a license as a capital management company (in Germany: Sec. 20 KAGB) or merely acts as a registered AIFM. This has been clarified by the EU Commission in its Q&A dated July 21, 2021.[95]

2.2.4 Review by ESAs

77 The transparency obligations are currently being revised by the ESAs at the instigation of the EU Commission[96] with regard to the indicators for measuring the most significant adverse impacts on sustainability factors (PAI) and the information on decarbonization targets. Corresponding drafts from the ESAs are expected to be submitted by the end of October 2023.[97] In light of the Climate Delegated Act Supplement, the ESAs have also proposed enhancements to the SFDR Delegated Act to make Taxonomy-compliant investments in natural gas and nuclear power visible. The ESAs submitted their final report, including a draft RTS, on September 30, 2022.[98]

78 The EU Commission has since commented on some of the questions of interpretation of the SFDR that were addressed to the EU Commission by the ESAs via Q&As.[99] BaFin also published selected questions and answers on the interpretation of the SFDR on September 5, 2022.[100]

79 The respective authorities of member states monitor compliance with the requirements set out in the SFDR and the Taxonomy Regulation. These authorities must also determine measures and sanctions in the event of violations.[101] Germany has enacted the Fondsstandortgesetz (FoStoG) for this purpose, which provides for corresponding amendments and supplements to the KAGB, WpHG and VAG. These amendments include sanctions via fine provisions. In addition, the FoStoG assigns auditors the task of assessing compliance with disclosure requirements by companies subject to reporting requirements. The IDW Practice Note on the Disclosure and Taxonomy Regulation is intended to provide auditors with guidance on the audit procedure.[102]

2.3 FROM TRANSPARENCY TO CONTENT CONTROL (PROTECTION AGAINST GREENWASHING)

80 As a regulatory concept, the SFDR is based on the assumption that creating transparency about the “sustainability level” of a financial product is sufficient to establish sufficient comparability of financial products and to protect investors with sustainability preferences from making bad investments. This concept is flanked by the requirements for sustainability preference queries under MiFID II (see 2.4 below).

81 Regulators are currently moving away from this approach. They are moving toward defining material requirements for financial products that must be met before a financial product can be described as sustainable. The regulatory starting point for this is to protect investors from being misled by so-called *greenwashing*.

82 For example, on May 31, 2022, ESMA published a *supervisory briefing* outlining common supervisory criteria for the supervision of sustainability-related investment funds to counteract greenwashing. The briefing contains

- Guidelines for the supervision of fund documentation and marketing materials, and
- Guiding principles for the use of sustainability-related terms in fund names and
- Guidelines for convergent oversight of sustainability risk integration by AIFMs and UCITS managers.

83 Related to this supervisory briefing is another consultation paper issued by ESMA on November 18, 2022, in which it develops guidelines on the use of ESG or sustainability-related terms in fund names. In these guidelines, which are intended to provide asset managers with more specific guidance on fund naming compared to the supervisory briefing, ESMA specifically proposes minimum shares for funds that use ESG or sustainability-related terms. In ESMA's view, a fund should

- have a minimum share of 80% in investments that meet environmental or social characteristics or sustainable investment objectives, provided that the fund designation contains an ESG-related word.
- Within this minimum share of 80%, a minimum share of 50% shall be invested in sustainable investments within the meaning of Art. 2 No. 17 SFDR, provided that a fund bears the word "sustainable" or another term derived from the word "sustainable" in its fund name.

84 Parallel to this, there is an initiative at national level in Germany to introduce a so-called "sustainability traffic light", which follows a similar protection concept (see 5.3. below).

2.4 WHAT ROLE WILL SUSTAINABILITY PLAY IN THE CUSTOMER ADVISORY PROCESS IN THE FUTURE?

85 Under MiFID II and the IDD, investment service providers and insurance intermediaries are required to recommend "suitable" products to their customers that meet their needs as part of the investment advice they provide. Any preferences clients may have for sustainable investments had so far not been taken into account in the needs assessment (so-called client exploration). To change this, the action plan provided for a corresponding adjustment of the delegated acts on MiFID II and IDD, which deal with the customer advisory process.[103] To implement these requirements from the action plan, the EU Commission adopted amendments to three delegated acts as part of its *Sustainable finance package* of April 21, 2021[104], which were published in the Official Journal of the EU on August 2, 2021.

86 The regulations contained therein have become effective as follows:

Legal act	Subject of regulation	Entry into force/implementation
Delegated Regulation (EU) 2021/1253 (**MiFID II**)	Assessment of sustainability preferences for financial instruments	August 2, 2022
Delegated Regulation (EU) 2021/1257 (**IDD**)	Assessment of sustainability preferences and product governance (e.g. target market) for insurance products	August 2, 2022
Delegated Directive (EU) 2021/1269 (MiFID II)	Product governance (including target market) for financial instruments	November 22, 2022

87 Three further amendments to delegated acts concern the consideration of sustainability risks in the risk management of capital management companies and insurance companies (see 3.2 below).

2.4.1 Banks/savings banks (securities services companies)

88 Delegated Regulation (EU) 2021/1253, which amended Delegated Regulation (EU) 2017/565,[105] provides that investment services firms will be required to identify the ESG preferences of their clients as part of the suitability assessment.[106] Specifically, according to the new version of Art. 2 (7) in conjunction with. Art. 54 of Delegated Regulation (EU) 2017/565, the client must be asked whether and to what extent one of the following financial instruments should be included in her investment strategy:

– a financial instrument for which the client or potential client specifies that a minimum proportion must be invested in environmentally sustainable investments as defined in Art. 2 No. 1 of the Taxonomy Regulation;
– a financial instrument for which the client or potential client determines that a minimum proportion must be invested in sustainable investments as defined in Art. 2 No. 17 of the SFDR;
– A financial instrument that considers Principal Adverse Impacts (PAIs) on sustainability factors, where the client determines qualitative or quantitative elements which are used to demonstrate this consideration.

89 As indirectly follows from the 2nd point, the mere fact that a financial instrument falls under the scope of Art. 8 SFDR will not be sufficient to recommend such a financial instrument as suitable to an investor with an ESG preference.[107] This is because – at least according to the legislative assumption of the EU Commission – an investor who has an ESG preference will at least expect that the financial instrument offered to him as ESG-compatible contains at least a sustainable investment or a "PAI qualification". A financial product that only contains minimum exclusions would thus be an "Art. 8 product", but it would not be suitable for an investor with an ESG preference pursuant to Art. 2(7)(a) or (b) Delegated Regulation (EU) 2017/565 due to the lack of a sustainable investment (however, qualification as a "lit. c product" may be possible). It would be necessary, but also sufficient, if at least one environmentally sustainable economic activity is financed with the capital raised by the financial product. This could be ensured, for example, in the case of an investment fund with a sector focus on "energy" by a combination of minimum exclusions and a commitment to invest in the shares of at least one renewable energy company (sustainable investment) or that the investment fund aims to achieve a maximum CO_2 footprint of $< X$ (PAI qualification).

90 ESMA published **guidelines on the integration of sustainability preferences into client consultation and suitability assessment for** investment advice and asset management in September 2022, following a public consultation.[108] The guidelines are currently being translated into the official EU languages and published on ESMA's website. The publication

of the translations in all official EU languages triggered a two-month period within which national supervisors had to notify ESMA whether they comply or intend to comply with the guidelines.

91 Furthermore, product issuers and investment firms will have to consider sustainability preferences in their target market determination. This results from an amendment to Delegated Directive (EU) 2017/593.[109] ESMA is currently revising the **guidelines on MiFID II Product Governance against** this background in order to take the ESG requirements of Delegated Directive (EU) 2017/593 into account appropriately.[110] The final guidelines are expected to be published in the first half of 2023.

92 At the level of German financial industry associations (DK, BVI and DDV), an **ESG** target market concept has been developed for this purpose and agreed with BaFin.[111]

2.4.2 Insurances

93 Parallel regulations can be found in the Amendment Regulation of April 21, 2021 to Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359, which deals with the integration of sustainability aspects into the management of conflicts of interest and product governance at insurance companies as well as into the advisory process for insurance products.[112]

2.5 HOW ARE CO_2-BENCHMARKS REGULATED?

94 In order to better regulate carbon-benchmarks, the EU has amended Regulation (EU) 2016/1011 through the **CO_2-Benchmark Regulation**.[113] As with the Taxonomy Regulation, the EU Commission's aim in amending the regulation is to counteract regulatory fragmentation within the EU: Various categories of indices for low-carbon investments are already available on the market today.[114] While some benchmarks aim to reduce the carbon footprint of a standard investment portfolio, others pursue the goal of selecting only financial instruments that contribute to achieving the 2 °C target set out in the Paris Climate Agreement. Notwithstanding these differences, all these benchmarks are predominantly promoted as benchmarks for low CO_2 investments.[115] This leads to a fragmentation of the internal market, since the respective reference value methodology is not clear to the users of reference values. According to the EU, this warrants a harmonized legal framework.[116]

95 The amendment of Regulation (EU) 2016/1011 by the CO_2-Benchmark Regulation therefore provides for minimum standards regarding specific CO_2 reference values. It also aims to increase transparency in the inclusion of environmental, social and corporate governance factors in reference value methods.

96 In detail, the CO_2-Benchmark Regulation provides for the following regulations:

2.5.1 Distinction between *transition* and *positive Paris-aligned benchmarks*

97 Uniform reference value categories are introduced throughout Europe:

98 EU *Climate Transition Benchmarks* (**EU CTB**) and *EU Paris-aligned Benchmarks* (**EU PAB**).[117] The reference values underlying an EU CTB intend to relate to companies that pursue a measurable, science-based "decarbonization strategy."

99 EU PABs, in contrast, include reference values that pursue the more ambitious goal of making a positive contribution to achieving the 2 °C target set in the Paris Climate Agreement.

2.5.2 Transparency about methodology

100 The Benchmark Regulation aims to enable market participants to make an informed decision on the use of ESG reference values offered on the market. To this end, since April 30, 2020, reference value administrators have had to disclose the extent to which their methodology actually takes account of ESG factors.[118] This information must show how the underlying assets were selected and weighted and why certain assets were excluded. In particular, benchmark administrators for EU PABs must disclose the formula used to determine whether and why the respective benchmark company's emissions are in line with the long-term goal of mitigating global warming as set out in the Paris Climate Change Agreement.[119] The frequency with which the benchmark methodology is reviewed must also be disclosed. In the event of significant changes, the reasons for the change shall be disclosed and explained.

2.5.3 Delegated acts

101 On Level 2, three delegated acts were published in the Official Journal of the EU on December 3, 2020.[120] The legal acts entered into force on December 23, 2020.

102 The delegated regulations specify (1) minimum standards for EU CTBs and EU PABs, (2) the minimum content of the explanation of how ESG factors are considered in the benchmark methodology, and (3) guidelines on which explanations are to be included in a benchmark statement. Supplementary annexes provide sample reference value statements and an illustration of how ESG factors must be considered in the reference value statement.

103 In accordance with the TEG report, the minimum criteria for the design of EU reference values are based on the IPCC scenario as the reference temperature scenario.[121] This is based on the report of the Intergovernmental Panel on Climate Change on the consequences of a global warming of 1.5 °C compared to pre-industrial levels.[122] Based on the IPCC scenario, the decarbonization targets for EU CTB and EU PAB must be calculated, taking into account greenhouse gas emission intensity as the main factor.[123] When defining the minimum criteria for the design of EU reference values, the so-called IPCC scenario is used as the reference temperature scenario – in accordance with the TEG report.[124] This is based on the report of the Intergovernmental Panel on Climate Change on the consequences of a global warming of 1.5 °C compared to pre-industrial levels.[125] Based on the IPCC scenario, the decarbonization targets for EU CTB and EU PAB are to be calculated, with greenhouse gas emission intensity as the main factor.[126] The GHG intensity is calculated by dividing the absolute GHG emissions by the enterprise value.[127] Decarbonization requires an annual GHG emission intensity reduction of at least 7%.[128]

This means that administrators must continuously tighten the criteria for the EU CTB and EU PAB to incentivize GHG emissions reductions. The starting point is GHG emissions baselines that are already significantly – by 30% for EU CTBs and 50% for EU PABs – below the average for the investment universe.[129] In order for EU CTBs and EU PABs to provide a realistic picture of the real economy, they must be invested in GHG-intensive sectors to the same extent as the share of these sectors in the total investable (equity) investment universe.[130] Thus, decarbonization should occur precisely in the GHG-intensive sectors and not by shifting investments to other sectors with per se low GHG emissions. In addition, various minimum exclusion criteria as well as the DNSH principle at company level must be observed.[131]

104 Compared to the original Commission proposal, the practical implementation of the Level 2 requirements has been simplified in that partial references to websites are possible in order to provide the full information required for the declaration.[132]

2.5.4 EU benchmark label?

105 Meanwhile, the EU Commission is examining the possibility of introducing a new label that would encompass all pillars (environmental, social and corporate governance). The label is to be awarded to EU CTBs and EU PABs. The goal of such an EU ESG benchmark label, according to the EU Commission, would be to bring more clarity to the market and help combat ESG washing. To this end, an auditing firm (PwC) is preparing a study on behalf of the EU Commission that is intended to provide a comprehensive overview of the existing market for ESG-related benchmarks. In the course of preparing the study, interested market participants were able to fill out questionnaires in which they could comment on the benefits of introducing an EU label for ESG benchmarks by March 31, 2022.[133] ESMA has already clarified in a statement to the EU Commission that it considers an EU ESG benchmark label to be useful.[134]

2.5.5 Regulation of ESG ratings?

106 In a letter to the Commission dated January 28, 2021, ESMA highlighted the regulation of ESG ratings as a key challenge in *Sustainable Finance*.[135] Previously, the French Autorité des marchés financiers (AMF) and the Dutch Autoriteit Financiële Markten (AFM) had published a joint position paper advocating for European regulation of ESG data service providers and supervisory action by ESMA.[136]

107 As a core element of a future regulatory framework, companies that provide ESG ratings and assessments are to be registered and supervised by a public authority. This is to ensure that ESG data service providers are subject to the same (minimum) requirements regarding organizational duties, handling of conflicts of interest and transparency requirements. In addition, the regulators advocate for specific product requirements for ESG ratings and valuations, taking into account the proportionality principle. These should result in ESG ratings being based on up-to-date, reliable and transparent data sources and developed according to robust methodologies that are transparent and can be scrutinized by investors.

108 It remains to be seen whether the EU Commission will take up these proposals.

3. SUSTAINABILITY IN RISK MANAGEMENT

3.1 RATING PROCESS

109 The EU Commission had asked ESMA to look for solutions as to whether and how Credit rating agencies (CRAs) should comprehensively consider sustainability and long-term risks in their rating process.[137] In its market investigation conducted for this purpose, ESMA reached the following conclusions in July 2019:

110 CRAs do consider ESG factors in their ratings. However, the extent to which they take them into account can vary significantly depending on the asset class and the rating agency's methodology.[138] ESMA does not consider it advisable to apply the EU-Rating Regulation (Regulation (EC) No. 1060/2009) in such a way as to explicitly require CRAs to consider sustainability features in all rating assessments.[139] Instead, ESMA has limited itself to adopting guidelines aimed at improving transparency on the extent to which sustainability factors are the main drivers of the rating score.[140] Since 2020, ESMA has based its supervisory practice on these guidelines.[141] In its New SF Strategy, the EU Commission has announced that it will take measures to ensure that ratings take sustainability risks into account systematically and transparently (see 1. above).[142]

3.2 INSTITUTIONAL INVESTORS AND ASSET MANAGERS

111 In its Action Plan, the EU Commission had stated that the EU rules at the time on the obligation of institutional investors and asset managers to take sustainability factors and risks into account when making investment decisions were neither sufficiently clear nor coherent across sectors.[143] There were also indications that institutional investors and asset managers were not systematically taking sustainability criteria and risks into account in their investments.[144] ESMA subsequently made recommendations to the EU Commission for an amendment of the Level 2 legal texts to the UCITS Directive (2009/65/EU) and the AIFMD (2011/61/EU).[145] The EU Commission took up these recommendations and implemented them via corresponding amendments to the Level 2 legal texts, which were published in the Official Journal of the EU on August 2, 2021.[146] According to these, UCITS and AIF management companies have to

- consider sustainability risks in their overall organizational structure,
- consider sustainability risks in their investment process, and
- take into account possible adverse effects on sustainability factors, and
- include sustainability risks in their risk management policy.[147]

112 These requirements have been in effect since August 1, 2022.

113 EIOPA had issued corresponding recommendations for insurance companies.[148] They have been incorporated in the amending Regulation to Delegated Regulation (EU) 2015/35 and in the amending Regulation to Delegated Regulations (EU) 2017/2359 and (EU) 2017/2358 of the EU Commission dated April 21, 2021.[149]

114 These regulations have also been in effect in member states since August 1, 2022.

115 The regulatory requirements for the risk management of AIFMs are also relevant for the management of private equity, venture capital and private debt funds, provided they are managed by licensed capital management companies (i.e. those holding a license pursuant to Sec. 20 KAGB). For registered AIFM, however, the European requirements of Delegated Regulation 2021/1255 do not apply. However, according to the supervisory practice of BaFin, registered KVGs must also observe certain ESG-related risk requirements (consideration of ESG risks, among other things, when assessing the materiality of risks and comparing the overall risk profile with risk coverage potential, No. 4 KaMaRisk in conjunction with No. 1.1 of the BaFin information sheet on sustainability risks (see 5.1 below).

3.3 SUSTAINABILITY IN SOLVENCY SUPERVISION FOR BANKS

116 ESG factors also play an increasingly important role in banking supervision. The Action Plan includes a mandate for the EU Commission to examine whether risks associated with climate and other environmental factors can be included in institutions' risk management strategies and banks' capital requirements.[150]

117 In fulfillment of this mandate, the 2018 banking package (consisting of CRD V[151] and CRR II[152]) included frameworks on the consideration of ESG risks in the context of risk management and institutional supervision, as well as on issues related to the regulatory treatment of assets and ESG risks in the capital adequacy of institutions. These regulations included a review and reporting mandate directed towards the EBA. The EBA submitted the first of these reports in June 2021 (see 3.3.1 below). Building on this, the EU Commission then included proposals for anchoring sustainability in banking supervisory law in its further banking package published in October 2021 (see 3.3.3 below).

118 On December 13, 2022, EBA published a **roadmap** setting out the objectives and a timeline for the implementation of mandates and tasks in the area of sustainable finance and ESG risks, superseding its 2019 action plan.[153] In the roadmap, EBA outlines its phased-in, comprehensive approach to integrating ESG risks into the banking supervisory framework to support the EU's efforts to transition to a sustainable economy.

3.3.1 Incorporation of ESG risks into the risk management and supervision of institutions (CRD V)

119 As part of the 2018 banking package, the EBA was mandated to examine whether ESG risks can be included in the *supervisory review and evaluation process* (SREP) of institutions by the competent supervisory authorities (in Germany, BaFin).[154] In doing so, the EBA had to examine the following:

- The development of a **single definition** of "ESG risks" including physical risks and transition risks;

- The development of appropriate qualitative and quantitative criteria for assessing the impact of ESG risks on the short-term, medium-term, and long-term financial stability of institutions; these criteria include **stress testing procedures and scenario analyses** that assess the impact of ESG risks in scenarios of varying severity;

- The regulations, procedures, mechanisms, and policies that institutions should use to **identify, assess, and manage ESG risks;**

- The **analytical methods and tools** used to assess the impact of ESG risks on institutions' **lending** and **financial intermediation activities**.

120 In June 2021, the EBA presented the Report on Management and Supervision of ESG Risks for Credit Institutions and Investment Firms ("**EBA Report**") to the EU Commission, the European Parliament and the Council.[155] It contains, among other things

- Definitions and explanations of ESG risks and factors,

- Processes, mechanisms, and strategies to implement ESG risks in business strategies, internal governance arrangements, and institution risk management so that ESG risks can be professionally captured, assessed, and managed,

- Indicators, methods and metrics for measuring and assessing ESG risks,

- Recommendations to relevant regulators on incorporating ESG risks into supervisory practice and the supervisory review and evaluation process (SREP).

121 Prior to this, the European Central Bank (ECB) published its final **guidance** on climate and environmental risks in November 2020, which describes how institutions should, in the ECB's view, **manage climate and environmental risks safely** and **prudently** within the current supervisory framework and disclose information on these risks transparently (**ECB Guidance**).[156] To this end, the ECB Guide sets out 13 expectations[157] on how banks should consider climate and environmental risks in the areas of business strategy, governance[158], risk management and disclosure. Accordingly, banks are expected to

- understand impacts of climate and environmental risks on their business environment;

- include climate and environmental risks when defining and implementing business strategy;
- incorporate climate and environmental risks into their governance and risk appetite and risk management frameworks; and
- disclose information and key performance indicators on material climate and environmental risks.

122 The ECB Guide is intended to raise institutions' awareness of climate and environmental risks. It is also intended to serve as a basis for supervisory dialogue and to ensure consistent supervisory practice across the euro area.[159] To anchor these expectations among institutions and make them aware of the concrete need for action, the ECB has published further analyses[160] and studies[161] on institutions' consideration of climate and environmental risks, as well as conducting a **climate stress test**.[162]

123 To ensure that banks take ESG factors into account in their lending and loan monitoring activities in the future, the EBA has also included corresponding requirements in its **guidelines on lending and loan monitoring** published on May 29, 2020.[163] According to these guidelines, institutions must take ESG factors into account in their credit risk appetite as well as in their risk management strategies and also take ESG risks into account when assessing the financial circumstances of borrowers.[164]

124 The guidelines also contain requirements for credit institutions that wish to grant **sustainable loans**.[165] In these cases, credit institutions are to provide appropriate concepts and processes to regulate the granting and monitoring of sustainable loans. Among other things, lists of projects or activities as well as corresponding assessment criteria are to be provided to show which type of lending is classified as sustainable. Furthermore, credit institutions must establish processes with the help of which sustainable use of funds can be evaluated.

125 The German supervisory authority BaFin has announced that it will adopt the guidelines in its supervisory practice by implementing them in MaRisk (comply statement) (see 5.1 below)

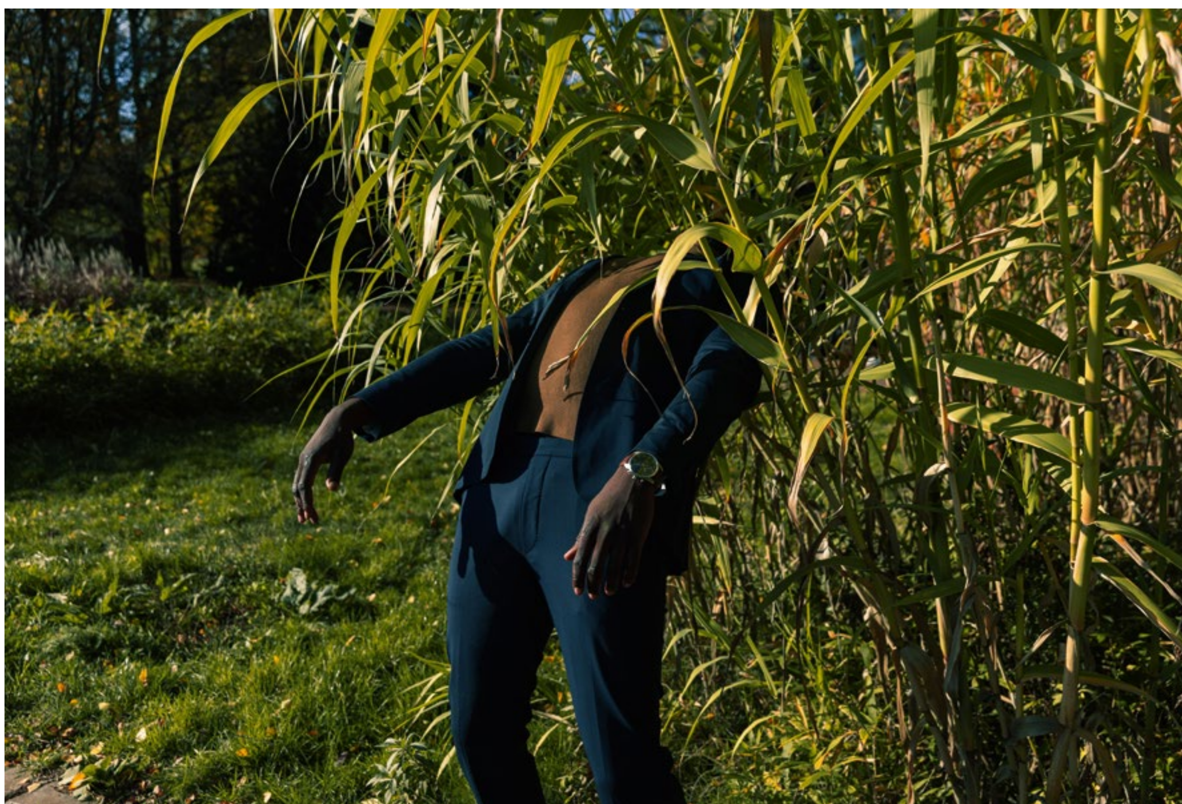
Investment firms

126 Directive (EU) 2019/2034 from 27 November 2019 (**IFD**) tasked the EBA with creating a report by 26 December 2021on the introduction of technical criteria for the supervisory review and evaluation process in relation to ESG activities. This review and evaluation process was to include the potential causes and impact of ESG related risks on investment firms.[166] Such analysis can be found in the EBA report of June 2021[167]. In addition, in November 2021, EBA and ESMA published a

consultation paper on draft guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) of investment firms.[168] According to this paper, ESG risks are to be included in the identification and in the assessment of the main vulnerabilities of the business model of investment firms.

127

In October 2022, as part of its mandate from the IFD, the EBA supplemented its June 2021 report with a further analysis regarding **smaller, non-interconnected and medium-sized investment firms**.[169] According to this report, most of the assessment criteria that are also applicable to banks and large investment firms should apply in principle to medium-sized investment firms. However, the supervisory authorities must apply the principle of proportionality in their supervision. In the case of small and non-interconnected investment firms, authorities must consider on a case-by-case basis whether and to what extent they take ESG risks into account as part of their SREP.



3.3.2 Classification and Regulatory Treatment of Assets from a Sustainability Perspective (CRR II)

128

Credit institutions that have issued exchange-traded securities will have to **disclose** information on **environmental, social and governance** (ESG) risks defined in the EBA report, initially on an annual basis and subsequently on a semi-annual basis, starting on June 28, 2022.[170] For the implementation of these Pillar 3 disclosure requirements, the EBA issued its final draft of an Implementation Standard (ITS) on January 24, 2022.[171] The ITS is intended to encourage institutions to disclose meaningful and comparable information about their sustainability performance and funding activities. Among other things, it contains detailed guidance and explanations on various KPIs as well as ratios and proposes the introduction of templates and tables that institutions should use in the future to comply with their disclosure obligation under Article 449a CRR. According to the EBA's proposals, institutions should disclose their so-called ***Green Asset Ratio*** (GAR) (see 4.1. below). The GAR is an indicator with which institutions indicate which part of their exposures contributes to the objectives of climate change mitigation and climate change adaptation. The EU Commission has largely adopted the EBA's proposals for specifying the disclosure requirements under Article 449a CRR in Implementing Regulation (EU) 2022/2453 of December 19, 2022.[172] With the planned expansion of the scope of Art. 449a CRR according to the proposals in the 2021 banking package (see 3.3.3 below), all institutions would be covered by Pillar 3 disclosure on sustainability risks in the future.

129

Additionally, EBA considers whether **special supervisory treatment** would be justified for **exposures** related to assets or activities that are substantially linked to environmental and/or social objectives.[173] In particular, the EBA shall consider

- **methods for the assessment** of the effective riskiness of exposures related to assets and activities associated substantially with environmental and/or social objectives compared to the riskiness of other exposure;
- the development of **appropriate criteria** for the assessment of physical risks and transition risks, including the risks related to the depreciation of assets due to regulatory changes;
- the **potential effects** of a dedicated prudential treatment of exposures related to assets and activities which are associated substantially with environmental and/or social objectives **on financial stability** and bank **lending** in the Union.

130 To this end, the EBA must submit a further report on its findings to the European Parliament, the Council and the Commission by June 28, 2025, on the basis of which the EU Commission will draw up a **legislative proposal**, if appropriate. In its New SF Strategy, the EU Commission has held out the prospect of bringing forward the submission of this report to **2023** and has submitted a corresponding regulatory proposal as part of its 2021 banking package (see 3.3.3 below).

131 The EBA has also published a discussion paper on the possible inclusion of environmental risks in Pillar 1 **capital requirements** on May 2, 2022.[174] In particular, the paper examines the highly controversial question of whether loans that serve to finance environmental objectives should be privileged by means of a "***supporting factor***" or whether "***penalizing factors***" should also be applied to the capital backing of risk exposures related, for example, to energy and resource efficiency as well as infrastructure and transport fleets.

132 To encourage private and public investment in infrastructure projects, the capital requirements for risk exposures arising from infrastructure projects are to be reduced, provided that the projects meet various criteria that can lower their risk profile and improve the predictability of cash flows.[175] This is in line with the objective of encouraging investment by institutions to flow into high-quality infrastructure projects, thereby contributing to the transition to a climate-resilient economy with low carbon emissions and to the circular economy. Thus, CRR II already specifically sets out the capital requirements for credit risk for exposures to legal entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services – provided that an exposure meets the criteria set out in Art. 501a CRR II. This includes that the obligor has assessed whether the financed assets contribute to any of the following environmental objectives:

- Climate change mitigation,
- Climate change adaptation,
- Sustainable use and protection of water and marine resources,
- Transition to a circular economy, waste prevention and recycling,
- Prevention and reduction of environmental pollution as well as
- Protecting healthy ecosystems and biodiversity.

Investment firms

133 EBA is also to consider, in relation to investment firms, whether special supervisory treatment of assets used for activities that are materially related to environmental or social objectives in the form of adjusted K-factors or adjusted K-factor coefficients would be justified from a prudential perspective.[176] In addition, by June 26, 2024, the EU Commission is mandated to submit a report to the Parliament and the Council, in cooperation with

ESMA and EBA, on, among other things, an assessment of whether there are ESG risks

- in internal corporate management,
- in the remuneration policy or
- in risk management

which must be considered or that need to be included in the supervisory review and evaluation process.[177]

134 Additionally, investment firms have been required to disclose information on ESG risks on a regular basis since December 26, 2022.[178]

3.3.3 Banking Package 2021

135 Based on its new SF strategy, the EU Commission has included binding requirements for the inclusion of sustainability risks in the risk management of credit institutions in the CRR and the CRD in the "Banking Package to strengthen banks' resilience and better prepare for the future"[179] ("**Banking Package 2021**") of October 2021. The new regulations are intended to make the banking sector more resilient to sustainability risks. At the same time, the EU Commission wants to incentivize banks to make an active contribution to a sustainable economic system. Specifically, the EU Commission proposes the following points in the Banking Package 2021:

- Uniform definitions for the different types of ESG risks as well as for ESG factors[180];
- Disclosure requirements for risk exposures related to ESG risks[181];
- Extension of the personal scope of application of the disclosure requirement on ESG risks pursuant to Art. 449a CRR II;
- Timing of the EBA report on the supervisory treatment of risk exposures in an ESG context brought forward from 2025 to 2023[182];
- Incorporation of short-, medium-, and long-term horizons of ESG risks into strategies and processes for assessing internal capital needs and governance[183];
- Development specific plans to address ESG risks by management[184];
- Introduction of a sustainability dimension to the supervisory review and evaluation process (SREP)[185].

136 The trilogue negotiations between the EU Commission, the EU Parliament and the Council on the Banking Package 2021 are scheduled to start at the **beginning of 2023**.

3.4 SUSTAINABILITY IN SOLVENCY SUPERVISION FOR INSURANCE UNDERTAKINGS

137 In parallel to the EBA, EIOPA is addressing the question of how to integrate sustainability risks, especially those related to climate change, into the investment and underwriting practices of (re)insurers.

138 In September 2019, EIOPA had already submitted an opinion with recommendations to the EU Commission.[186] In EIOPA's view, the insurance industry must intensively address sustainability risks, which will increasingly impact the insurance sector in the coming years and decades.[187] The opinion also points out that the medium- to long-term effects of climate change cannot be fully captured in Solvency II capital requirements.[188] EIOPA therefore emphasizes the importance of **scenario analyses** for insurers' risk management.[189] Furthermore, EIOPA advocates the development of a so-called **impact underwriting**, which would include the integration of ESG considerations into the underwriting strategy of (re)insurance undertakings and the development of new products that address climate change risks and the promotion of risk-reducing behavior.[190]

139 As a follow-up to this opinion, EIOPA published on December 2, 2020, a discussion paper (up for consultation) on a Methodology on potential inclusion of climate change in the *Nat Cat Standard Formula*.[191] In the paper, EIOPA presents possible steps and process changes to reflect climate change in Pillar 1 (Solvency II) requirements. Following this consultation, EIOPA has published a related methodology paper in June 2021 that explores whether and how climate change should be included in *Nat Cat Modules*.[192]

140 Following up on the September 2019 Opinion, EIOPA also issued a further Opinion to national supervisors on April 19, 2021, setting out expectations on how supervisors should oversee the integration of climate change risk scenarios by insurers into their *Own Risk & Solvency Assessment* (**ORSA**).[193]

141 On December 5, 2021, EIOPA published a **3-year plan** outlining the issues to be addressed related to sustainability risks.[194] These include:

- Integrating sustainability risks into the regulatory framework of insurers and pension funds;
- Consolidate macro/microprudential risk assessment of sustainability risks;
- Promote sustainability disclosures and a sustainable conduct of business framework;
- Support supversion of sustainability risks and supervisory convergence in the EU;
- Address protection gaps;
- Promote the use of open-source modelling and data in relation to climate change risks;
- Contribute to international convergence for the assessment and management of sustainability risks.

142 On August 2, 2022, EIOPA published its final **Application Guidance** on how to consider climate change in the ORSA.[195] The guidance is intended to provide assistance to insurance undertakings on how to incorporate climate change risks as part of their own ORSA assessment and provides case studies to help with materiality assessments and climate change scenario building.

143 On December 5, 2022, EIOPA summarized its previous considerations on the supervisory **treatment of sustainability risks under Solvency II** in a discussion paper.[196] In the paper, EIOPA describes the planned scope, methods and data sources for a corresponding assessment in the following areas:

- **Assets and transition risks**: Examination of potential impacts of risks arising from the transition to a lower-carbon economy on equities, bonds, and real estate;
- **Underwriting risk and adaptation to climate change**: Impact on non-life insurance products of climate-related adaptation measures on underwriting risks and the associated risks of loss from a regulatory perspective, examined in relation to non-life insurance;
- **Social risks and objectives**: Discussion on how social risks or compromised social objectives could translate into regulatory risks and assessesment of appropriate prudential treatment.

144 Market participants have the opportunity to comment on this until March 5, 2023.

4. TRANSPARENCY AND LONG-TERM ORIENTATION

4.1 SUSTAINABILITY IN DISCLOSURE AND REPORTING REQUIREMENTS

145 Companies that are required to submit a non-financial statement are now also subject to special disclosure requirements under the Taxonomy Regulation (4.1.1). The group of companies that is obligated to sustainability reporting, as well as the requirements for sustainability reporting, will be expanded in the future – staggered over time – by the requirements of the CSRD (4.1.2).

4.1.1 Sustainability Disclosures under the Taxonomy Regulation

146 Companies that are required to submit a non-financial statement must present in their non-financial statement how and to what extent their activities are linked to environmentally sustainable economic activities.[197] Non-financial companies must disclose the following KPIs for this purpose:

- What proportion of their turnover is generated from products or services associated with an environmentally sustainable economic activity, and
- What proportion of their capital expenditures (CapEx) and/or operating expenditures (OpEx) relate to assets or processes associated with an environmentally sustainable economic activity?[198]

147 The disclosure requirements are further specified in a Level 2 Regulation, which was published in the Official Journal of the EU on December 10, 2021 and has been applied incrementally since January 1, 2022 (**Delegated Act Art. 8 Taxonomy Regulation**).[199] The Delegated Act Art. 8 Taxonomy Regulation Art. 8 Taxonomy Regulation provides details of the KPIs to be disclosed for the reporting companies. In addition to the requirements for non-financial companies, it also contains specific requirements for credit institutions, asset managers, investment firms and insurance companies.

148 Accordingly, non-financial companies shall calculate the KPIs to be disclosed as follows[200]:

- **Turnover KPI:**
  Net turnover derived from goods or services associated with Taxonomy-aligned economic activities (numerator),
  divided by total net turnover (denominator).
- **CapEx KPI:**
  Capital expenditures associated with Taxonomy-aligned economic activities,
  or
  Capital expenditures that serve to expand taxonomy-aligned economic activities pursuant to a so-called CapEx plan,
  or
  Capital expenditures related to the acquisition of products from taxonomy-aligned economic activities (numerator),
  divided by the sum of capital expenditures (denominator).
- **OpEx KPI:**
  Operating expenses which are associated with Taxonomy-aligned economic activities
  or
  part of the CapEx plan,
  or
  Operating expenses related to the purchase of products from Taxonomy-aligned economic activities (numerator),
  divided by the sum of operating expenditures (denominator).

149 **The CapEx plan** is intended to help companies credibly demonstrate that they are seeking Taxonomy compliance. Therefore, the plan especially has to fulfill the following conditions:

- Enabling an expansion of the scope of Taxonomy-aligned economic activities, or
- Conversion of an economic activity into an Taxonomy-aligned economic activity within a period of five years, unless a longer period is objectively justified by special characteristics of the economic activity in question, and
- Approval by the management of the non-financial company.

150 In order to make reporting transparent, companies should also provide information on the proportion of economic activity that is Taxonomy-*eligible* but not yet Taxonomy-*aligned*. In addition, the share of economic activities that is Taxonomy-non-eligible must be reported. For reporting, companies should use “standardized” tables, which are reproduced in Annex II of the Delegated Regulation.[201]

151 As the indicators of Turnover, CapEx and OpEx are not considered suitable to demonstrate alignment of financial economic activities with the Taxonomy, the draft Delegated Regulation provides for specific KPIs and calculation methods for **financial entities**.[202]

152 According to this, **credit institutions** are each to provide indicators for:

- on-balance sheet assets in connection with its financing activities,
- off-balance sheet exposures and
- commissions and fees in connection with other non-financing transactions.

153 Institutions exceeding the minimum thresholds pursuant to Art. 94 CRR are also required to disclose information relating to their trading portfolios (trading books).[203]

154 The main indicator for disclosure by credit institutions is the **Green Asset Ratio**. It expresses the extent to which credit institutions themselves finance Taxonomy-aligned economic activities and thus provides information on the ratio of Taxonomy-aligned *exposure* to the institution's total exposure. The calculation of the GAR has to be based on the risk positions and the balance sheet according to the to the scope of prudential consolidation and include information on stock and flows, transitional and enabling activities, and specialized and general purpose lending.[204] In addition, the Delegated Regulation contains detailed requirements for further key figures that credit institutions have to disclose with regard to their Taxonomy orientation, including a KPI on financial guarantees issued to companies, the KPI for assets under management or a KPI for fees and commission income.

155 For the other sectors, Level 2 regulation for Art. 8 Taxonomy Regulation provides for the disclosure of the following KPIs:

- **Investment Firms:** KPIs for their main investment services and activities carried out on own account and for their other services and activities (Annex I Section A of Directive 2014/65/EU – MiFID);[205]
- **Asset Managers: Green Investment Ratio (GIR)**, which shows the weighted average value of all investments directed toward or related to the financing of Taxonomy-aligned economic activities relative to the value of total assets in terms of both collective and individual portfolio management activities;[206]

– **Insurance Undertakings:** KPIs related to their investments as well as their insurance activities. The KPI relating to investments shows the weighted average of investments used to finance or associated with Taxonomy-aligned economic activities. The KPI relating to insurance activities indicates the share of gross premiums written from "non-life insurance" or reinsurance gross premiums related to taxonomy-compliant insurance activities in relation to total gross premiums written.[207]

156 In order to give the companies concerned sufficient time to implement the Taxonomy-related reporting, Level 2 regulation to Art. 8 Taxonomy Regulation provides for a gradual implementation of the reporting obligations. Accordingly, the share of Taxonomy-eligible economic activities as well as certain qualitative information had to be disclosed for the first time as of January 1, 2022 for the reporting period 2021. The complete requirements are then to be met from January 1, 2026 for the 2025 reporting period. Assistance in implementing the reporting requirements is provided by FAQs published by the EU Commission.[208] In parallel, the PoSF has published considerations for voluntary disclosures as part of Taxonomy-eligibility reporting. These are intended to support reporting companies that wish to voluntarily provide additional disclosures related to the Taxonomy-eligibility of their economic activities in addition to the mandatory reporting.[209]

157 Currently, the Taxonomy-related disclosure requirements only affect those companies that are already required to submit non-financial statements under the **Non-Financial Reporting Directive**[210] **(NFRD**, which in Germany is usually referred to as the **CSR** Directive, where CSR stands for Corporate Social Responsibility) and the amendments to the Accounting Directive[211] contained therein.[212] This particularly affects **large capital market-oriented companies** with more than **500 employees**.[213] However, the gradual implementation of the CSRD (see below) will expand the scope of companies that have to disclose sustainability reports. This results from the fact that the scope of application of Art. 8 Taxonomy Regulation "follows" the scope of application of the CSRD.

4.1.2 Sustainability reporting obligations under the CSRD

158 The **Corporate Sustainability Reporting Directive (CSRD)**[214], announced on December 16, 2022, which amends and replaces the NFRD, applies to large companies, regardless of their capital market orientation, and – will at a later date – apply to all small and medium-sized capital market-oriented companies.[215] Instead of the current 11,600 or so companies, around 49,000 companies will be covered across Europe in the future – including a large proportion of the German *Mittelstand*. The CSRD must be implemented into national law by July 6, 2024.

159 The CSRD provides for **a gradual implementation** depending on the size of the company:

– for fiscal years beginning on or after January 1, 2024: companies already subject to the NFRD (reporting in 2025 on 2024 data);
– for fiscal years beginning on or after January 1, 2025: large companies not currently subject to the NFRD (reporting in 2026 on 2025 data) – including a large proportion of the German Mittelstand;
– for fiscal years beginning on or after January 1, 2026: listed SMEs and small and non-complex credit institutions and captive insurance entities (reporting in 2027 on 2026 data); listed SMEs also have an opt-out for fiscal years beginning before January 1, 2028;[216]
– for fiscal years beginning on or after January 1, 2028: companies from third countries with a net turnover > EUR 150 million in the EU in the last two fiscal years that have at least one subsidiary or branch in the EU, which in turn must meet certain requirements.[217]

160 In terms of content, the CSRD standardizes non-financial statements on sustainability. The statements must now be included in the **(group) management report**. This sustainability reporting follows the principle of *double materiality*. This means that it must include information which is *material* for assessing,

- the impact of the company's activities on sustainability aspects (*inside out*) as well as
- the impact of sustainability issues on the company's business performance, results and position (*outside in*).[218]

161 This information includes, for example, information

- on sustainability risks and opportunities,
- on the consideration of climate-related economic transformation in corporate strategy, and
- on the role of management in this process
- describing a plan on how the company's plans are consistent with the Paris Agreement to limit global warming to 1.5 °C (**Climate Plan**[219]).
- on the main actual or potential negative impacts of its own operations and value chain.

162 SMEs, small and non-complex credit institutions and captive insurance entities can opt for simplified reporting.[220] The reporting requirements on the value chains are restricted with regard to non-reporting companies in these value chains.[221]

163 In addition, the non-financial report must contain the disclosures required by Art. 8 Taxonomy Regulation.

164 The statements are audited externally by auditors, but initially only as part of a *limited assurance audit*.[222]

165 In November 2022, **EFRAG** submitted a final draft of a first set (SET 1) of reporting standards (*EU Sustainability Reporting Standards*, ***ESRS***) to the Commission, which will adopt the reporting standards as a delegated regulation.[223] In the draft, EFRAG significantly reduced the number of disclosure requirements and related data points compared to previous versions of the draft reporting standards. EFRAG has also dropped the principle of *rebuttable presumption*, according to which entities would have had to report on all aspects of sustainability unless they could rebut *materiality*. The final draft of the reporting standards initially contains only sector-independent standards that apply to all industries. EFRAG divides these sector-independent standards into *cross-cutting standards* that relate to all aspects of sustainability – i.e., environmental, social and governance – and *topical standards* that relate to one of the aspects of sustainability. The following table illustrates the this:

SET 1 – Sector Independent Reporting Standards			
Cross-cutting Standards	**Topical Standards**		
	Ecology	**Social**	**Good corporate governance**
ESRS 1 – *General Requirements*	ESRS E1 – *Climate Change*	ESRS S1 – *Own workforce*	ESRS G1 – *Business Conduct*
ESRS 2 – *General disclosures*	ESRS E2 – *Pollution*	ESRS S2 – *Workers in the value chain*	
	ESRS E3 – *Water and marine resources*	ESRS S3 – *Affected communities*	
	ESRS E5 – *Resources and circular economy*	ESRS S4 – *Customers and end-users*	

166 Currently, EFRAG is developing a second set of sector-specific reporting standards (SET 2), including:[224]

- Textiles, accessories, shoes, jewelry
- Mining & coal mining
- Road traffic
- Food and beverages
- Power generation and utilities
- Agriculture, livestock and fishing.
- Oil and gas (upstream & downstream)
- Motor vehicles

4.2 SUSTAINABILITY IN CORPORATE GOVERNANCE

167

The EU Commission was concerned that corporate management might focus too much on short-term financial returns and ignore the opportunities and risks arising from environmental and social sustainability considerations. In interaction with corresponding capital market pressure, this could lead to unnecessary exposure to sustainability risks in the long term.[225] Against this background, in February 2019, the EU Commission had asked the European supervisory authorities (ESMA, EBA and EIOPA, together "ESAs") for opinions on whether there is such undue pressure on companies to act in the short term from the capital market.[226]

168

The ESAs submitted their opinions in December 2019. Accordingly, they see no clear indications that the capital market is exerting undue pressure on companies to act in the short term.[227] It is true that tendencies toward a rather short-term action horizon are discernible, especially since conventional investment strategies are mostly designed for periods of (only) less than five years. However, this does not mean that there is inappropriate pressure to act in the short term, especially as there is no definition of inappropriate pressure.[228] None of the ESAs identified specific examples of undue pressure. EBA and ESMA point out that various steps have already been taken to promote long-term investment decisions (e.g., regulation of remuneration), the effects of which would first have to be observed.[229]

169

Even though the ESAs found no specific evidence of undue pressure to act in the short term, the EBA and ESMA in particular call for further steps to promote a long-term horizon of action in corporate governance. To this end, they propose, among other things, the creation of uniform standards and benchmarks, the further explicit standardization of sustainability considerations in the regulations of banking and capital markets law, and more far-reaching, standardized disclosure requirements. In particular, they suggest amending the Non-Financial Reporting Directive (NFRD) to provide for more extensive disclosure of ESG-relevant information.[230] These requirements have already been partially implemented in the NFRD and the draft CSRD (see 4.1 above).

170 The Commission's proposal on the **CSDDD** (see in more detail below 6.2) also requires EU member states to ensure that sustainability aspects are taken into account in corporate governance.[231] Thus, when exercising their duty to act in the best interests of the company, members of the company's management should take into account the short, medium and long-term consequences of their decisions for sustainability aspects. This shall also extend to the consequences for human rights, climate change and the environment. Violations of this duty are to be sanctioned through corporate liability.

171 The EU Commission's proposal for a directive has been subject to a controversial debate in the legislative process, and it remains to be seen whether the final version of the CSDDD will contain a corresponding passage. Within the EU Commission, the Regulatory Scrutiny Board had to be outvoted so that the proposal on due diligence could be included. In the Council's draft of November 30, 2022, the passage on due diligence obligations has been deleted. In contrast, the previous draft by a member of parliament includes the passage. Which view will prevail will become clear in the upcoming trilogue procedure between the Commission, Council and Parliament.

172 In addition to extending liability-based sustainability-related due diligence, the CSDDD is expected to provide further incentives for sustainability in corporate governance. For example, companies are to draw up an **Action Plan** in which they define measures to mitigate climate change and meet the climate targets of the Paris Agreement. This plan is likely to be substantially congruent with the climate plan that must be published under the CSRD (see here, 5.1). The Commission's proposal provides that variable remuneration components of the executive board should be linked, where appropriate, to the achievement of targets from this climate plan.

5. NATIONAL DEVELOPMENTS

5.1 BAFIN GUIDANCE NOTICE

173 In parallel to the plans at European level, BaFin published a Guidance Notice on Dealing with Sustainability Risks[232] on December 20, 2019 (**BaFin Guidance Notice**). It is intended to serve as a guide for companies supervised by BaFin to address sustainability risks in a timely manner. The principles and procedures outlined therein are to be understood as *good practice guidelines* which are non-binding; concrete audit requirements are not (initially) formulated.[233] The BaFin Guidance Notice is not intended to weaken or extend binding legal or supervisory requirements, particularly with regard to the European specifications for the integration of sustainability risks at insurance undertakings, investment firms, asset management companies and credit institutions.[234]

174 The BaFin Guidance Notice addresses its recommendations to all companies supervised by BaFin.[235] The focus is on risk management. The sustainability risks defined in the BaFin Guidance Notice are to be included more strongly in their risk assessment by the supervised companies, taking into account the principle of proportionality. This is to be ensured by means of responsible governance which, within the framework of an appropriate business organization, incorporates sustainability risks into the business and risk strategy, communicates these internally within the company and is responsible for their implementation within the company.

175 It also deals with the mapping of sustainability risks in company-specific stress tests, outsourcing and issues on a group level. The BaFin Guidance Notice also contains information on the use of ratings.

176 On September 26, 2022, BaFin published a new version of its supervisory Circular containing the minimum requirements for risk management – MaRisk – for consultation purposes (**7th MaRisk amendment**).[236] In doing so, BaFin is, on the one hand, incorporating the EBA guidelines for Loan Origination and Monitoring[237] (see 3.3.1 above) into its administrative practice. On the other hand, the core elements from the BaFin Guidance Notice, which had previously been formulated as non-binding recommendations, are transferred to MaRisk and thus explicitly made into audit-relevant requirements for the institutions supervised by BaFin.

177 This shows that the German supervisory authority expects more commitment and stringency in the future when it comes to including sustainability risks in risk management. Institutions are to adapt their existing internal processes and develop suitable measurement, management and risk mitigation tools to manage sustainability risks in the form of both physical risks and transition risks. As a result, the institutions are to develop an approach to dealing with sustainability risks that is appropriate to their business model and risk profile.

5.1.1 WHAT ARE SUSTAINABILITY RISKS?

178

BaFin is developing its own understanding of risk with regard to sustainability and defines sustainability risks as events or conditions from the environmental, social or governance areas (*environmental, social and* governance risks – ESG risks), the occurrence of which can potentially have a negative impact on the net assets, financial position or results of operations of a supervised company. In this respect, ESG risks act as risk drivers and can have an impact on counterparty risks, market price risks, liquidity risks, operational risks, and other significant risk types.[238] As part of the risk inventory, management must now also adequately and explicitly include the impact of ESG risks as part of the overall risk profile.

5.1.2 STRATEGIES – RESPONSIBLE CORPORATE GOVERNANCE – BUSINESS ORGANIZATION

179 BaFin is increasingly working towards a strategic approach to sustainability risks by the management within the **business and risk strategy**.[239] Whether independent strategies are developed for this purpose or existing ones are supplemented is to be left to the supervised companies. However, their approach to sustainability risks must be clearly communicated both within the company and externally.

180 What requirements will result from the new MaRisk in this respect?

181 According to the 7th MaRisk amendment, the external influencing factors to be taken into account in the future when defining and adjusting the business strategy include not only market developments, the competitive situation and the regulatory environment, but also **changing environmental conditions** and the **transition to a sustainable economy**.[240] The company's risk strategy must explicitly include the effects of ESG risks. In particular, the effects of ESG risks must be taken into account when determining the risk appetite, based on suitable risk indicators for ESG risks.

182 Business managers will only fulfill their responsibility for proper business organization and its further development if they can assess risks, including ESG risks, and take the necessary measures to limit them.[241]

183 The risk controlling function, which is responsible for the appropriate monitoring and communication of material risks, must also explicitly consider the impact of ESG risks in this context.[242]

184 The institution's organizational guidelines shall also include rules for considering the impact of ESG risks.[243].

5.1.3 RISK MANAGEMENT AND STRESS TESTS

185

According to the recommendations of the BaFin Guidance Notice, institutions should already integrate sustainability risks into their risk identification, management and controlling processes as part of risk management.[244] The 7th MaRisk amendment now formulates this as a binding requirement. This means that institutions are to investigate and document the effects of material ESG risks against the background of their risk positions comprehensively and – as far as reasonable and possible – also quantitatively.[245] In addition, the effects of ESG risks are to be taken into account in the future as part of the **stress tests** for material risks that are to be carried out regularly, and the insights gained from these tests are to be incorporated into the strategy of the institution as well as into the risk management and controlling processes.[246]

5.2 BAFIN GUIDELINE ON SUSTAINABLE INVESTMENT ASSETS (DRAFT)

186

In August 2021, BaFin published a draft guideline on sustainable investment funds (draft guideline).[247] In this guideline, BaFin formulates requirements for the investment conditions of public investment funds that have a reference to sustainability in their name or that are marketed as sustainable. In its draft directive, BaFin stipulates that the investment conditions for such sustainable investment funds must provide for the following:

- At least 75% of the investment fund must be invested in sustainable assets as defined by the SFDR or the Taxonomy Regulation,
- sustainability aspects/factors must be of decisive importance in the selection of assets for at least 75% of the investment assets, or a sustainable investment strategy must be pursued in the management of the entire funds (e.g. through a best-in-class strategy), or
- the investment terms must track a sustainable index.

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Following considerable criticism during the consultation phase, BaFin decided to postpone the planned directive. Capital management companies are nevertheless free to launch sustainable investment funds.[248] In this case, however, certain principles of the consultation version apply, including the above-mentioned requirements of the investment conditions.[249]

5.3 SF-ADVISORY COMMITTEE

188 The Sustainable Finance Advisory Committee (SF-AC), which advises the German government on the development of a sustainable finance strategy, has reconstituted itself for the 20th legislative term in six working groups and began its work in September 2022.[250] Since its establishment on June 6, 2019, the SF-AC had previously submitted a final report in February 2021, following consultations on its interim report published in March 2020, which contains specific recommendations for action to the German government.[251] Even though the specific recommendations for action are addressed to the federal government, there are three actors to be mentioned for the implementation of these recommendations: The financial sector, the real economy and politics. Secondary addressees are academia and civil society, which are to accompany and promote the process.

189 The SF-AC's total of 31 recommendations relate to five areas of action, each of which is dealt with in a separate chapter.[252]

1. Policy framework (chapter 2): The recommendations refer to the creation of a reliable policy framework in Germany and the EU in order to set a coherent course for sustainability in the financial and real economy. In doing so, the public sector should not only act as a role model, but also include other policy areas that have a decisive impact on a sustainable transformation.

2. Reporting (chapter 3): Corporate reporting should form a basis for sustainable investment decisions and holistic risk management. The Council identifies four core requirements for such reporting: It should be forward-looking, ensure comparability, take into account not only external factors but also the consequences of the company's activities for society and the environment and the information needs of different stakeholders.

3. Knowledge building (chapter 4): The aim is to ensure systematic knowledge building among those responsible for regulation, management and supervision of companies, financial consulting and the general public. Relevant research findings, necessary decision-making aids and additional management competencies are to be built up and communicated.

4. Financial products (chapter 5): The recommendations, which are directed in particular at the financial sector, focus on the creation of financial products that are effective in terms of sustainability in order to meet the expected increase in demand from private customers for sustainable investment products.

5. Consolidation (chapter 6): The recommendations on institutional consolidation are aimed at the financial sector, the real economy and policymakers alike. They concern the organization of working structures and responsibilities as well as the question of efficient implementation within the framework of established public-sector structures.

190 The report contains a prioritization regarding the implementation of these recommendations. The SF-AC cites the reporting proposals addressed to the financial sector and the real economy in chapter 3 as the most important levers. It expressly recommends that the implementation of the recommendations in chapter 3 should be prioritized in terms of time. In addition, the SF-AC advocates early implementation of the sustainable orientation of public investment issues and capital investments recommended in Chapter 2 and of the consolidation of sustainable finance addressed in Chapter 6.[253]

191 The topics presented by the SF-AC were taken up by the German government in its Sustainable Financing Strategy adopted on May 5, 2021.[254] This contains a total of 26 measures. In its role as a role model, the federal government plans, for example, to gradually shift the federal government's equity investments into sustainable investments and to issue green federal securities.

192 A current concern of the SF-AC is to increase transparency in corporate sustainability reporting, leading to greater credibility and acceptance of stakeholder accountability. In October 2022, the SF-AC issued an open letter calling for international regulation and standardization of sustainability reporting. The criteria elaborated by global standard-setting initiatives – such as the IFRS International Sustainability Standards Boards (ISSB) – should serve as a basis. The letter is addressed to the European Parliament, the Council of the European Union, the European Commission, the EFRAG Sustainability Reporting Board, the German Federal Government, the Global Reporting Initiative and the IFRS International Sustainability Standards Board.[255]

193 In addition, an **ESG scale ("sustainability traffic light")** is to be published in spring 2023 and included in the PRIIPs Key Information Document. The inclusion of the ESG scale is intended to ensure greater transparency with regard to sustainability features of investment products and thus improve comprehensibility in investment advice. The responsible SF-AC working group is currently developing a detailed concept that will be tested by advisors and investors in the first quarter of 2023.[256]

5.4 GERMAN CORPORATE GOVERNANCE CODE

194

In the context of corporate law, the new version of the **German Corporate Governance Code** (GCCC)for listed stock corporations published on May 08, 2022 sets new standards in the area of sustainability in corporate governance.[257] The Executive Board is now to identify and assess ecological and social risks, opportunities and impacts. This is the first time that the GCCC requires that impacts of the company on sustainability factors be considered "inside out". Previously, sustainability factors only had to be considered "outside in" as potential risks for the company. In addition, the internal control system and the risk management system are now also to cover sustainability-related targets. These regulations are flanked by the fact that the Supervisory Board is required to take sustainability issues into account in its advisory and monitoring activities. To this end, it must maintain a sufficient competence profile. This also applies to sustainability reporting.

6. DUE DILIGENCE IN SUPPLY CHAINS AND HUMAN RIGHTS

6.1 LKSG

195

In June 2021, the German parliament passed the Law on Corporate Due Diligence Obligations in Supply Chains (**LkSG**), which came into force on January 1, 2023.[258] Companies covered by the LkSG must observe human rights and environmental obligations in their supply chains. In particular, they are to prevent corresponding risks, minimize them and put an end to any violations of human rights or environmental duties.[259] The law applies to companies regardless of their legal form, provided they have their head office, principal place of business, administrative headquarters or registered office in Germany and generally have at least 3,000 employees in Germany (which also includes workers posted abroad). As of January 1, 2024, the threshold will be lowered to 1,000 employees. **Credit institutions** are also covered by the LkSG if they grant large exposures as defined in Art. 392 CRR to suppliers.[260] To guide the application of the LkSG, the Federal Office for Economics and Export Control (BAFA), the Federal Ministry for Economics and Climate Action (BMWK) and the Federal Ministry of Labor and Social Affairs (BMAS) have published joint FAQs.[261]

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In order to meet their obligations under the LkSG, companies must implement risk management and compliance processes for their supply chains. A violation of the obligations of the LkSG can be punished with a fine of up to EUR 800,000.00 or, for companies with an average annual turnover of more than EUR 400 million, with a fine of up to 2% of the average annual turnover.[262] However, the law does not provide for civil liability, which has been discussed in the meantime.[263]

6.2 CSDDD

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At EU level, comparable obligations already exist or are planned for individual sectors.[264] In addition, general regulation is also intended at EU level. In February 2022, the EU Commission presented a proposal for a directive on corporate sustainability obligations, the "Corporate Sustainability Due Diligence Directive (**CSDDD**)".[265] The proposal aims to promote sustainable and responsible corporate behavior in all value chains and goes significantly beyond the LkSG in some respects. The CSDDD is intended to cover EU limited liability corporations with at least 500 employees and a net turnover of at least EUR 150 million worldwide. These thresholds will be lowered to 250 employees and EUR 40 million net turnover if companies generate at least 50% of their turnover in a so-called "high impact" sector. In addition, companies from third countries are included if they generate net sales of more than EUR 150 million in the EU or generate net sales of more than EUR 40 million in the EU and 50% or more of their global sales are attributable to a high-impact sector.

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The due diligence obligations of the CSDDD should generally be observed in the company's own area of activity, at subsidiary-level and at companies within the value chain. The value chain includes both (indirect) suppliers and customers. However, this only applies if an "Established Business Relationship" is maintained. In addition to human rights, the due diligence obligations also include compliance with all major international climate and environmental agreements. A particularly serious difference to the LkSG is the regulation of liability for damages under civil law.

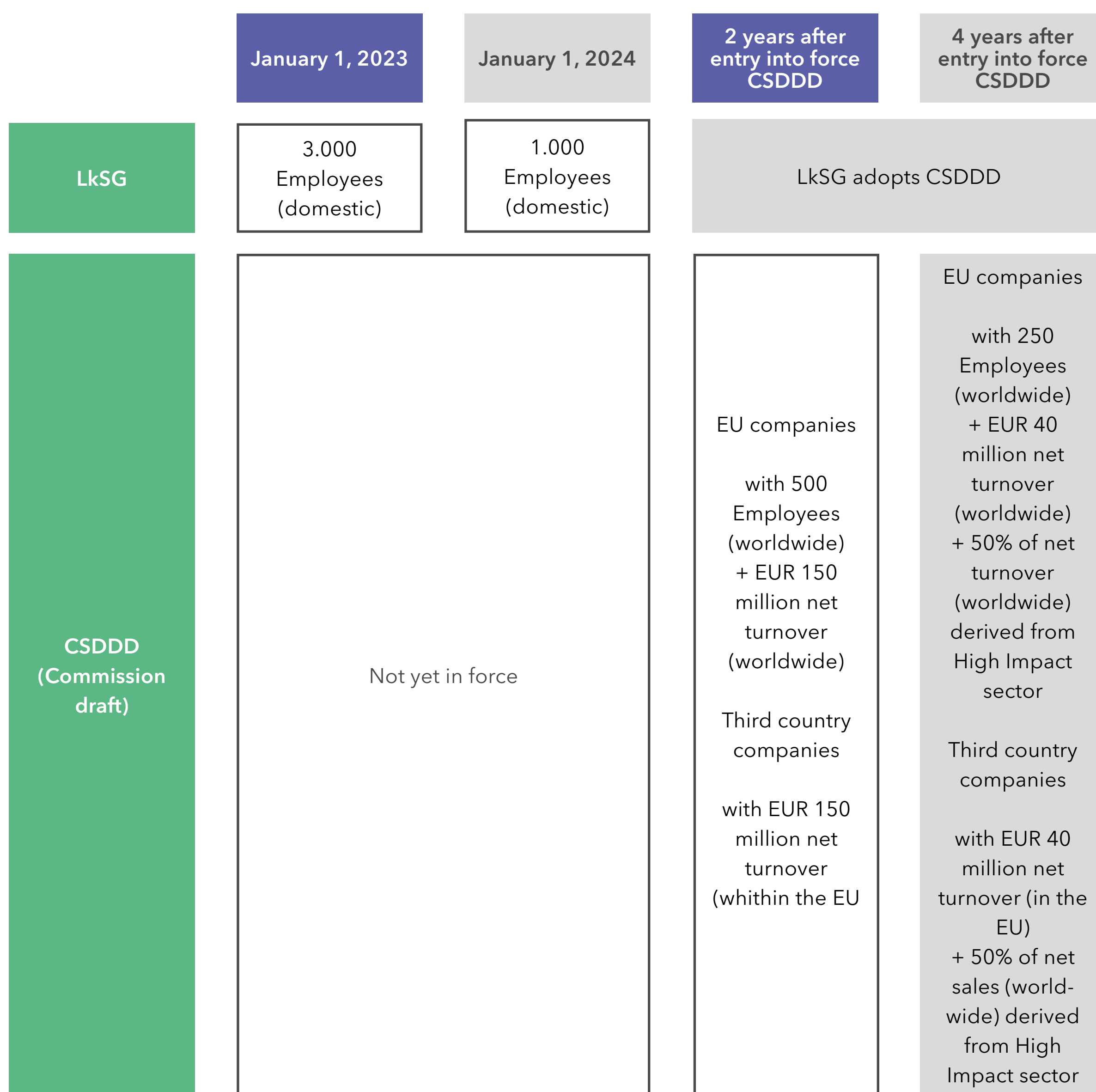
199

Prior to its proposal on the CSDDD, the Commission already published due diligence guidelines for EU companies to address the risk of forced labor in their operations and supply chains in July 2021.[266] These guidelines provide specific and practical advice to help companies identify, prevent and eliminate forced labor in their supply chains.

6.3 OUTLOOK

200 The LkSG, the CSDDD and the minimum safeguards of the Taxonomy Regulation (see 2.1.2) are based on common soft law provisions from the UNGPs and the OECD Guidelines for Multinational Enterprises. Therefore, the regulations overlap to a large extent, resulting in synergies. For example, anyone who has to fulfill the obligations under the LkSG is simultaneously taking a step towards Taxonomy compliance. However, the requirements are not completely congruent. The requirements of the UNGPs and the OECD Guidelines have so far been implemented most consistently in the Taxonomy Regulation (Art. 18 as interpretetd by the PoSF). The LkSG and the Council's draft CSDDD, on the other hand, fall short of the requirements. It therefore remains to be seen whether a uniform regulatory environment will ultimately emerge, or whether the CSDDD and minimum safeguards under the Taxonomy Regulation will diverge.

201 The respective application deadlines for the LkSG and the Commission's CSDDD proposal are illustrated in the following table:



202 It is not clear whether the thresholds and application periods of the Commission proposal will be retained. In addition, it is being discussed to change the scope of application with regard to net turnover from high impact sectors from a relative threshold to an absolute threshold.[267] This is because the relative threshold may lead to inconsistent results: For example, some companies with absolutely higher – but relatively lower – net turnover from high impact sectors might not be covered, while other companies with absolutely lower – but relatively higher – net sales would fall within the scope.

GLOSSARY

AFM	Autoriteit Financiële Markten	Niederländische Finanzaufsichtsbehörde
AIF	Alternative Investment Funds	Alternative Investmentfonds
AIFM	Alternative Investment Fund Manager	Verwalter von alternativen Investmentfonds
AIFMD	Alternative Investment Fund Managers Directive (Richtlinie 2011/61/EU)	Richtlinie über die Verwalter alternativer Investmentfonds
AMF	Autorité des marchés financiers	Französische Finanzaufsichtsbehörde
BAFA	Federal Office of Economics and Export Control	Bundesamt für Wirtschaft und Ausfuhrkontrolle
BMWK	Federal Ministry for Economic Affairs and Climate Action	Bundesministerium für Wirtschaft und Klimaschutz
BMAS	Federal Ministry of Labour and Social Affairs	Bundesministerium für Arbeit und Soziales
BVI	German Investment Funds Association	Bundesverband Investment und Asset Management e.V.
CapEX	Capital Expenses	Investitionsausgaben
CRA	Credit Rating Agencies	Ratingagenturen
CRD V	5. Capital Requirements Directive (Richtlinie (EU) 2019/878)	5. Kapitaladäquanzrichtlinie
CRR II	2. Capital Requirements Regulation (Verordnung (EU) 2019/876)	2. Kapitaladäquanzverordnung

CSR-Richtlinie	Non-Financial Reporting Directive ("NFRD")	Corporate Social Responsibility-Richtlinie
CSRD	Corporate Sustainability Reporting Directive (Proposal)	Richtlinie über die Nachhaltigkeitsberichterstattung von Unternehmen (Entwurf)
CSDDD	Corporate Sustainability Due Diligence Directive	Vorschlag für eine Richtlinie über Nachhaltigkeitspflichten von Unternehmen
DDV	German Derivatives Association	Deutscher Derivate Verband
DelVO	Delegated Regulation	Delegierte Verordnung
DK	The German Banking Industry Committee	Die Deutsche Kreditwirtschaft
DNSH	Do no significant harm	Vermeidung einer erheblichen Beeinträchtigung
EBA	European Banking Authority	Europäische Bankaufsichtsbehörde
EFRAG	European Financial Reporting Advisory Group	Europäische Beratungsgruppe zur Rechnungslegung
EIOPA	European Insurance and Occupational Pensions Authority	Aufsichtsbehörde für das Versicherungswesen und die betriebliche Altersversorgung
EP	European Parliament	Europäisches Parlament
ESAs	European Supervisory Authorities (ESMA, EBA, EIOPA)	Europäische Aufsichtsbehörden
ESG	Environment Social Governance	Umwelt, Soziales und Unternehmensführung
ESMA	European Securities and Markets Authority	Europäische Wertpapier- und Marktaufsichtsbehörde

EU CTB	EU Climate Transition Benchmarks	Referenzwerte für Investitionen in eine klimafreundlichere Wirtschaft
EU PAB	EU Paris-aligned Benchmarks	Referenzwerte für Investitionen im Einklang mit dem Pariser Übereinkommen
EuGB	Proposal for a Regulation of the European Parliament and of the Council on European green bonds	Verordnungsentwurf über europäische grüne Anleihen
EZB	European Central Bank	Europäische Zentralbank
FoStoG	German Fund Jurisdiction Act	Fondsstandortgesetz
GAR	Green Asset Ratio	Green Asset Ratio
GIR	Green Investment Ratio	Green Investment Ratio
IBIP	Insurance-based investment product	Versicherungsanlageprodukt
IDD	Insurance Distribution Directive (Richtlinie (EU) 2016/97)	Versicherungsvermittlungs-richtlinie
IDW	Institute of Public Auditors in Germany	Institut der Wirtschaftsprüfer in Deutschland
IFD	Investment Firm Directive (Richtlinie (EU) 2019/2034)	Richtlinie über die Beaufsichtigung von Wertpapierfirmen
IFR	Investment Firm Regulation (Verordnung (EU) 2019/2033)	Verordnung über Aufsichtsanforderungen an Wertpapierfirmen
ILO	International Labour Organization	Internationale Arbeitsorganisation

IPCC	Intergovernmental Panel on Climate Change	Zwischenstaatlicher Ausschuss für Klimaänderungen; Weltklimarat
ITS	Implementing Technical Standard	Technischer Durchführungsstandard
JRC	Joint Research Center	Gemeinsame Forschungsstelle
KAGB	German Investment Code	Kapitalanlagegesetzbuch
Klima-DelVO	Complementary Climate Delegated Act (DelVO (EU) 2021/2139)	Komplementärer delegierter Klimaschutzakt
KPI	Key Performance Indicator	Leistungskennzahl
KWG	German Banking Act	Kreditwesengesetz
MiFID II	Markets in Financial Instruments Directive II (Richtlinie 2014/65/EU)	Finanzmarktrichtlinie II
MREL	Minimum Requirement for Own Funds and Eligible Liabilities	Mindestanforderung an Eigenmittel und berücksichtigungsfähige Verbindlichkeiten
NCAs	National Competent Authorities	Nationale Aufsichtsbehörden
NFRD	Non-Financial Reporting Directive (Richtlinie 2014/95/EU)	CSR-Richtlinie (Corporate Social Responsibility)
OECD	Organisation for Economic Co-operation and Development	Organisation für wirtschaftliche Zusammenarbeit und Entwicklung
OGAW	Undertakings for Collective Investments in Transferable Securities	Organismen für gemeinsame Anlagen in Wertpapieren

OpEx	Operating Expenses	Betriebsausgaben
ORSA	Own Risk and Solvency Assessment	Eigene Risiko- und Solvabilitätsbewertung
PAI	Principal Adverse Impact	Wichtigste nachteilige Auswirkungen
PEPP	Pan-European Personal Pension Product	Europaweites privates Altersvorsorgeprodukt
PoSF	Platform on Sustainable Finance	Plattform für ein nachhaltiges Finanzwesen
PRIIP-VO	Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs)	Verordnung über Basisinformationsblätter für verpackte Anlageprodukte für Kleinanleger und Versicherungsanlageprodukte, VO (EU) Nr. 1286/2014
RTS	Regulatory Technical Standards	Technischer Regulierungsstandard
SF	Sustainable Finance	Nachhaltige Finanzen
SFDR	Sustainable Finance Disclosure Regulation	Verordnung über nachhaltigkeitsbezogene Offenlegungspflichten im Finanzdienstleistungssektor, VO (EU) 2019/2088
SFDR-DelVO	Delegated Regulation supplementing the SFDR (Proposal)	Delegierte Verordnung zur Konkretisierung der Vorgaben der SFDR (Entwurf)
SREP	Supervisory Review and Evaluation Process	Aufsichtlicher Überprüfungs- und Bewertungsprozess
TEG	Technical expert group on sustainable finance	Technische Expertengruppe zu nachhaltiger Finanzierung

THG	Greenhouse Gas	Treibhausgas
TLAC	Total Loss-Absorbing Capacity	Einheitliche Mindestquote für die Verlustabsorptionsfähigkeit global systemrelevanter Institute
Umwelt-DelVO	Delegated Regulation on Technical Screening Criteria for the four remaining environmental objects	Delegierte Rechtsakte zur Taxonomie-Verordnung mit den Beurteilungskriterien zu den Umweltzielen nach Art. 9 lit. c–f TaxonomieVO
VAG	German Insurance Supervision Act	Versicherungsaufsichtsgesetz
VO	Regulation	Verordnung
WpHG	German Securities Trading Act	Wertpapierhandelsgesetz

ENDNOTES

1 COM (2018) 97 final. The action plan takes up recommendations made by a high-level expert group set up by the EU Commission, which presented its final report in January 2018 (Financing A European Economy – Final Report 2018 by the High-Level Expert Group on Sustainable Finance); available at: https://ec.europa.eu/info/publications/180131-sustainable-finance-report_de.

2 At the Paris Climate Change Conference in December 2015, 195 countries agreed to limit the rise in average global temperature to well below 2 °C compared with pre-industrial levels. The text of the agreement is available at: https://www.bmu.de/fileadmin/ Daten_BMU/Download_PDF/Klimaschutz/paris_abkommen_bf.pdf.

3 Action Plan, p. 3.

4 Action Plan, p. 5 ff.

5 Action Plan, p. 9 ff.

6 Action Plan, p. 12 ff.

7 Climate Target Plan, Sept. 17, 2020; available at: https://ec.europa.eu/clima/policies/eu-climate-action/2030_ctp_de.

8 See Investment Plan for the European Green Deal and the Mechanism for a Just Transition, EU Commission Q&A; available at: https://ec.europa.eu/commission/presscorner/ detail/en/qanda_20_24.

9 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Strategy for Financing the Transition to a Sustainable Economy ("New Sustainable Finance Strategy"); available at: https://eur-lex.europa.eu/resource.html?uri=cellar:9f5e7e95-df06-11eb-895a-01aa75ed71a1.0001.02/DOC_1&format=PDF.

10 EU Commission, A Green Deal Industrial Plan for the Net-Zero Age, COM(2023) 62 final; available at: https://commission.europa.eu/document/41514677-9598-4d89-a572-abe21cb037f4_en.

11 The "Level 1" of the Lamfalussy procedure usually applied in European financial market legislation provides for a kind of framework legislation, which is then substantiated at Level 2 by technical implementing provisions; see v. Hein, in: Schwark/Zimmer, KMRK, 5th ed. 2020, § 18 WpHG Rz. 3; Seitz, BKR 2002, 340, 341 et seq.

12 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 establishing a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088, OJ EU No. L 198/13.

13 Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by setting out the technical assessment criteria for determining the conditions under which an economic activity is considered to make a significant contribution to climate change mitigation or adaptation and for determining whether that economic activity avoids significant adverse impacts on any of the other environmental objectives, OJ. EU No. L 442/1; Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of the information to be disclosed by undertakings covered by Article 19a or Article 29a of Directive 2013/34/EU in relation to environmentally sustainable economic activities and by specifying the methodology to be used to ensure compliance with this disclosure requirement, OJ EU No. L 443/9.

14 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on. sustainability-related disclosure requirements in the financial services sector, OJ EU No. L 317/1; Commission Delegated Regulation (EU) 2022/1288 of 6. April 2022 supplementing Regulation 2019/2088 of the European Parliament and of the Council as regards regulatory technical standards specifying the details of the content and presentation of information related to the principle of avoidance of significant harm, the content, methods and presentation of information related to sustainability indicators and adverse sustainability impacts, and the content and presentation of information related to the promotion of environmental or social attributes and sustainable investment objectives in pre-contractual documents, websites and periodic reports, OJ EU No. L 196/1.

15 Regulation (EU) 2019/2089 of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU reference levels for climate change, as regards EU reference levels aligned with the Paris Agreement, and as regards sustainability-related disclosures for reference levels, OJ EU No. L 317/17.

16 Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the inclusion of sustainability factors, risks and preferences in certain organizational requirements and operating conditions for investment firms, OJ EU L 277/1.

17 Commission Delegated Directive (EU) 2021/1269 of 21 April 2021 amending Delegated Directive (EU) 2017/593 by incorporating sustainability factors into product monitoring obligations, OJ EU L 277/137.

18 Commission Delegated Regulation (EU) 2021/1257 of 21 April 2021 amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the inclusion of sustainability factors, risks and preferences in the prudential and governance requirements for insurance undertakings and insurance distributors and in the information requirements and conduct of business rules applicable to the distribution of insurance investment products, OJ EU L 277/18.

19 However, this applies to the Taxonomy Regulation with the restriction that it only covers the "E" for the time being, i.e. only provides for a classification for environmental sustainability. The classifications for "S" and "G" targets are to be added later. Social aspects are only considered insofar as compliance with eight core conventions of the International Labor Organization (ILO core labor standards) is a minimum requirement for environmental sustainability (Art. 13 Taxonomy Regulation). As it stands, the Taxonomy Regulation thus falls short conceptually of the overarching regulatory goal of aligning private capital flows with all three ESG sustainability goals.

20 Art. 20 Taxonomy Regulation.

21 Art. 1 par. 1 Taxonomy Regulation. Art. 18 Taxonomy Regulation merely provides for a minimum standard of human and labor rights protection as a prerequisite for the environmental sustainability of an economic activity.

22 Art. 2 No. 1, Art. 3 Taxonomy Regulation.

23 Art. 3 lit. a Taxonomy Regulation.

24 Delegated Regulation (EU) 2021/2139.

25 Art. 2 No. 17 SFDR.

26 Cf. ESAs, Joint Consultation Paper ESG disclosures, April 23, 2020, JC 2020 16, p. 8.

27 Recital 19 Taxonomy BER.

28 ESAs, Final Report on draft Regulatory Technical Standards, October 22, 2021, JC 2021 50, p. 8, 3rd par.

29 Recitals 9, 12 and 15 of the Taxonomy Regulation.

30 Art. 4 (1) Taxonomy Regulation.

31 Cf. recital 9 of the Taxonomy Regulation.

32 Recital 10 SFDR.

33 Art. 1 par. 2 lit. b Taxonomy Regulation.

34 Art. 2 No. 2 Taxonomy Regulation.

35 Art. 2 No. 1 lit. j SFDR.

36 Art. 2(1)(b)(i) EP amendment to the Taxonomy Regulation.

37 Art. 2 No. 3 Taxonomy Regulation with reference to Art. 2 No. 12 SFDR.

38 Art. 2 par. 1 lit. c EP amendment proposal to the Taxonomy Regulation.

39 Art. 26 par. 2 lit. b Taxonomy Regulation; recital 6 Taxonomy Regulation.

40 Art. 2 par. 1 lit. a Taxonomy Regulation.

41 Art. 3 lit. b Taxonomy Regulation.

42 Art. 3 lit. b Taxonomy Regulation.

43 Art. 3 lit. c Taxonomy Regulation.

44 See in each case Art. 10 – 15 par. 1 Taxonomy Regulation.

45 Art. 10 – 15 Taxonomy Regulation.

46 Art. 16 Taxonomy Regulation.

47 Art. 10 par. 2 Taxonomy Regulation.

48 Art. 17 Taxonomy Regulation.

49 Art. 18 Taxonomy Regulation.

50 PoSF, Final Report on Minimum Safeguards, available at: https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-minimum-safeguards_en.pdf.

51 Art. 19 Taxonomy Regulation as well as respectively Art. 10/11 par. 3 and respectively Art. 12 – 15 Art. 2.

52 Delegated Regulation (EU) 2021/2139.

53 Draft Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act, available at: https://ec.europa.eu/finance/docs/law/221219-draft-commission-notice-eu-taxonomy-climate.pdf.

54 Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/217 as regards specific disclosure requirements for those economic activities, OJ EU No. L 188/1.

55 PoSF, Technical Working Group, Part A: Methodological report March 2022, available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220330-sustainable-finance-platform-finance-report-remaining-environmental-objectives-taxonomy_en.pdf.

56 PoSF: Technical Working Group, Supplementary: Methodology and Technical Screening Criteria, available at: https://finance.ec.europa.eu/system/files/2022-11/221128-sustainable-finance-platform-technical-working-group_en.pdf.

57 Cf. Art. 2 No. 1 Taxonomy Regulation.

58 https://ec.europa.eu/sustainable-finance-taxonomy/index.htm.

59 ESAs, Joint Consultation Paper ESG disclosures, April 23, 2020, JC 2020 16, p. 8.

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