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ESG update

Posted 02.09.2021

EU institutions continue to shape the EU regulatory environment in the ESG field. Through the so-called "**April Package**" published on 21 April 2021, significant progress was made on standard-setting and reporting on sustainability related disclosures through the adoption of a number of draft legal instruments, some of which have been finally adopted in the meantine, affecting EU corporates and financial sector players.

1. **I. The EU Taxonomy Climate Delegated Act**

The **Taxonomy Climate Delegated Act** is a delegated regulation supplementing the Taxonomy Regulation. It establishes the technical screening criteria for determining when an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation within the meaning of Article 9 of the Taxonomy Regulation and for determining whether that economic activity causes no significant harm to other environmental objectives.

The Taxonomy Climate Delegated Act contains the first-ever “green list” - EU classification system for determining whether activities are “environmentally sustainable” with regard to the objectives of climate change adaptation and climate change mitigation and the absence of significant harm to other environmental objectives resulting from Article 9 of the Taxonomy Regulation. The applicable technical screening criteria are set out in the annexes.

A classification with regard to the other objectives of Article 9 of the Taxonomy Regulation will be published for consultation before the end of this year. Sectors not included in the Taxonomy Climate Delegated Act (agriculture, certain energy sectors and manufacturing activities) will be covered in a further delegated act later this year.

Who is concerned? Companies subject to the obligation to publish non-financial statements in accordance with the Non-Financial Reporting Directive ("**NFRD**"), which lays down the rules on disclosure of non-financial and diversity information by certain large companies. To the extent that their activities are aligned with the Taxonomy Regulation, they will have to refer to the Taxonomy Climate Delegated Act. Those covered are large public interest entities with at least 500 employees, total assets of EUR 20 million and/or net turnover of EUR 40 million and which are one of the following: (i) EU entities that have transferable securities admitted to trading on an EU regulated market; (ii) EU credit institutions; (iii) EU insurance undertakings, or (iv) EU entities that are designated by Member States as public-interest entities. Following the CSRD proposal (see below), the application will be extended.

When will it apply? The text was formally adopted on 4 June 2021. It will apply from 1 January 2022.

1. **II. The Corporate Sustainability Reporting Directive proposal**

The proposed Corporate Sustainability Reporting Directive ("**CSRD**") revises and strengthens the disclosure rules in the NFRD, in place since 2018, to ensure alignment with the Sustainable Finance Disclosure Regulation ("**SFDR**") and the Taxonomy Regulation and to create a consistent and coherent flow of sustainability information throughout the financial value chain. The principal novelties proposed are:

- the extension of the scope of the reporting requirements in the NFRD;
- a requirement to audit reported sustainability information so that it is reliable;
- introduction of more detailed reporting requirements and a requirement to report according to mandatory EU sustainability reporting standards, notably the taxonomy;
- the obligation to publish all information as part of companies' management reports, and disclosed in a digital, machine-readable format.

Also important in this respect is the **Disclosures Delegated Act**, another delegated regulation supplementing the Taxonomy Regulation, adopted by the Commission on 6 July 2021. This text specifies the content, methodology, and presentation of information to be disclosed by both non-financial and financial undertakings in accordance with Article 8 of the Taxonomy Regulation on how and to what extent their activities are associated with activities that qualify as environmentally sustainable.

Who is concerned? All large undertakings within the meaning of the Accounting Directive, whether they are listed or not, and without any threshold (see the current NFRD 500-employee threshold mentioned above). According to the Commission, around 50,000 EU companies will need to follow the new standards compared to 11,000 companies currently covered. The Commission is also proposing to further extend the scope to include listed SMEs, with the exception of listed micro-enterprises.

When will it apply? The legislative process takes about 18 months. According to the draft CSRD, undertakings will have to apply the new rules in their 2024 report covering the financial year 2023.

1. **III. Delegated Acts on sustainability preferences, fiduciary duties, and product governance**

A series of amending delegated acts (" **Delegated Acts**") were adopted with the aim to better reflect sustainability preferences in insurance and investment advice, on the one hand, and sustainability considerations in product governance and fiduciary duties, on the other hand. The Delegated Acts contain amendments to existing rules under the Insurance Distribution Directive (IDD), MiFID II, the Solvency II Directive, the UCITS Directive and the Alternative Investment Fund Managers Directive (AIFMD). A link to the Delegated Acts as published in the Official Journal on 2 August 2021 can be found here.

The following implications can be noted, in particular:

- Insurance and investment advisers will be required to obtain information not only about the client's investment knowledge and experience, ability to bear losses, and risk tolerance as part of the suitability assessment, but also about their sustainability preferences.
- Existing rules on fiduciary duties in delegated acts for asset management, insurance, reinsurance and investment firms are clarified to encompass also sustainability risks, such as the impact of climate change and environmental degradation on the value of investments. Conflicts of interest identification must also take into account sustainability concerns.
- Product approval processes and target market definitions must consider the product's sustainability factors.

Who is concerned? AIFMs, UCITs management companies and investment companies, insurance intermediaries and (re)insurance undertakings as well as MiFID firms manufacturing and distributing financial instruments will have to adapt their documentation and practices.

When will they apply? As of August 2022 (as of 22 November 2022 for amending Delegated Directive (EU) 2021/1269 regarding the integration of sustainability factors into the product governance obligations of MiFID firms).

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