

Clients & Friends Memo

Overview of the European Sustainability Taxonomy Regulation

21 April 2020

Introduction

On 15 April 2020, the Council of the European Union published a [press release](#) stating that it had reached political agreement on the regulation on the establishment of an EU-wide framework designed to facilitate sustainable investment through a common classification system for sustainable activity (the “**Taxonomy Regulation**”).

The [Taxonomy Regulation](#) will enable investors to refocus their investments on more sustainable technologies and businesses, and is aimed at directing sufficient private capital to sustainable investments to enable the EU to become carbon neutral by 2050 (and achieve the [Paris Agreement's](#) 2030 targets).

The Taxonomy Regulation

The general framework

The Taxonomy Regulation provides a general framework for the development of an EU-wide classification system for environmentally sustainable economic activities. It does not itself define sustainable financial products, but sets out the criteria to be considered for a product or activity to be considered environmentally sustainable. The detail of what constitutes an environmentally sustainable activity or product will be built up gradually over time through complex delegated legislation, helping investors and companies determine whether certain activities qualify as “sustainable” (i.e. whether certain projects / activities pursue the EU’s environmental goals and contribute to the transition towards a low carbon economy).

Environmentally sustainable activities

The Taxonomy Regulation sets out six different types of economic activities that qualify as sustainable activities:

Cadwalader, Wickersham & Taft LLP (Cadwalader) is a registered limited liability partnership established under the laws of the State of New York. The personal liability of our partners is limited to the extent provided in such laws. Additional information is available upon request or at [www.cadwalader.com](#). A list of our partners, who are Solicitors or Registered Foreign Lawyers in England and Wales, is available for inspection at the above address. Regulated by the Solicitors Regulation Authority.

This memorandum has been prepared by Cadwalader for informational purposes only and does not constitute advertising or solicitation and should not be used or taken as legal advice. Those seeking legal advice should contact a member of the Firm or legal counsel licensed in their jurisdiction. Transmission of this information is not intended to create, and receipt does not constitute, an attorney-client relationship. Confidential information should not be sent to Cadwalader without first communicating directly with a member of the Firm about establishing an attorney-client relationship. ©2020 Cadwalader, Wickersham & Taft LLP. All rights reserved.

1. Climate Change Mitigation – i.e. the activity contributes to greenhouse gas stabilisation consistent with the goals of the Paris Agreement, through certain prescribed means including, for example, the generation of renewable energy;
2. Climate Change Adaptation – i.e. the activity includes adaptation solutions that substantially reduce the adverse impact (or risk) of the current and expected future climate on (i) other people, nature or assets; or (ii) the economic activity itself, in each case without increasing the risk of an adverse impact on other people, nature and assets;
3. Sustainable Use and Protection of Water and Marine Resources – i.e. the activity substantially contributes to achieving the good status of water bodies or marine resources, or to preventing their deterioration when they are already in good status, through certain prescribed means (including, for example, through waste water management);
4. Transition to a Circular Economy – i.e. the economic activity contributes substantially to waste prevention, re-use and recycling, through certain prescribed means (including, for example, by improving the recyclability of certain products);
5. Pollution Prevention and Control – i.e. the activity contributes substantially to pollution prevention and control through certain prescribed means (including, for example, by preventing or, where that is not practicable, reducing pollutant emissions into air, water or land (other than greenhouse gasses)); and
6. Protection and Restoration – i.e. the activity contributes substantially to protecting, conserving or restoring biodiversity and to achieving the good condition of ecosystems, or to protecting ecosystems that are already in good condition, through certain prescribed means (including, for example, sustainable land use and management).

The taxonomy for climate change mitigation and climate change adaptation should be established by the end of 2020 in order to ensure its full application by the end of 2021. For the four other objectives, the taxonomy should be established by the end of 2021 for application by the end of 2022.

Note also that other economic activities which directly enable any of the above six objectives shall also qualify as environmentally sustainable activities, provided that any such activity (i) does not lead to a “lock-in” of carbon intensive or other types of assets that undermine long-term environmental goals; and (ii) has a substantial positive environmental impact on the basis of life-cycle considerations.

Additional considerations

In addition to contributing to one of the six objectives described above, for an activity to qualify as an environmentally sustainable activity under the Taxonomy Regulation, the activity must also comply with the following criteria:

- No Significant Harm – i.e. the activity must not significantly harm any of the environmental objectives above;
- Compliance with Technical Screening Criteria – i.e. the activity must comply with technical screening criteria for each of the six objectives that will be specified by the European Commission; and
- Minimum Social and Governance Safeguards – i.e. the activity must be carried out in compliance with a number of minimum social and governance safeguards as referred to in the Taxonomy Regulation.

Application of the Taxonomy Regulation

The Taxonomy Regulation applies to the following parties:

- “Financial Market Participants” who offer “Financial Products” – financial market participants (as defined in the [Disclosure Regulation](#)) will be required to provide, in pre-contractual disclosures and periodic reports, information on how and to what extent the investments that underlie their “financial products” support economic activities that meet the criteria for environmental sustainability under the Taxonomy Regulation. As defined in the Disclosure Regulation, “financial products” include: (i) portfolios managed in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments; (ii) alternative investment funds; (iii) insurance-based investment products meeting certain criteria; (iv) pension products; (v) pension schemes; (vi) UCITS; and (vii) pan-European Personal Pension Products. For those financial products that do not invest in environmentally friendly activities, a disclaimer will need to be included by the financial market participant stating that the relevant investments “...do not take into account the EU criteria for environmentally sustainable investments.”;
- Financial and Non-financial Companies Falling under the Non-Financial Reporting Directive – firms in scope of the [Non-Financial Reporting Directive](#) will need to disclose information on how and to what extent the undertaking’s activities are associated with environmentally sustainable economic activities. The European Commission will publish the detailed reporting requirements by 1 June 2021; and
- Individual Member States and the EU – individual Member States and the EU must apply the criteria specified in the Taxonomy Regulation for determining environmentally sustainable economic activities for the purposes of any legislative / measures setting out the requirements of financial market participants or issuers in respect of financial products or corporate bonds to label such products as “environmentally sustainable”.

The announcement of the adoption of the Taxonomy Regulation on 15 April 2020 means that the Council has adopted its position at first reading. The Taxonomy Regulation now needs to be

adopted by the European Parliament at second reading, before it is published in the EU Official Journal. It will enter into force 20 days following publication in the EU Official Journal, although the measures relating to the climate mitigation and adaptation objectives will apply from 31 December 2021, while requirements relating to the other environmental objectives are due to apply from 31 December 2022.

* * *

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

| | | |
|-------------------|----------------------|--|
| Joanna Valentine | +44 (0) 20 7170 8640 | joanna.valentine@cwt.com |
| Michael Sholem | +44 (0) 20 7170 8545 | michael.sholem@cwt.com |
| Christopher Smith | +44 (0) 20 7170 8736 | christopher.smith@cwt.com |