

EU Taxonomy Regulation

Overview

What is it?

The Taxonomy Regulation¹: (i) establishes a taxonomy, or glossary, for assessing whether certain economic activities are considered “*environmentally sustainable*” in accordance with one or more of six prescribed environmental objectives, and (ii) introduces additional disclosure obligations for products in scope of the SFDR². In time, the intention is to extend the taxonomy beyond purely environmentally sustainable objectives to include social objectives.

Impact on the industry

It provides a toolkit for assessing whether an investment is “*environmentally sustainable*”. Products in scope of the Taxonomy Regulation must disclose the extent to which the economic activities underlying the investments made by the product qualify as “*environmentally sustainable*”, so that investors can compare the extent to which products contribute to an environmental objective. The bar is set high so that generally investments must tick many boxes before they are considered sufficiently “green” to meet the “*environmentally sustainable*” test.

Application

The Taxonomy Regulation came into force on 12 July 2020 and the first of the disclosure obligations apply from **1 January 2022**.

Scope

It applies to EU **financial market participants** that make available **financial products** (as defined in the SFDR) and to non-EU financial market participants that make available financial products to EU investors under the national private placement regime.

“Financial market participants”	AIFMs, UCITS management companies, MiFID investment firms, managers of qualifying VC funds or qualifying social entrepreneurship funds, pan-European personal pension product providers, manufacturers of pension products and institutions for occupational retirement provision.
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“Financial products”	AIFs, UCITS, portfolios managed under MiFID, IBIPs, pension products and PEPPs.
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Additional disclosure obligations apply to undertakings required to publish non-financial information pursuant to Directive 2013/34/EU (Accounting Directive) which are not covered in this note.

What is an “*environmentally sustainable*” activity?

An economic activity is “*environmentally sustainable*” under the taxonomy where it meets the following four conditions; it:

1. “**contributes substantially**” to one or more **environmental objectives** (see below), or directly enables other activities to make a substantial contribution to one or more of those objectives;
2. **does not “significantly harm”** any of the environmental objectives;
3. is carried out in compliance with the **minimum safeguards** listed in the Taxonomy Regulation; and
4. complies with **technical screening criteria** established by the Commission (some of which are yet to be published).

The test is framed by reference to “economic activities” rather than “investments” deliberately to prevent the classification of investments as “*environmentally sustainable*” where economic activities benefiting from those investments cause more harm than is contributed to a particular environmental objective.

What are the environmental objectives?

The Taxonomy Regulation defines six environmental objectives:

1. climate change mitigation (Article 10);
2. climate change adaptation (Article 11);
3. the sustainable use and protection of water and marine resources (Article 12);
4. the transition to a circular economy (Article 13);
5. pollution prevention and control (Article 14); and
6. the protection and restoration of biodiversity and ecosystems (Article 15).

The disclosure obligations within the Taxonomy Regulation apply from **1 January 2022** for the first two environmental objectives and from **1 January 2023** for the remaining four.

For products not contributing to the Taxonomy Regulation environmental objectives, there is a prescribed negative statement that should be made from **1 January 2022**.

Next steps

Managers should consider the Taxonomy Regulation disclosure obligations set out overleaf and plan accordingly.

The FCA has issued a discussion paper suggesting that it will implement its own version of the Taxonomy Regulation which is likely to be fairly similar. However managers should monitor UK developments closely in order to understand any potential domestic divergence.

¹ Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment and amending Regulation (EU) 2019/2088

² Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector

Disclosure obligations under the Taxonomy Regulation

The table below summarises the information that must be disclosed under the Taxonomy Regulation. The **pre-contract** and **periodic** disclosures must be included in the pre-contract and periodic disclosures made by the financial market participant in respect of its financial products pursuant to Articles 6 and 11 of the SFDR. For products in scope of Article 8 or 9, such disclosures should also feature on the firm's **website** (in accordance with Article 10 of the SFDR).

Financial product	Information to disclose	Disclosure	Deadline
Financial product that contributes to an environmental objective (Article 9 SFDR product)	<ul style="list-style-type: none">Information on the environmental characteristics to which the investment underlying the financial product contributes.A description of how and to what extent the investments underlying the product are made in economic activities that qualify as “<i>environmentally sustainable</i>”.The proportion of investments that are in <i>environmentally sustainable</i> economic activities as a percentage of all investments selected for the financial product.	<ul style="list-style-type: none">Pre-contractPeriodicWebsite	1 Jan 2022 for climate change – related objectives. Otherwise, 1 Jan 2023
Financial product which promotes environmental or sustainable characteristics (Article 8 SFDR product)	<ul style="list-style-type: none">The same information required in relation to an Article 9 product (listed in the row above).A prescribed statement that the “do not significant harm” principle applies only to those underlying investments that take into account the EU criteria for “<i>environmentally sustainable</i>” economic activities, and that the remaining underlying investments do not take such criteria into account.	<ul style="list-style-type: none">Pre-contractPeriodicWebsite	1 Jan 2022 for climate change – related objectives. Otherwise, 1 Jan 2023
Other financial products	<ul style="list-style-type: none">A prescribed statement that the investments underlying the financial product do not take into account the EU criteria for environmentally sustainable economic activities.	<ul style="list-style-type: none">Pre-contractPeriodic	1 Jan 2022

The disclosure obligations under the Taxonomy Regulation are supplemented by regulatory technical standards (RTS) prescribing the content and presentation of the required disclosures. The RTS are currently due to come into effect on 1 July 2022 and consolidated with the RTS for the SFDR. As such, financial market participants need to comply only with the level 1 disclosures required under the Taxonomy Regulation and SFDR until the RTS come into effect on 1 July 2022.

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