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European Commission Action on Climate Taxonomy and ESG Rating Provider Regulation

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On June 13, 2023, the European Commission **published** “a new package of measures to build on and strengthen the foundations of the EU sustainable finance framework.” The aim is to ensure that the EU sustainable finance framework continues to support companies and the financial sector in connection with climate transition, including making the framework “easier to use” and providing guidance on climate-related disclosure, while encouraging the private funding of transition projects and technologies. These measures are **summarized in a publication**, “A sustainable finance framework that works on the ground.” Overall, according to the Commission, the package “is another step towards a globally leading legal framework facilitating the financing of the transition.”

The sustainable finance package includes the following measures:

- **EU Taxonomy Climate Delegated Act:** amendments include (i) new criteria for economic activities that make a substantial contribution to one or more non-climate environmental objectives, namely, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems; and (ii) changes expanding on economic activities that contribute to climate change mitigation and adaptation “not included so far – in particular in the manufacturing and transport sectors.” The EU Taxonomy Climate Delegated Act has been operative since January 2022 and includes 107 economic activities that are responsible for 64% of greenhouse gas emissions in the EU. In addition, “new economic sectors and activities will be added, and existing ones refined and updated, where needed in line with regulatory and technological developments.” “For large non-financial undertakings, disclosure of the degree of taxonomy alignment regarding climate objectives began in 2023. Disclosures will be phased-in over the coming years for other actors and environmental objectives."

- **Proposed Regulation of ESG Rating Providers:** the Commission adopted a proposed regulation, which was based on 2021 recommendations from the International Organization of Securities Commissioners, aimed at promoting operational integrity and increased transparency in the ESG ratings market through organizational principles and clear rules addressing conflicts of interest. Ratings providers would be authorized and supervised by the European Securities and Markets Authority. The regulation "provides requirements on disclosures around" ratings methodologies and objectives, and "introduces principle-based organizational requirements on" ratings providers activities. The Commission is also seeking advice from ESMA on the presentation of credit ratings, with the aim being to address shortcomings related to "how ESG factors are incorporated into methodologies and disclosures of how ESG factors impact credit ratings."
- **Enhancing Usability:** the Commission set out an overview of the measures and tools aimed at enhancing the usability of relevant rules and providing implementation guidance to stakeholders. The **Commission Staff Working Document** "Enhancing the usability of the EU Taxonomy and the overall EU sustainable finance framework" summarizes the Commission's most recent initiatives and measures. The Commission also published a new **FAQ document** that provides guidance on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and on the interactions between the concepts of "taxonomy-aligned investment" and "sustainable investment" under the SFDR.

Taking the Temperature: As previously discussed, the Commission is increasingly taking steps to achieve the goal of reducing net greenhouse gas emissions by at least 55% by 2030, known as Fit for 55. Recent initiatives include the adoption of a carbon sinks goal, the launch of the greenwashing-focused Green Claims Directive, and now, the sustainable finance package.

Another objective of these regulatory initiatives is to provide increased transparency for investors as they assess sustainability and transition-related claims made by issuers. In this regard, the legislative proposal relating to the regulation of ESG rating agencies is significant. As noted in our longer survey, there is little consistency among ESG ratings providers and few established industry norms relating to disclosure, measurement methodologies, transparency and quality of underlying data. That has led to a number of jurisdictions proposing regulation, including (in addition to the EU) the UK, as well as to government inquiries to ratings providers in the U.S.