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A sustainable finance framework that works on the ground

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A sustainable finance framework that works on the ground

Introduction

The European Green Deal[1] and the transition to a climate-neutral and sustainable economy by 2050 present considerable challenges, in particular in the current geopolitical and economic context, but also offer opportunities for the EU. Investment in the green transition will help make Europe the first climate-neutral continent and build a sustainable, fair, and prosperous society. Investments in clean and sustainable energy sources and energy efficiency will strengthen the EU's open strategic autonomy and reduce our reliance on Russian and fossil fuel imports from outside the EU, helping to moderate energy prices in the future. To do so, investments in our capacity to develop and manufacture clean technologies are also required, to avoid creating new strategic dependencies and to reinforce the EU's competitiveness. By contrast, failure to take action on time to address climate and nature-related risks will bear significant costs for businesses and society and may lead to disruptive readjustments, with implications for financial stability. To achieve these goals, the EU will need additional investments of about EUR 700 billion annually to meet the objectives of the Green Deal, RepowerEU and the Net Zero Industry Act[2][3]. By far the greater part of these investments will have to come from private funding.

The EU's sustainable finance agenda aims to support companies and the financial sector in this effort by encouraging private funding of transition projects and technologies and facilitating financial flows to sustainable investments. The EU has made considerable progress in implementing its sustainable finance agenda over the last 5 years. Milestones include the adoption of the Taxonomy Regulation[4], the Sustainable Finance Disclosure Regulation (SFDR)[5], EU climate benchmarks in the Benchmark Regulation[6], the European Green Bond Regulation[7] and the Corporate Sustainability Reporting Directive (CSRD)[8]. The

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[1] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, *The European Green Deal*, COM(2019)640).

[2] Commission Staff Working Document on Investment needs assessment and funding availabilities to strengthen EU's Net-Zero technology manufacturing capacity, SWD(2023) 68 final.

[3] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of Regions, *The EU economy after COVID-19: implications for economic governance*, COM (2021) 662 final.

[4] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

[5] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, OJ L 317, 9.12.2019.

[6] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks, OJL 317, 9.12.2019.

[7] Proposal for a regulation of the European Parliament and of the Council on European green bonds, COM/2021/391 final. Political agreement reached by co-legislators on 28 February 2023.

EU has also made clarifications that fiduciary duties in asset management, (re-)insurance and investment sectors also encompass sustainability risks and has laid down provisions requiring sustainability preferences of retail investors to be discussed at the point of sale[9]. In autumn 2021, the Commission proposed prudential measures as part of the banking[10] and insurance[11] packages to increase the financial sector's resilience to sustainability risks; these are currently under negotiation by the co-legislators. Together, these elements ensure that the financial sector is increasingly taking account of sustainability factors.

The package presented today is an important step towards completing the sustainable finance framework. The Taxonomy Delegated Acts[12] will enable investments in more sectors and economic activities to be recognised as environmentally sustainable, including activities and associated criteria for all six environmental objectives of the Taxonomy Regulation[13]. The proposal for a regulation on transparency and integrity of environmental, social and governance (ESG) rating activities[14] will ensure that ESG ratings become a more reliable and transparent component of the sustainable finance value chain. The forthcoming European

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[8] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting, OJ L 322, 16.12.2022.

[9] Commission Delegated Directive amending Directive 2010/43/EU as regards the sustainability risks and sustainability factors to be taken into account for Undertakings for Collective Investment in Transferable Securities (UCITS); Commission Delegated Regulation amending Delegated Regulation (EU) No 231/2013 as regards the sustainability risks and sustainability factors to be taken into account by Alternative Investment Fund Managers; Commission Delegated Regulation amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products; Commission Delegated Directive amending Delegated Directive (EU) 2017/593 as regards the integration of sustainability factors into the product governance obligations; Commission Delegated Regulation amending Delegated Regulation (EU) 2015/35 as regards the integration of sustainability risks in the governance of insurance and reinsurance undertakings; Commission Delegated Regulation amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms;

[10] Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (COM/2021/664 final) and Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks, and amending Directive 2014/59/EU (COM/2021/663 final).

[11] Proposal for a directive of the European Parliament and of the Council amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision (COM/2021/581 final).

[12] Commission Delegated Regulation (EU) 2023/3851 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes no significant harm to any of the other environmental objectives and amending Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities; Commission Delegated Regulation (EU) 2023/3850 amending Delegated Regulation (EU) 2021/2139 establishing additional technical screening criteria for determining the conditions under which certain economic activities qualify as contributing substantially to climate change mitigation or climate change adaptation and for determining whether those activities cause no significant harm to any of the other environmental objectives;

[13] The six environmental objectives under the EU Taxonomy are: (i) climate change mitigation; (ii) climate change adaptation; (iii) sustainable protection and restoration of water and marine resources; (iv) the transition to a circular economy; (v) pollution prevention and control; and (vi) the protection and restoration of biodiversity and ecosystems;

[14] Proposal for a regulation on the transparency and integrity of Environmental, Social and Governance (ESG) rating activities, (COM(2023) 314 final).

sustainability reporting standards under the CSRD will enable companies to communicate sustainability information in a standardised way to a variety of lenders, investors and other stakeholders. The Commission Recommendation[15] illustrates how the sustainable finance framework encompasses transition finance and explains how companies, investors and financial intermediaries can voluntarily use the current sustainable finance framework to finance their transition to a climate neutral and sustainable economy, while enhancing their competitiveness, with practical examples and explanations. Finally, the accompanying staff working document on the usability of the EU Taxonomy and the wider EU sustainable finance framework provides an overview of the key pillars of the framework now in place, and takes stock of recently adopted usability measures[16].

Early analysis of reporting shows that the EU sustainable finance framework is beginning to work as intended, facilitating private finance for green and transition investments through transparency and as a comprehensive toolbox. For instance, companies are applying the taxonomy and are starting to communicate their sustainable investments based on it.

Notwithstanding the significant progress achieved to date, and the opportunities and competitive advantages the transition offers in the longer term, the Commission acknowledges that companies, in particular SMEs, face significant challenges when transitioning to a climate neutral and sustainable economy. These challenges include identifying solutions where green technologies are not yet available, articulating sustainability objectives and actions as part of business strategies, and complying with higher environmental and social sustainability standards and sustainability-related disclosure requirements and overcoming labour and skills shortages in the workforce.

The implementation and the first application of sustainability disclosure requirements may be challenging as well, as the phase-in of reporting raises implementation and usability questions and requires firm-level investments into originating, processing, and quality assuring of the required information. The Commission is committed to actively supporting implementation, and to ensuring the framework's usability and inclusiveness for companies of different sizes, business models and with different starting points.

A sustainable finance framework that works on the ground

With the mains elements of the sustainable finance framework in place[17], companies and financial entities have started to apply the tools and disclosure standards for their economic and financing activities. Over the next few years, the quality and availability of disclosures and data will improve as the implementation of the sustainable finance framework progresses, and market actors will be able to leverage the taxonomy and other ESG information to make informed investment decisions, articulate and engage on sustainability objectives and obtain or provide financing for the transition to a climate neutral and

[15] Commission Recommendation on facilitating finance for the transition to a sustainable economy (C(2023) 3844).

[16] Staff working document on 'Enhancing the usability usability of the EU Taxonomy and the overall EU sustainable finance framework (SWD(2023) 209), accompanying the Communication from the Commission on a sustainable finance framework that works on the ground (COM(2023) 317).

[17] The foundations for an EU sustainable finance framework are outlined in the Action Plan on Financing Sustainable Growth (COM/2018/097 final) and the Strategy for Financing the Transition to a Sustainable Economy (COM/2021/390 final).

sustainable economy. The benefits from applying the framework will increase with the progressive availability of data. This will coincide with the implementation of the European Single Access Point (ESAP)[18], which will enable digital and open access to that data.

Taxonomy reporting from the first year of application shows that the taxonomy is working on the ground. Data shows that companies in the STOXX Europe 600 index that reported some alignment with the taxonomy[19], on average reported taxonomy alignment of around 23% for capital expenditure, 24% for operational expenditure and 17% for revenues[20]. This demonstrates that companies can invest in aligning economic activities with the taxonomy irrespective of their starting points. Financial institutions and investors can already use this data to identify companies and sectors in transition and to provide transition related financing solutions.

The Commission is committed to supporting the sustainable finance framework's implementation and ensuring that the tools and disclosures work in practice. Based on stakeholder feedback, the Commission will intensify its efforts to enhance the framework's usability and coherence, ensuring that the various elements are easy to use and administrative burdens are minimised as much as possible. The Commission also stands ready to provide technical support to Member States to facilitate this implementation, including the forthcoming European sustainability reporting standards, through the Technical Support Instrument[21].

The sustainable finance framework is inclusive and proportionate. It will enable small and medium-sized enterprises (SMEs) to raise finance for their transition while minimising administrative burden. Non-listed SMEs, in particular micro enterprises, are not subject to the EU sustainable finance regulatory framework due to their size and administrative capacity, however some SMEs may be interested in financing sustainable investments and can derive benefits by voluntarily using sustainable finance tools. However, SMEs could need the support of their financing and value chain partners when considering their transition finance needs and when raising transition finance in practice. In this context, financial intermediaries should consider that the capacity of SMEs to provide detailed information may be limited and to apply the principle of proportionality when dealing with SME clients interested in raising finance for green investments.

A series of initiatives and targeted measures have already been adopted to address key usability issues and questions raised by stakeholders. For example, the Commission has recently clarified the interaction between the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR) in relation to the concept of 'sustainable investment' and how operators should interpret the EU Taxonomy's requirements in terms of compliance

[18] Proposal for a Regulation of the European Parliament and the Council establishing a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability, COM/2021/723 final. Political agreement reached by co-legislators on 23 May 2023.

[19] As of 17 May 2023, 63% of the STOXX Europe 600 undertakings have already disclosed their taxonomy eligibility and alignment for financial year 2022; source: Bloomberg.

[20] Nearly two in three companies that disclosed taxonomy-eligible capital expenditure reported a non-zero alignment figure and one in two companies that disclosed eligible revenue reported a non-zero degree of aligned revenue; Source: Bloomberg.

[21] Technical Support Instrument under Regulation (EU) 2021/240 of the European Parliament and of the Council of 10 February 2021 establishing a Technical Support Instrument, (OJ L 57, 18.2.2021).

with minimum safeguards including social and governance aspects[22]. This complements the recent publication of a Commission guidance on the interaction between the SFDR and the Benchmark Regulation regarding products passively tracking Climate Transition Benchmarks and Paris-aligned Benchmarks[23].

The Commission will continue its work on enhancing the usability of the taxonomy and of the wider sustainable finance framework, with the support of the European Supervisory Authorities (ESAs) and the Platform on Sustainable Finance, and based on further stakeholder engagement. The comprehensive assessment of the SFDR announced in December 2022 is an important part of these efforts. As part of the SFDR assessment, a public consultation will be launched in autumn 2023.

Transition finance

The transition to a climate neutral and sustainable economy requires urgent investments, at scale, in green technologies and sustainable economic activities. It also necessitates investments in transitional activities, in line with the Taxonomy Regulation[24], where green technologies are not yet available. The financial sector can support the development of such technologies. Today's package is another step towards a globally leading legal framework facilitating the financing of the transition.

Transition finance can be raised not only by companies with the highest sustainability performance, but also by companies with different starting points and clear sustainability objectives. The sustainable finance regulatory framework already recognises investments in the transitioning of economic activities, assets and companies to climate and environmental objectives, for instance through the taxonomy[25]. Based on the sustainability information and tools provided through the framework, private investors and financial institutions will progressively be able to identify sustainable investments and investments in transition projects more effectively and more systematically. These disclosures and tools also provide an opportunity for companies to articulate their sustainability targets and transition pathways to investors and stakeholders in a standardised manner.

The taxonomy includes transitional activities for which no technologically and/or economically feasible low carbon alternative is currently available but where significant

[22] The Commission Notice C(2023) 3719 on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and its link to the Sustainable Finance Disclosure Regulation (SFDR) clarifies that investments in taxonomy-aligned 'environmentally sustainable' economic can be automatically qualified as 'sustainable investments' under the SFDR.

[23] The Commission adopted a set of Q&As on 5 April 2023 to clarify that the SFDR deems products passively tracking Climate Transition Benchmarks and Paris-aligned Benchmarks to have 'sustainable investments', as defined in the SFDR, as their objective.

[24] Transitional activities are defined in Article 10(2) of the Taxonomy Regulation as an activity for which there is no technologically and economically feasible low-carbon alternative where it supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1,5°C above pre-industrial levels, including by phasing out greenhouse gas emissions, in particular emissions from solid fossil fuels, and where that activity: has greenhouse gas emission levels that correspond to the best performance in the sector or industry; does not hamper the development and deployment of low-carbon alternatives; and does not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets.

[25] The taxonomy covers six environmental objectives: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; the protection and restoration of biodiversity and ecosystems.

improvements can nevertheless be achieved to transition to a climate-neutral economy[26]. In addition, the taxonomy recognises investments in economic activities that will become taxonomy-aligned in 5 (exceptionally 10) years. Such investments can be disclosed as taxonomy-aligned capital expenditure and can be financed through the issuance of European green bonds. Such bonds can then be included in the composition of a benchmark or of a financial product with sustainability characteristics or pursing sustainability objectives.

At the initial stage of the transition, taxonomy alignment levels in terms of revenue will be lower, especially for certain companies and economic sectors. However, alignment levels are already expected to be higher in terms of capital expenditure. This is confirmed by first data showing that a large number of companies are reporting taxonomy-aligned capital expenditure that is materially higher than their aligned revenue, especially in high-emitting sectors where transition finance is most needed, and that average taxonomy alignment for certain sectors is significantly higher in terms of capital expenditure compared to revenue. For instance, in the utilities sector a 70% average aligned capital expenditure compared to 40% aligned revenue and in the energy sector a 23% average aligned capital expenditure compared to 7% aligned revenue[27].

There are also important synergies across tools and disclosures, for instance in the context of companies deciding to set transition targets and develop transition plans. More than 13 000 companies worldwide have set transition targets to date[28], with some opting for a transition plan to specify these targets. The forthcoming European sustainability reporting standards will ensure that companies can communicate their climate transition plans and targets, if they have those, in a standardised manner. This can help these companies receive financing from financial market actors to support their transition efforts. The Platform on Sustainable Finance will monitor market practices related to transition targets and plans as well as capital flows towards the EU's sustainability objectives.

Taxonomy Delegated Acts on environment and climate

The taxonomy is a cornerstone of the EU's sustainable finance framework and an important market transparency tool that helps direct investments to the economic activities most needed for a green transition. The Taxonomy Climate Delegated Act covering climate change mitigation and adaptation has been up and running since January 2022 and includes a total of 107 economic activities that are responsible for 64% of greenhouse gas emissions in the EU-27[29]. The adoption of the Taxonomy Environmental Delegated Act, which includes criteria for the remaining four environmental objectives, is a crucial step in developing the taxonomy framework. The inclusion of more economic activities covering all six environmental objectives, and consequently more economic sectors and companies, will increase the potential of sustainable investments in the EU. To complement this, targeted amendments to the Taxonomy Climate Delegated Act expand on economic activities not included so far[30].

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[26] See footnote 24.

[27] Data based on taxonomy-alignment reporting of 455 companies up to 16 May 2023; source: GS SUSTAIN Goldman Sachs Global Investment Research.

[28] Source: Global Climate Action Portal, United Nations Framework Convention on Climate Change.

[29] Based on NACE Rev. 2 codes included in the Taxonomy Climate Delegated Act and data from Eurostat 2021, https://ec.europa.eu/eurostat/databrowser/view/env_ac_ainah_r2/default/table?lang=en.

[30] The delegated act also makes targeted amendments and clerical corrections to selected existing climate criteria.

These additions will facilitate investments in green technologies, net-zero manufacturing capacity and renewable energy supply, reinforcing the EU's industrial policy as announced in the Green Deal Industrial Plan for the Net-Zero Age[31].

The delegated acts are informed to a very large extent by the recommendations of the Platform on Sustainable Finance[32]. However, the package presented today does not include all the economic activities for which the Platform made recommendations. The Commission has prioritised those economic activities with the greatest potential to make a substantial contribution, and for which it was possible to endorse or refine the recommended criteria within a short timeframe. Economic activities that require a deeper assessment and calibration of criteria will continue to be assessed and reviewed by the Commission with a view to addressing them at a later stage.

The taxonomy defines the criteria that economic activities need to achieve to become sustainable and therefore sets out the path of their transformation. The level of taxonomy-aligned assets will increase as the transition to a climate neutral and sustainable economy progresses. New economic sectors and activities will be added, and existing ones refined and updated, where needed in line with regulatory and technological developments; this is something that the Platform on Sustainable Finance will provide advice on under its current mandate[33].

The taxonomy is above all a tool for companies, to facilitate their access to finance for the green transition, and for the financial sector, to support the building of sustainable finance portfolios and measure the degree of sustainability of investments. It is not a mandatory list to invest in. Investors can also use the taxonomy to take better-informed investment decisions. They can still choose to invest in companies that carry out activities that have different degrees of environmental performance, or activities that do not comply with the taxonomy criteria. The mere fact that a company does not have taxonomy-aligned activities does not mean that conclusions can be drawn regarding the company's environmental performance or its ability to access finance. Companies can voluntarily use the taxonomy as a tool to specify transition targets for economic activities, for instance in combination with a transition plan. The accompanying Commission Recommendation on transition finance further explains how the taxonomy can be voluntarily used for that purpose.

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. The rollout of the taxonomy and associated disclosure requirements will continue to be developed with a view to helping SMEs make use of that framework on a voluntary basis, without imposing burdens on them.

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[31] Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of Regions, *A Green Deal Industrial Plan for the Net-Zero Age*, COM(2023) 62 final.

[32] See https://finance.ec.europa.eu/system/files/2022-03/220330-sustainable-finance-platform-finance-report-remaining-environmental-objectives-taxonomy-annex_en.pdf and https://finance.ec.europa.eu/system/files/2022-11/221128-sustainable-finance-platform-technical-working-group_en.pdf. The Platform's reports inform the work of the Commission, but they are of an advisory nature. They do not bind the Commission on the inclusion of specific sectors and activities in the EU Taxonomy.

[33] Stakeholders will also have an opportunity to notify the Platform on Sustainable Finance about activities they believe should be covered in the EU Taxonomy.

In parallel, the Commission will continue to engage in global forums to encourage the uptake of taxonomies internationally and refine approaches for their interoperability. The appropriate use of taxonomy principles will also continue to feature as part of the work of the International Platform on Sustainable Finance.

ESG ratings and credit ratings

With the implementation of the sustainable finance framework progressing, it is time to consider the functioning of the ESG ratings market[34]. Transparent, reliable and qualitative ESG ratings contribute to the effectiveness and integrity of the financial markets and investor protection.

Following consultations, studies and outreach, today the Commission is adopting a proposal for a regulation on the functioning of the ESG ratings market. The key aim of the Commission proposal is to increase transparency on ESG ratings methodologies, objectives, characteristics and data sources. Additionally, it aims to increase clarity on the operations of ESG rating providers, in particular to prevent and mitigate potential risks associated with conflicts of interest. A more transparent ESG rating ecosystem will lead to a clearer identification of the three dimensions of sustainability[35].

Based on the set of recommendations for ESG rating providers and regulators published by the International Organization of Securities Commissions (IOSCO) in November 2021, the proposal provides for the authorisation and supervision of ESG rating providers by the European Securities and Markets Authority (ESMA). Furthermore, it provides requirements on disclosures around their methodologies and objectives of ratings, and introduces principle-based organisational requirements on their activities. Given the structure and complexity of the ESG ratings market, which includes many smaller ESG rating providers, the initiative incorporates a number of safeguards and mitigating measures for those smaller market players. The objective is to foster accessibility and promote innovation in the market, particularly during the initial phase of the Regulation’s application.

Recent years have also brought changes and improvements related to disclosure and incorporation of ESG factors in credit ratings. Some credit rating agencies are making disclosures above what is required by Regulation 1060/2009 on credit rating agencies[36] and by the ESMA Guidelines. As a result, the Commission is seeking advice from ESMA on the rules on the presentation of credit ratings and rating outlooks, as well as on the rules for assessing the compliance of methodologies used by credit rating agencies. This aims to

[34] The proposal does not cover ESG data providers. The evidence for regulatory intervention in this area was less convincing and a number of other initiatives, such as the CSRD or the European Single Access Point (ESAP), should contribute to improving the quality and availability of sustainability data. This initiative also does not cover internal ratings developed by financial institutions such as banks or asset managers as they are used for investment decisions concerning their own products, risk fewer potential conflicts of interests and do not serve the same purpose as ESG ratings, which are marketed at institutional investors and companies.

[35] The Commission is conducting a study to assess the current state of play of the social dimension of ESG investing in the EU, focusing on investment gaps, challenges faced by market participants and market practices. The study will explore ways to strengthen the social investment framework in capital markets, identifying obstacles and possible policy options for future action.

[36] Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (OJ L 302, 17.11.2009, p. 1).

address shortcomings related to: (i) how ESG factors are incorporated into methodologies; and (ii) disclosures of how ESG factors impact credit ratings[37].

Forthcoming European sustainability reporting standards

Sustainability is an important factor in the competitiveness of companies in the longer term, and sustainability and competitiveness can go hand in hand. Sustainability disclosures are a critical source of information for financial institutions to help them direct capital to transition investments and create financial products with sustainability objectives. The CSRD is an important milestone in providing transparency on sustainability risks, impacts and opportunities for undertakings. It is also the basis for companies to provide reliable, accurate and comparable high-quality sustainability information to financial market participants and other stakeholders.

The standardisation of sustainability information to be reported by companies is a key element of the legal framework and will soon be possible with the forthcoming European sustainability reporting standards (ESRS). The Commission is currently consulting stakeholders on the final version of a first set of ESRS based on draft standards prepared by EFRAG. The standards will provide the guidance companies need when determining what data to report and how to ensure that the information they supply is material to them and useful for the financial institutions. The Commission and EFRAG have been working closely with the International Sustainability Standards Board (ISSB) and the Global Reporting Initiative (GRI) to ensure a very high level of interoperability between the different sets of standards. It is the ultimate intention of the Commission that when a company reports sustainability information in accordance with the ESRS, they will be deemed to be compliant with global standards.

Sustainability reporting is expected to enhance undertakings' access to financial capital and identification and management of own risks and opportunities, helping to increase competitive advantage by contributing to the transition. The Commission has made efforts to ensure the delegated ESRS act will meet the intended policy objectives in a proportionate manner, minimising regulatory burdens as much as possible. The Commission has considered the approach to materiality, additional phase-ins, making some disclosures voluntary, additional flexibilities in some disclosure requirements, and further interoperability with the ISSB, and will carefully assess the comments received in the public consultation before finalising the delegated act. Uniform standards will also help to limit the growing costs that companies face from having to meet the multiple individual demands for information from different stakeholders.

Furthermore, separate standards will be developed for listed SMEs which are proportionate and relevant to the capacities and the characteristics of SMEs and to the scale and complexity of their activities. The standards will focus on the financing-relevant information needed by financial institutions[38] and will also constitute a limit for the information which ESRS can

[37] Commission Delegated Regulation (EU) No 447/2012 of 21 March 2012 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council on credit rating agencies.

[38] In this regard, the obligation to report sustainability information for listed SMEs begins to apply only from the 2026 financial year onward. The Directive provides a further two-year opt-out, meaning that listed SMEs do not have to report sustainability information until the 2028 financial year.

require large undertakings to disclose from SMEs in their value chains. This is an important safeguard specified in the CSRD to limit the indirect effects on SMEs of value chain reporting requirements imposed on large undertakings. Non-listed SMEs, which are not in the scope of the Directive, may nevertheless face increased information requests from larger companies in their value chains and from financial institutions. The Commission acknowledges the challenge that non-listed SMEs may face in this regard due to their size and more limited resources. The Commission therefore encourages large corporates and financial intermediaries to apply the principle of proportionality when engaging with SMEs and to exercise restraint when requesting information from SME value chain partners.

In addition, SMEs may want to report key sustainability information to raise sustainable or transition finance. To that end, one of the Commission's priorities is for EFRAG to develop a voluntary standard for non-listed SMEs, which may use it to standardise the sustainability information they wish to report, and which can make it easier for them to participate in the transition to a sustainable economy.

Conclusion

Early evidence shows that the EU sustainable finance agenda is working on the ground and that sustainable finance tools are starting to facilitate investments into the transition to a climate neutral and sustainable economy. The EU sustainable finance framework will continue to be developed and refined to ensure its effectiveness in achieving its intended goals and in supporting the objectives of the European Green Deal.

The Commission is committed to strong cooperation at international level. Developing sustainable finance frameworks together with other international partners and jurisdictions to the largest extent possible will help ensure international interoperability, enable the EU to fully leverage the potential of international finance for the transition, and avoid complexity, fragmented markets and extra costs for businesses.

The Commission will continue to provide practical guidance to market players, to support the application of existing rules in a clear and effective way. It will also continue to assess gaps and usability concerns and uncertainties and how to address them. Specific focus will be placed on assessing how to make the sustainable finance framework more usable and inclusive for SMEs without overburdening these firms. Another priority will be to continue work on facilitating transition finance, including by exploring how to better integrate the taxonomy into the framework in a simple and user-friendly way. The Platform on Sustainable Finance and the European Supervisory Authorities will provide key input in this context. A set of outreach activities to public and private stakeholders will be conducted for these purposes.

This work will also involve close cooperation with international partners through the International Platform on Sustainable Finance and in the G20 as well as with Multilateral Development Banks and EU Development Finance Institutions, notably in the context of the Neighbourhood, Development and International Cooperation Instrument (NDICI – Global Europe) and the Global Gateway. The Commission will continue to work on how it can help partner countries, in particular Low- and Middle-Income Countries, to develop robust and credible sustainable finance frameworks with the aim to improve global comparability and interoperability.

The next steps outlined above will further solidify the sustainable finance framework's practical application by companies, financial intermediaries and investors, thereby enabling the scaling up of the sizeable investment needed to further the green transition and pave the way towards a climate neutral and sustainable economy by 2050.