

Concepts of sustainable investments and environmentally sustainable activities in the EU Sustainable Finance framework

1 Introduction

1. The purpose of this document is to explain how the concept of sustainability is inscribed in the EU Sustainable Finance ('SF') framework. This concept is reflected in the definition of sustainable investments in the Sustainable Finance Disclosure Regulation ('SFDR') and the definition of environmentally sustainable economic activities introduced in the Taxonomy Regulation ('EU Taxonomy' / 'TR'). Stakeholders that are subject to these legislative texts need to understand and apply these legal concepts to comply with their obligations under these regulatory regimes. Additionally, users of this information need to understand the basis of these disclosures and the approach followed under each framework.
2. This document is intended as an aide to stakeholders to navigate the SF framework concerning the SFDR definition of sustainable investment and the TR definition of environmentally sustainable economic activities. It is a purely factual presentation of the relevant legal provisions in EU Directives, Regulations and Commission Delegated Regulations as well as the relevant guidance provided by the European Commission ('Commission') and the European Supervisory Authorities ('ESAs')¹.
3. This document does not add to, interpret or replace the relevant legal texts and has no legal effect. ESMA does not assume any liability for its contents. Readers are advised to always refer directly to the relevant legislation. **This document does not provide guidance on the application of relevant rules and should not be construed as such.**
4. Given the close link between the concept of sustainability and the application of the 'Do no significant harm' ('DNSH') principle, it would be advisable to read this document together with the [document on the DNSH](#) principle in the SF framework².

2 The concept of sustainability in the EU Taxonomy and SFDR frameworks

2.1 EU Taxonomy Regulation

5. The key objective of the TR is to establish a unified classification system for sustainable economic activities to help reorient capital flows towards sustainable investments. It provides a definition of environmentally sustainable investment³ as "*an investment in one*

¹ The European Supervisory Authorities are EBA, EIOPA and ESMA.

² Ref.: [ESMA30-379-2281](#) | 22 November 2023.

³ Article 2 (1) [Regulation \(EU\) 2020/852](#) (TR).

or several economic activities that qualify as environmentally sustainable” in accordance with the Regulation.

6. For an economic activity to be considered as environmentally sustainable⁴ (or ‘taxonomy-aligned’) specific criteria should be fulfilled. These are set out in the TR. An economic activity is taxonomy-aligned when that activity:
 - contributes substantially to one or more of the six environmental objectives established by the TR⁵;
 - does not significantly harm any of those environmental objectives⁶;
 - is carried out in compliance with minimum safeguards⁷; and
 - complies with the technical screening criteria (‘TSC’) established in accordance with the TR.
7. In addition to the economic activities that substantially contribute to the six environmental objectives, the TR identifies two other types of activities which can be deemed environmentally sustainable if they meet the TR criteria. These are:
 - i) ‘enabling’ activities⁸ which enable another activity to make a sustainable contribution to one of the six environmental objectives provided that they: a) do not lead to a lock-in of assets that undermine long-term environmental goals, considering the economic lifetime of those assets; and (b) have a substantial positive environmental impact, on the basis of life-cycle considerations; and
 - ii) ‘transitional’ activities (only in the context of climate change mitigation) for which no technologically and economically feasible low-carbon alternative exists and where they support the transition to a climate-neutral economy in a manner that is consistent with a 1.5-degree pathway⁹. The TR sets out certain conditions for these activities to be deemed as transitional. In particular, these activities should: a) have greenhouse gas emission levels that correspond to the best performance in the sector or industry; b) not hamper the development and deployment of low-carbon alternatives; and c) not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets.
8. To be considered environmentally sustainable or ‘taxonomy-aligned’, an economic activity should meet all the above criteria (including the TSC that are discussed below) and be carried out in compliance with the minimum safeguards set out in Article 18 TR. These

⁴ Article 3 TR.

⁵ Article 9 TR identifies the following environmental objectives: (a) climate change mitigation; (b) climate change adaptation; (c) sustainable use and protection of water and marine resources; (d) transition to a circular economy; (e) pollution prevention and control; and (f) protection and restoration of biodiversity and ecosystems.

⁶ Article 17 TR.

⁷ Article 18 TR.

⁸ Article 16 TR.

⁹ Article 10(2) TR.

minimum safeguards are procedures that need to be implemented by the undertaking to ensure alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the ILO declaration on Fundamental Rights and Principles at Work and the International Bill of Human Rights. Moreover, when implementing the minimum safeguards, undertakings must adhere to the principle of DNSH in SFDR¹⁰, the application of which is explained in the section that follows.

9. To support a robust classification system of environmentally sustainable economic activities the Commission has established TSC for the six environmental objectives. The TSC are sector-specific, granular criteria which are science-based. They are used to assess the conditions of 'substantial contribution' and 'do not significant harm' for specific economic activities. At this stage, the EU Taxonomy does not provide TSC for all economic activities. To ensure that investments are channelled towards economic activities that make the greatest positive impact on the environmental objectives¹¹, the Commission prioritised economic activities that potentially contribute most to the environmental objectives and developed TSC for those activities.
10. The TSC for substantial contribution and DNSH in relation to the environmental objectives of climate change mitigation and climate change adaptation are set out in the Climate Delegated Act and the Complementary Climate Delegated Act¹². The Commission, as part of the SF package¹³ that was published on 13 June 2023 officially adopted the 'Environmental Delegated Act'¹⁴ that establishes TSC for the remaining four environmental objectives¹⁵. At the same time, the Commission introduced targeted amendments to the 'Climate Delegated Act' and the 'Disclosures Delegated Act'¹⁶.
11. The TR imposes a requirement for financial and non-financial undertakings to report on how and to what extent their activities are associated with economic activities that qualify as environmentally sustainable. It should be highlighted that under the TR framework the assessment of environmental sustainability is carried out at the economic activity level.
12. Non-financial undertakings are required to disclose the extent to which their turnover, CapEx and OpEx are associated with economic activities that qualify as environmentally sustainable. The relevant disclosures provide information for all economic activities that are 'taxonomy-eligible' (i.e. economic activities for which TSC criteria have been developed) and distinguish between those activities that are 'taxonomy-aligned (i.e. environmentally sustainable) and those that are not. The disclosures also provide aggregated information on Taxonomy non-eligible economic activities (i.e. activities for which relevant TSC are not yet in place). Financial undertakings (credit institutions,

¹⁰ Article 18(2) TR.

¹¹ Recital 48 TR.

¹² CDR 2021/2139 ('[Climate Delegated Act](#)') and CDR 2022/1214 ('[Complementary Climate Delegated Act](#)') covering certain gas and nuclear activities.

¹³ Please access the SF package through the link [here](#).

¹⁴ The [Environmental Delegated Act](#) was officially adopted on 27 June 2023.

¹⁵ These are: a) sustainable use and protection of water and marine resources; b) transition to a circular economy; c) pollution prevention and control; and d) protection and restoration of biodiversity and ecosystems.

¹⁶ The Disclosures Delegated Act ([Delegated Regulation \(EU\) 2021/2178](#)) specifies the content and presentation of information disclosed pursuant to Article 8 TR concerning environmentally sustainable activities.

insurance and reinsurance undertakings, investment firms and asset managers) are also under an obligation to report on the taxonomy-alignment of their economic activities. The Disclosures Delegated Act sets out the content and presentation of the information that should be disclosed by financial and non-financial undertakings as well as the relevant KPIs that financial undertakings should report.

13. To support the implementation of the EU Taxonomy, the Commission developed some tools and documents which can be found on the [EU Taxonomy Navigator website](#). These include the following:

- an [FAQs repository](#),
- the [EU Taxonomy Calculator](#), an interactive, educational tool relating to the reporting obligations under the Disclosures Delegated Act;
- the [EU Taxonomy Compass](#) an online tool which aims to make the contents of the EU Taxonomy easier to access. The EU Taxonomy Compass currently covers the Climate Delegated Act and the Complementary Delegated Act and will be updated to include future delegated acts;
- the [EU Taxonomy User Guide](#), which explains what the Taxonomy is and aims at supporting relevant undertakings to assess Taxonomy-eligibility and Taxonomy-alignment.

14. A list of Commission FAQ documents on the TR is included in Annex I of this paper.

2.2 Sustainable Finance Disclosure Regulation (SFDR)

15. The SFDR defines sustainable investment¹⁷ as:

- a) an investment in an economic activity that contributes to an environmental or social objective;
- b) the investment does not significantly harm any environmental or social objective; and
- c) investee companies follow good governance practices in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

16. Relevant for the application of the SFDR concept of 'sustainable investments' are also:

- a) the Commission Delegated Regulation ('CDR') 2022/1288¹⁸ which sets out technical details and specific requirements regarding entity-level principal adverse impact ('PAI') disclosures and disclosures in relation to financial products' promotion of environmental

¹⁷ Article 2(17) [SFDR](#).

¹⁸ [CDR 2022/1288](#), Article 59, point (e)(ii).

- or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports; and
- b) the consolidated Q&A document which puts together responses from the Commission on questions that require interpretation of Union Law and responses from the ESAs on matters relating to the practical application of the SFDR¹⁹.
17. As regards the application of the good governance practices requirement, the Commission clarified that where investee companies do not meet this pre-condition, the financial product would be in breach of Article 8 or Article 9 SFDR. Additionally, the Commission explained that the good governance practices do not need to be applied in case of investments in government bonds²⁰.
18. The SFDR foresees specific transparency requirements for two types of financial products:
- a) financial products that promote environmental or social characteristics provided that the companies in which the investments are made follow good governance practices²¹. These are the products disclosing under Article 8 SFDR; and
- b) financial products that have sustainable investment as their objective²². These are the products disclosing under Article 9 SFDR.
19. Financial products disclosing under Articles 8 or 9 that make sustainable investments are required to disclose several elements which relate to the sustainability aspect of their investments and explain the basis for assessing their investments as sustainable. These disclosures include, amongst others, the below elements:
- A description of how the sustainable investments contribute to a sustainable investment objective;
 - Explanations on how the SFDR DNSH principle is complied with by showing how the PAI indicators have been taken into account;
 - How the sustainable investments are aligned with the OECD Guidelines for Multinational Enterprises and the Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights; and
 - The policy to assess good governance practices of investee companies.²³
20. Moreover, financial products disclosing under Article 8 SFDR that promote environmental characteristics and financial products disclosing under Article 9 SFDR that invest in sustainable investments contributing to environmental objectives are required to provide

¹⁹ [Consolidated questions and answers on the SFDR and the CDR 2022/1288](#),

²⁰ Idem Q&As V.5 and V.6, respectively.

²¹ Article 8 SFDR.

²² Article 9 SFDR.

²³ The detailed disclosure obligations for financial products are set out in Annexes II-III (pre-contractual disclosures) and Annexes IV-V (periodic disclosures) of CDR 2022/1288.

disclosures on those sustainable investments which are taxonomy-aligned, according to Articles 5 and 6 TR.

21. The Commission and the ESAs provided additional clarifications on the definition of sustainable investment in a series of published Q&As²⁴. In particular, the Commission explained that the notion of sustainable investment can be measured at the level of a company and not only at the level of a specific activity²⁵. The Commission explained that Articles 8 and 9 SFDR are neutral in terms of product design²⁶. Furthermore, the Commission clarified²⁷ that the SFDR does not set out minimum requirements that qualify concepts such as contribution, DNSH, or good governance, i.e. the key parameters of a 'sustainable investment'. Financial market participants ('FMPs') must carry out their own assessment for each investment and disclose their underlying assumptions.
22. Moreover, the Commission has outlined two safe harbours regarding the notion of sustainable investments under SFDR. In particular:
 - a) Passive funds tracking an EU Climate Benchmark. In the relevant Q&A²⁸, the Commission explained that financial products which are passively tracking Paris-aligned Benchmarks (PABs) and Climate Transition Benchmarks (CTBs), which are financial products with carbon emissions reduction as their objective and referred to under Article 9(3) SFDR, are automatically deemed to be making sustainable investments as defined in Article 2(17) SFDR.
 - b) Investments in 'environmentally sustainable' economic activities. These investments can be automatically qualified as 'sustainable investments' in the context of the product level disclosures under SFDR²⁹. This clarification will address the issue of the double assessment of those investments under both the EU Taxonomy and SFDR. However, the Commission notes that for investments in an undertaking with some degree of taxonomy-alignment through a funding instrument that does not specify the use of proceeds, FMPs would still need to check additional elements under the SFDR in order to consider the whole investment in that undertaking as sustainable investment. This means that the FMPs would still need to: (i) check whether the rest of the economic activities of the undertaking comply with the environmental elements of the SFDR DNSH principle; and (ii) assess whether they consider the contribution to the environmental objective sufficient.
23. The ESAs, furthermore, explained³⁰ that, in line with the Commission's interpretation about discretion within sustainable investments in SFDR, it is possible for FMPs to define their own contribution criteria for socially sustainable investments and create their own framework for their sustainable investments under SFDR as long as they adhere to the

²⁴ [Consolidated questions and answers on the SFDR and the CDR 2022/1288](#), Ref.: JC 2023 18 | 17 May 2023.

²⁵ Idem Q&A II.1.

²⁶ Idem Q&A V.1.

²⁷ Idem Q&A II.2.

²⁸ Idem Q&A V.9.

²⁹ [Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and its link to the Sustainable Finance Disclosure Regulation \(SFDR\)](#), June 2023, Q&A 4.

³⁰ [Consolidated questions and answers on the SFDR and the CDR 2022/1288](#), Q&A V.16.

minimum criteria of Article 2(17) SFDR, i.e. contribution, DNSH and good governance. FMPs should not, however, interpret Article 2(17) SFDR differently for different financial products that they make available and apply different interpretations of “sustainable investments” to different financial products that they offer.

24. Annex II of this paper includes a list of documents from the Commission and the ESAs that provide guidance on the SFDR.

2.3 Overview of SFDR sustainable investments and Taxonomy environmentally sustainable activities

25. The following table aims at providing a comparative overview of the concepts of sustainable investments under SFDR and Taxonomy environmentally sustainable activities.

	Taxonomy Regulation (TR)	Sustainable Finance Disclosures Regulation (SFDR)
Which stakeholders should apply the concepts of a) Taxonomy environmentally sustainable activities; and b) sustainable investment?	The concept of <u>environmentally sustainable</u> economic activities is applied by financial and non-financial undertakings which fall within scope of TR Article 8, to assess whether an economic activity is environmentally sustainable, i.e. Taxonomy-aligned. This assessment is carried out as part of the non-financial reporting of these undertakings.	FMPs that fall within scope of the SFDR ³¹ to assess whether investments of Article 8 and 9 financial products can be deemed as ‘sustainable investments’.
What does the application of these concepts entail?	An economic activity is deemed environmentally sustainable (taxonomy – aligned), when the following requirements are met: a) substantial contribution to one or more of the TR environmental objectives; b) do not significantly harm any of those objectives; c) compliance with certain minimum safeguards; and d) compliance with the TSC for substantial contribution and DNSH.	An investment is deemed as ‘sustainable’ when it meets the following requirements: a) it is in an economic activity contributing to an environmental or social objective; b) the investment does not significantly harm any environmental or social objective; and c) the investee companies follow good governance practices.

³¹ Article 2(1) SFDR sets out a list of FMPs.

<p>Does the framework contain specific criteria for the application and disclosure of the concepts of SFDR sustainable investments and Taxonomy environmentally sustainable activities?</p>	<p>The Commission developed sector-specific and science-based criteria (i.e. the TSC in accordance with the TR).</p> <p>These are set out in the Climate Delegated Act and the Complementary Climate Delegated Act³² for the two climate environmental objectives and the 'Environmental Delegated Act'³³ for the remaining four environmental objectives.</p>	<p>The SFDR framework does not set out specific criteria, thresholds or targets for the assessment of sustainable investments.</p> <p>Nevertheless, specific disclosures are prescribed for products disclosing under Article 8 or 9 that make sustainable investments. These disclosures include, amongst others; a) a description of how the sustainable investments contribute to a sustainable investment objective; b) explanations on how the SFDR DNSH principle is complied with by showing how the PAI indicators have been taken into account; c) how the sustainable investments are aligned with the OECD Guidelines for Multinational Enterprises and the Guiding Principles on Business and Human Rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights; and d) the good governance practices of investee companies³⁴.</p>
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³² CDR 2021/2139 ('[Climate Delegated Act](#)') and CDR 2022/1214 ('[Complementary Climate Delegated Act](#)') covering certain gas and nuclear activities.

³³ The [Environmental Delegated Act](#) was officially adopted on 27 June 2023

³⁴ The detailed disclosure obligations for financial products are set out in Annexes II-III (pre-contractual disclosures) and Annexes IV-V (periodic disclosures) of CDR 2022/1288.

<p>Do the relevant criteria refer to specific targets or thresholds?</p>	<p>The EU Taxonomy TSC for substantial contribution and DNSH refer to specific targets or thresholds or specific requirements which should be met when the economic activity is carried out.</p>	<p>The SFDR framework does not prescribe specific targets or thresholds for the assessment of sustainable investments; however sustainable investments must at least abide by the three criteria of Article 2(17): contribution, DNSH and good governance.</p>
<p>What is the scope of application of the two concepts?</p>	<p>The notion of environmentally sustainable investments is applied at the economic activity level and relates to economic activities that are taxonomy-eligible i.e. economic activities for which TSC regarding substantial contribution and DNSH have been developed.</p> <p>Moreover, environmental sustainability under the TR relates to the 'E' aspect of ESG.</p>	<p>Sustainable investments can be measured at the level of economic activity or that of a company.³⁵</p> <p>Additionally, sustainable investments in the SFDR framework can be in economic activities that contribute to either environmental or social objectives.</p>

³⁵ [Consolidated questions and answers on the SFDR and the CDR 2022/1288 Q&A II.1](#)

Annex I –Commission FAQ documents on the Taxonomy Regulation

The list below includes FAQ documents published by the Commission providing guidance on the application of the TR:

April 2021

- [What is the EU taxonomy and how will it work in practice?](#)

July 2021

- [What is the EU taxonomy Article 8 Delegated Act and how will it work in practice?](#)

December 2021

- [How should financial and non-financial undertakings report taxonomy-eligible economic activities and assets in accordance with the Taxonomy Regulation Article 8 Disclosures Delegated Act?](#)

February 2022

- [Commission Notice on the interpretation of certain legal provisions of the Taxonomy Regulation Article 8 Disclosures Delegated Act on the reporting of eligible economic activities and assets](#)
- [FAQ on the Taxonomy Complementary Climate Delegated Act](#)

December 2022

- [Draft Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act establishing technical screening criteria for economic activities that contribute substantially to climate change mitigation or climate change adaptation and do no significant harm to other environmental objective](#)
- [Draft Commission Notice on the interpretation and implementation of certain legal provisions of the Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets](#)

June 2023

- [Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and its link to the Sustainable Finance Disclosure Regulation \(SFDR\)](#)

Annex II –FAQ documents from the Commission and the ESAs on the SFDR

The list below includes documents with guidance from the ESAs and the Commission regarding the SFDR:

- [Clarifications on the ESAs' draft RTS under SFDR](#), Ref: JC 2022 23 | 2 June 2022;
- [Consolidated questions and answers](#) (Q&A) on the SFDR (Regulation (EU) 2019/2088) and the SFDR Delegated Regulation (Commission Delegated Regulation (EU) 2022/1288), Ref.: JC 2023 18 | 17 May 2023;
- [Commission decision of 5.4.2023](#) on the answers to be provided to questions requiring the interpretation of Union law submitted on 9 September 2022 by the ESAs under Article 16b(5) of Regulations (EU) No 1093/2010, (EU) No 1094/2010 and (EU) No 1095/2010 of the European Parliament and of the Council, and amending Commission Decisions of 6 July 2021 and 13 May 2022
 - o [Annex I](#)
 - o [Annex II](#)