

What do Companies Need to Know About the EU Taxonomy?

What is the EU Taxonomy?

The EU Taxonomy, entered into force in July 2020, is an industry classification mechanism that will help channel investments toward climate and environmental projects/activities as well as aid companies in the transition to becoming more sustainable.

The Taxonomy aims to go some distance in reducing greenwashing. For investors, greenwashing is where a financial product is made out to be sustainable, but the investment proceeds are not fully utilized toward sustainable activities. The Taxonomy will provide investors, companies, and policymakers with the methodology to identify economic activities that are considered environmentally sustainable and in doing so will help to accomplish the objectives of the European Green Deal.

What are the key points of the Regulation?

The Taxonomy is a transparency tool that will require mandatory disclosure by some companies and investors on their percentage of turnover/assets aligned with Taxonomy activities. This will aid in the comparison of companies as well as investment portfolios. The classification system used by the Taxonomy outlines 6 environmentally sustainable economic activities:

Taxonomy objectives:



1. Climate change adaptation



2. Climate change mitigation



3. The sustainable use and protection of water and marine resources



4. The transition to a circular economy



5. Pollution prevention and control



6. The protection and restoration of biodiversity and ecosystems

An economic activity is seen as sustainable if it:

- A. Substantially contributes to at least one of the six environmental objectives listed in the Taxonomy; and
- B. Does no significant harm to any of the other objectives, while also respecting human rights and labor standards.

The regulation will require mandatory reporting on climate change mitigation and adaptation (1 and 2) from January 2022, the other 4 objectives from January 2023, for companies that are under the scope of the NFRD. The scope will expand under the scope of the Corporate Sustainable Reporting Directive (CSRD).

Who does the Taxonomy affect?

There are three groups that will be affected by the Taxonomy: The first group is asset managers, asset owners and other financial institutions, which may wish to apply a screening process to identify sustainable investment opportunities. The second includes large companies with more than 500 employees, which also fall under the scope of the Non-Financial Reporting Directive (NFRD). The third group are EU Member States that want to set public measures, standards or labels of green financial products or green bonds.

What is the context to the Taxonomy?

The EU Taxonomy will help the EU reach the objectives of the European Green Deal strategy to become the first climate-neutral continent with three goals:

- No net emissions of greenhouse gases by 2050;
- Economic growth not relying on resource use;
- No person and no place left behind.

Is there a connection to the SFDR?

The Sustainable Finance Disclosure Regulation (SFDR) introduces investor requirements of investee companies which are linked with the Taxonomy by including indicators that reflect “environmentally sustainable economic activities”.

What does it mean for companies?

For companies, the Taxonomy can help establish a meaningful and clear transition strategy by reducing impacts to the 6 environmentally sustainable activities or substantially contributing towards them. This allows investors to make more informed industry-level investment decisions which consider a common set of sustainability criteria.