

SPOTLIGHT ON TAXONOMY

**WHAT is the Taxonomy?**

A **list of economic activities** that are considered **environmentally sustainable** for investment purposes¹.

WHY a Taxonomy?

To provide clarity and transparency on environmental sustainability to investors, financial institutions, companies and issuers thereby enabling informed decision-making in order to foster investments in environmentally sustainable activities.

WHAT is it NOT?

It is not a mandatory list to invest in, nor a standard, nor an exclusion list. It does not harmonise the existing market practices and strategies with regards to sustainable finance.

HOW is this list defined?

The proposed Taxonomy Regulation² lays out the **four conditions** for an activity to qualify. An activity must:

- a) **Contribute substantially** to at least one of the **six environmental objectives**³ defined in the Regulation;
- b) do **no significant harm** to any of the other environmental objectives;
- c) comply with **Minimum Social Safeguards**; and
- d) comply with **Technical Screening Criteria (TSC)**.

The regulation sets out numerous **requirements** for the TSC, notably that the criteria must be science-based, qualitative and/or quantitative (and contain thresholds where possible), build on existing market practices and EU legislation and consider life cycle impacts.

The proposed Taxonomy Regulation provides the framework for the subsequent development of the taxonomy through delegated acts. These delegated acts will specify which economic activities can be considered environmentally sustainable in line with their TSC.

As a first step, the Commission set up a Technical Expert Group (TEG) on Sustainable Finance which is tasked to recommend by June 2019⁴ a first list of economic activities delivering substantially on **climate change mitigation and adaptation objectives** (while not significantly harming any of the other environmental objectives). The Commission will take this advice on board

¹ Before investing into an environmentally sustainable economic activity investors will have to conduct proper due diligence to assess whether the investment is in line with their risk/return profile.

² <http://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-353-F1-EN-MAIN-PART-1.PDF>

³ The six environmental objectives as defined in the proposed Regulation are: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems.

⁴ The mandate can be extended until December 2019.

in preparation of the first delegated act on a *climate* taxonomy. Subsequent delegated acts will follow to expand the taxonomy to cover the other environmental objectives and hence have an EU *environmental* taxonomy⁵.

Key FEATURES:

Reflect technological and policy developments

The taxonomy will need to be regularly updated in order to reflect the latest policy- and technological developments. This work will be carried out by the Platform on Sustainable Finance, which - as foreseen by the proposed Taxonomy Regulation - will replace the TEG after its mandate. The same Platform will advise the Commission on the inclusion of economic activities delivering substantially on other environmental objectives.

Build on market practices

The taxonomy will take into account existing market practices. This will make them easier to use and ensure that they are aligned with existing frameworks.

Not green ≠ brown

The taxonomy will only contain activities that contribute substantially to environmental objectives i.e. “green”. However, not being on the list does not mean that those activities are considered “brown” i.e. having a significant negative impact on the environment, they are simply not categorized. As a matter of fact, some of these uncategorized activities might still contribute positively to environmental objectives (but only very marginally) or simply be neutral.

Transitioning polluting sectors

The taxonomy will also include activities in economic sectors that have a negative impact on the environment as long as they reduce that negative impact substantially. This will enable polluting sectors to transition and move onto greener pathways.

Technology neutrality

Any technology that meets the technical screening criteria i.e. the substantial contribution and the do no significant harm requirements can be considered for activities that qualify under the taxonomy. In that respect the taxonomy is “technology-neutral”.

The use of the taxonomy

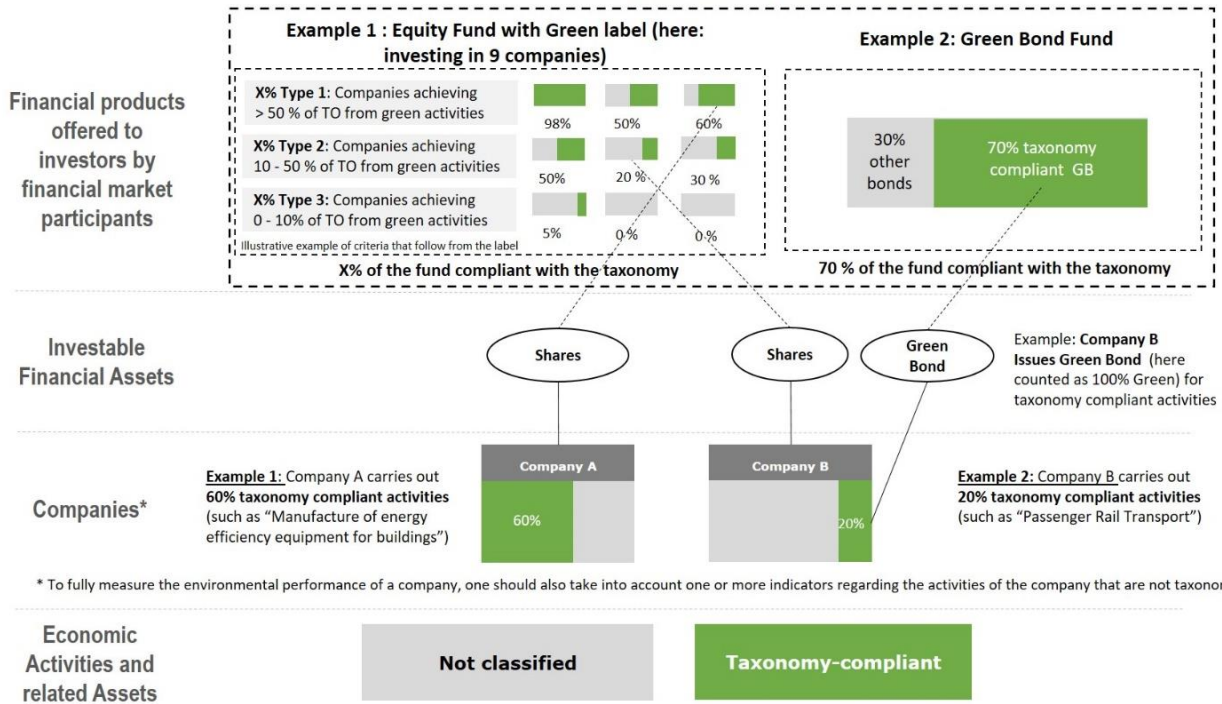
For financial institutions, the regulation only sets out **disclosure requirements**. Below, the way in which the taxonomy could be used by green funds or investment products is shown:

⁵ The proposed Taxonomy regulation also foresees a review clause to further expand the taxonomy to also cover *social* objectives and hence identify economic activities substantially contributing to the achievement of those.

SPOTLIGHT ON TAXONOMY

Disclaimer: the examples used below are for illustrative purposes only and do not pre-empt any policy decisions by the Commission with regards to labels and standards

All: disclosure of how ESG risks are taken into account



* To fully measure the environmental performance of a company, one should also take into account one or more indicators regarding the activities of the company that are not taxonomy compliant.