

Sixty second summary

EU taxonomy for sustainable activities



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The EU has published a draft taxonomy, or classification, for environmentally sustainable economic activities. It's designed to help assess companies and investments and identify those that have a substantial positive impact on the climate and the environment. Essentially, it aims to clarify what constitutes a “green” investment.

Background

To meet its goal of becoming the world's first climate-neutral bloc by 2050, the EU needs around €1tn of sustainable investment over the next decade. This investment cannot come solely from governments; private investors have a significant role to play. The taxonomy is intended to help investors identify and channel money towards genuinely “green” investments.

What is it?

The taxonomy is a classification system developed by the EU. It defines technical, science-based criteria for assessing whether or not specific economic activities make a substantial positive contribution to climate change. As an example, car manufacturing can be labelled as a sustainable investment until the end of 2025 if the vehicles produced emit less than 50g of CO₂ per km. After 2025, only the manufacture of zero-emission cars will be deemed “green”. The detail runs to over 500 pages.

Why is it needed?

Investors have found it hard to determine which companies are acting responsibly on climate change due to a lack of common standards for disclosing information. By clearly defining what it means to be “green” in each area, the taxonomy is expected to incentivise and encourage companies to launch new projects, or upgrade existing ones, to meet the assessment criteria.

What is its coverage?

The taxonomy covers “the economic activities of roughly 40% of listed companies, in sectors responsible for almost 80% of direct greenhouse gas emissions in Europe.” It doesn't cover all sectors at this stage – for example, nuclear energy and natural gas are expected to be added at a later date. The taxonomy will evolve over time, with more activities being added, and to reflect technological advances.

While developed for the EU, the EU is also working with other countries to agree a common set of standards that can be applied more globally. The taxonomy will be formally adopted at the end of May once translations are available in all EU languages.

How will it be used?

The taxonomy has potential to be used in a number of ways:

- Investors: will be better able to identify opportunities and confidently invest in projects and/or companies that have a substantial positive impact on the climate.
- Fund managers: will be able to improve transparency on sustainability risks and opportunities. This links to Sustainable Finance Disclosure Regulation, which will require managers to classify their funds into three categories of sustainability – grey, light green and dark green.
- Development of new sustainable investment opportunities: for example, standardisation introduced by the taxonomy could spur the growth of sustainability-linked debt issuances. These typically link the interest rate paid by borrowers to quantifiable performance targets and have heightened scrutiny of corporate expenditure and management plans with regard to emissions reductions.

What information will companies need to disclose in future?

A key date for EU corporates is 1 January 2022, when the Non-Financial Reporting Directive (NFRD) comes into effect. Under this, companies with more than 500 employees will be required to report what share of their revenue, capital, and operating expenditure is taxonomy-aligned. Some forward-looking criteria, e.g. capital expenditure and operating expenditure, can be included if a company intends to make an activity taxonomy-compliant within five years (low-carbon research and development for example).

The proposed Corporate Sustainability Reporting Directive (CSRD) is expected to extend these requirements to all large private companies and to all companies listed on EU regulated markets, increasing the number of companies that would need to follow sustainability reporting standards from 11,000 to nearly 50,000.

What does it mean for the UK?

The UK Government has announced it intends to fully implement a 'Green Taxonomy' to provide a common standard for measuring firms' environmental impact. It has also joined the International Platform on Sustainable Finance 'to ensure standards can operate internationally.'

We welcome the development of the taxonomy as an important step towards providing investors with the consistent and transparent information that they need to make informed decisions on sustainable investments. This should lead to increased confidence, and also provide a catalyst for innovation in a number of areas, including designing funds that can objectively be classed as "green" investments, and the development of investment opportunities supported by the additional level of disclosures that will be required from companies. Further work will be needed to develop and refine the criteria over time, and it's acknowledged that agreement more globally will also be helpful.