

How the EU Taxonomy can facilitate the green transition

Why do we need an EU Taxonomy?

Because we need reliable tools to support companies, jobs and sustainable growth. The EU Taxonomy is a trustworthy tool that translates the EU's green objectives into criteria for investment purposes. The EU Taxonomy criteria result directly from the EU's own 2050 and 2030 GHG emission reduction targets, over which the existing practices and sectorial regulation cannot have precedence. Given its pivotal role to serve as the gold standard for sustainable investments, the Taxonomy criteria cannot aim lower than the EU objectives that have been set.

The Taxonomy will be an EU-endorsed anti-greenwashing tool indicating goal-aligned environmental performance with a high confidence level. The EU Taxonomy will help compare the level of greenness across various investments, and it can therefore guide market participants in their investment decisions.

Private entities will have to refer to the EU Taxonomy in their legally binding statements, but there is no obligation for them as to what to invest in. While the EU Taxonomy is only one of many tools facilitating the sustainable transition and a voluntary one, companies can reliably use the EU Taxonomy to plan and to finance their investments to transition.

What is the EU Taxonomy?

The EU Taxonomy establishes an EU-wide framework to facilitate 'sustainable investment' that will help Europe become the first climate-neutral continent by 2050, as well as to address biodiversity loss and other environmental challenges. In this way, it is a key enabler of the EU Green Deal.

The taxonomy provides a **common understanding of 'environmentally sustainable' economic activities** in the sectors that are the most relevant to achieving climate neutrality and our environmental objectives (energy, manufacturing, transport, agriculture, buildings, etc.). **Commission delegated acts¹ will spell out performance thresholds² under which companies' specific activities can qualify as 'environmentally sustainable'. The performance thresholds are science-based and developed on the basis of a robust methodology and an inclusive process. They set out a path consistent with the EU's climate and environmental goals, based on currently available technologies and best-in-class practice.**

The activities which the Taxonomy covers as 'environmentally sustainable' include those which are already climate-neutral, as well as those which facilitate a reasonable transition toward this

¹ A first delegated act will contain criteria for the objectives of climate change mitigation and adaptation. A second delegated act will contain criteria for the four other environmental objectives – sustainable use of water resources, circular economy, pollution prevention and biodiversity.

² The delegated acts set out so-called technical screening criteria to define substantial contribution to one of the environmental objectives and the 'do no significant harm' to the other environmental objectives.



objective. To this end, it recognises (i) activities that are low impact and have the potential to replace high impact activities (for example wind energy) or that make a positive environmental contribution (for example afforestation) (ii) transitional activities for which low impact performance levels are not yet available but can achieve significant emissions reductions and have improved performance relative to their peers, (specifically for climate change mitigation; for example, best-in-class cement manufacturing) and (iii) activities that directly enable others to make a substantial contribution to an environmental objective (for example, manufacturing of renewable energy technologies).

Not all activities which can conceivably have positive environmental impacts can be considered for inclusion in the Taxonomy at the same time. The process for assessing activities needs to be rigorous, and EU co-legislators have prioritised activities which make a positive contribution to climate objectives (climate change mitigation and climate change adaptation). The EU Taxonomy is an evolving tool that will be developed over time, adding further relevant activities based on scientific evidence and broad stakeholder input. **Not being considered ‘environmentally sustainable’ under the EU Taxonomy does not mean that an activity is ‘environmentally harmful or unsustainable’.**

Who will use the EU Taxonomy and how?

Mandatory uses: There are two types of mandatory uses of the EU Taxonomy: on the one hand, the reporting obligations for issuers and financial market participants, on the other, requirement to use the taxonomy as a basis for public green standards and labels for financial products.

Large listed EU companies (including banks and insurance companies) **and financial market participants** (such as asset managers) **will have to disclose to what extent their activities or financial products align with or fund activities that meet the criteria set out in the EU Taxonomy.** This will feed the market with information on companies that are performing according to the EU Taxonomy and those that are taking steps to get there.

Member States and the EU will also use the EU Taxonomy as the basis of EU or national labels for green financial products or green corporate bonds. The EU Taxonomy thus provides a good basis for the development of further sustainable finance tools, including the EU Ecolabel for Retail Financial Products and future EU standards for green bonds (all under development) as well as green mortgages. Other EU or national policies may also refer to the Taxonomy Regulation, in order to build on or use either its main principles or its delegated acts, but such uses are not defined or mandated in the Taxonomy Regulation itself.

Voluntary uses: The EU Taxonomy can also be used voluntarily by market participants for a variety of purposes. **Investors (both institutional or retail) looking for ‘sustainable investments’ can use it to identify investment opportunities.** But the EU Taxonomy **does not constitute a mandatory list for investors** to invest in. Nor does it set mandatory requirements on environmental performance for companies. There are several ways in which markets can work with the criteria of the EU Taxonomy on a voluntary basis, a few examples are provided below, without the list being exhaustive.

What are the different criteria – ‘substantial contribution’ and ‘do no significant harm’?

To be considered ‘environmentally sustainable’, an economic activity must substantially contribute to one of the six environmental objectives without causing significant harm to any of the other objectives, and meet minimum social safeguards. Delegated acts define technical screening criteria for significant contribution and no significant harm. These criteria are specific to the economic activity. The technical screening criteria for determining whether an economic activity contributes substantially to an environmental objective ensure that it has a positive environmental impact or reduces negative impacts on the environment. The technical screening criteria for ‘do no significant harm’ ensure that the economic activity has no significant negative impact on the other environmental objectives. This also ensures coherence between the objectives in the Taxonomy and guarantees that progress towards one objective is not made at the expense of another.

How will the EU Taxonomy help companies’ green transition?

The EU Taxonomy will be a key reference point for companies and investors in identifying green investment opportunities. **Businesses can use it to upgrade their environmental performance to attract investors interested in sustainable investments.** They will be able to qualify their activities as Taxonomy-aligned both when they already operate according to the performance thresholds (based on the revenue from those activities), and when they define clear plans and commit financing to meeting those thresholds (i.e. based on capital expenditure set out in investment plans they draw up to achieve them **to finance their transition**).

Therefore, a Taxonomy-aligned investment does not only mean an investment into economic activities that are already Taxonomy-aligned, but also any investment that aims to achieve the needed transition. This can include investments into expanding taxonomy-aligned activities, into switching from an activity to a different activity that is taxonomy-aligned, or into improving the current environmental performance of an activity to reach the EU Taxonomy criteria. Such investments can be recognised as sustainable investments, even if they span several years. This is an important feature that can help the transition of businesses from their current environmental performance to the level of performance recognised by the Taxonomy as green. Moreover, the EU Taxonomy does not define green companies, but green economic activities. By doing so, it supports companies to transition by gradually increasing their share of green activities.

Why is the EU Taxonomy recognising only substantial contributions and not other impacts?

The Taxonomy is conceived as a tool to clearly indicate where investments are needed to deliver on the green transition objective, which implies a substantial contribution to the objectives. But it is important to recall that what does not qualify as ‘sustainable economic activity’ under the Taxonomy is not ‘unsustainable’ by definition. Recognising only substantial contribution as Taxonomy aligned does not exclude marginal greening from investment strategies. Other parts of the EU sustainable finance toolkit, such as the Sustainability Disclosures Regulation,³ create a comprehensive framework for investors, recognising different degrees of environmental performance and different types of investment strategies as promoting environmental characteristics.

³ Regulation (EU) 2019/2088 on sustainability- related disclosures in the financial services sector



The Taxonomy Regulation provides for a **Commission report** in which the Commission will analyse **whether the Taxonomy regulation should be extended to cover economic activities with no significant impact**. But the existing legal framework of the Taxonomy Regulation is already a useful toolkit for a number of different solutions towards the green transition.

Through what types of activities does the EU Taxonomy help the green transition?

‘Transitional activities’: The Taxonomy Regulation recognises that some activities that are needed in our economy have no technologically and economically feasible low-carbon alternatives today. Such economic activities can qualify as contributing substantially to the objective of climate change mitigation when they support the transition to a climate-neutral economy, in particular by phasing-out emission and when (i) their greenhouse gas emissions are substantially lower than the sector or industry average; (ii) they do not hamper the development and deployment of low-carbon alternatives; and (iii) they do not lead to a lock-in of assets incompatible with the objective of climate neutrality (considering the economic lifetime of those assets). The term “transitional activity” has been chosen to label such economic activities. The word transitional refers to the fact that, while they are recognised as sustainable investment on a par with others in the Taxonomy, the technical screening criteria for such transitional economic activities should ensure that they have a credible path towards climate-neutrality, and should be adjusted accordingly at regular intervals based on scientific evidence.

‘Enabling activities’: An economic activity can qualify as contributing substantially to one of the environmental objectives when it directly enables other activities to make a substantial positive environmental impact. Such enabling activities must not lead to a lock-in of assets that undermine long-term environmental goals, considering the economic lifetime of those assets, and should have a substantial positive environmental impact, on the basis of life-cycle considerations.

How about the activities that transition from causing significant harm to not causing significant harm?

The Taxonomy Regulation aims to encourage the flow of investment into those activities that reach the substantial contribution threshold. However, it is a valid demand to recognise also an investment that does not reach the substantial contribution threshold, but nevertheless improves in a meaningful way the significantly harmful environmental performance of an activity so that it would not cause significant harm in the future.

While the Taxonomy framework currently does not recognise such investments as ‘environmentally sustainable’, the Taxonomy Regulation requires the Commission to present a report on **how the Taxonomy Regulation legal framework could be extended to cover economic activities that cause significant harm**. It is the intention of the Commission to look into, among other issues, the question of how to **recognise transitioning out of environmentally harmful activities**, even if that transition does not reach the technical screening criteria threshold for substantial contribution.

The voluntary use of the ‘do no significant harm’ criteria can promote investment into mitigating harm. Companies that transition from significantly harmful level of environmental performance to not causing significant harm can disclose that to the market on a voluntary basis. Financial market participants working on engagement strategies can observe this threshold, again on a purely voluntary

basis, when engaging with investee companies. A company issuing a bond for the purpose of mitigating significantly harmful impacts can explain to investors that it is aiming to tackle significant harm. These voluntary uses of the 'do no significant harm' threshold are not regulated uses, it is left to the choice of individual actors whether they wish to refer to it or not. Importantly, investments into mitigating significant harm are not sustainable investments under the Taxonomy Regulation, as they do not achieve the substantial contribution threshold that would allow them to be qualified as such.

Can small companies, or companies in sectors not covered by the EU Taxonomy, benefit from the EU Taxonomy?

Businesses of any size, including small companies, can use the EU Taxonomy to explain to investors or stakeholders in general whether they perform environmentally sustainable activities. Whereas disclosures are mandatory for large listed EU companies, many small companies might find disclosing their Taxonomy alignment useful to do on a voluntary basis.

Those SMEs whose business model is focused on one or few green activities may find it quite easy to use the EU Taxonomy to disclose voluntarily, as only one or few sets of criteria would be applicable to them. For instance, a small manufacturer of energy efficient windows would only need to check what share of its turnover is from the sale of windows that comply with the taxonomy criteria.

Another way in which companies (big or small) in any sector – even in sectors that are not covered by the Delegated acts – can use the Taxonomy is when they invest into certain specific Taxonomy-aligned measures improving their environmental performance. Investments into such 'greening measures' can qualify as Taxonomy-aligned, regardless of whether the economic activity itself can reach the green performance threshold or not. For instance, when replacing a building's heating system or installing thermally efficient windows, those installations need to meet the criteria of the EU Taxonomy, and any economic activity can benefit from those greening measures as long as they do not substantially harm environmental goals.

Not only investors, but also lenders can use the EU Taxonomy to put together loan portfolios that consist of Taxonomy-aligned loans. For example a loan to renovate would qualify as Taxonomy-aligned if the above mentioned conditions for installation of heating systems or thermally efficient windows are met, or if the building after renovation reaches the substantial contribution threshold of the EU Taxonomy, without harming any of the other environmental objectives. Such loans might be granted to private individuals as well as companies.

Opportunities for greening and transition in the Taxonomy and in the broader sustainable finance framework are summarised below:

Companies in sectors covered by the Taxonomy

- Can find greening opportunities within the Taxonomy by checking Taxonomy list (including transitional and enabling activities) to know what counts in your sector as Taxonomy aligned.
- Can find greening opportunities within the Taxonomy by checking which greening measures are recognized by the Taxonomy
- Might see other greening opportunities not listed in the Taxonomy this might be recognized in future acts or it might be promoting environmental characteristics
- Can find opportunities to mitigate significant harm to environment by checking Taxonomy criteria for do no significant harm

Taxonomy-aligned

Other types of greening

Companies in any sector (whether or not covered by the Taxonomy DA)

- Can find greening opportunities within the Taxonomy by checking which greening measures are recognized by the Taxonomy
- Might see other greening opportunity not listed in the Taxonomy this might be recognized in future acts or explained to investors as promoting environmental characteristics

Make plans to invest in the greening opportunities:

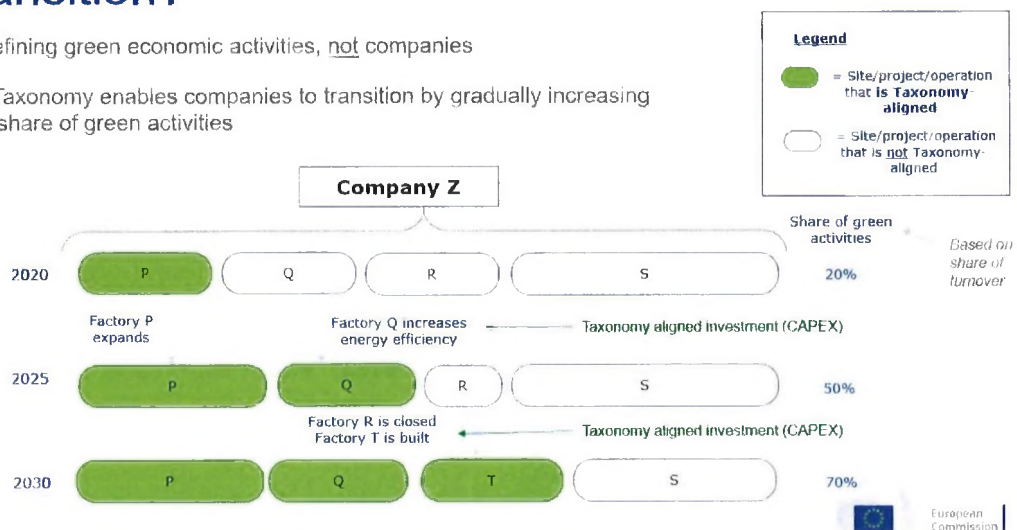
Greening opportunities in the Taxonomy	Greening measures in the Taxonomy	Other greening opportunities	Mitigating significant harm
<ul style="list-style-type: none"> Upgrade existing production sites and facilities in a way to meet Taxonomy criteria Open new ones that meet Taxonomy criteria 	<ul style="list-style-type: none"> Get energy efficient windows, boilers, etc. that are recognized in the Taxonomy, even if the activity itself to meet specific criteria these improvements are recognized by the Taxonomy 	<ul style="list-style-type: none"> Invest in the greening opportunity you see 	<ul style="list-style-type: none"> Upgrade environmental performance to not do significant harm

Taxonomy-aligned green investments
dedicated capital investment, loans and debt

Investments promoting environmental characteristics
under the Sustainability Disclosure Regulation

How does the Taxonomy help companies to transition?

- By defining green economic activities, not companies
- The Taxonomy enables companies to transition by gradually increasing their share of green activities



Why is the level of ambition of the EU Taxonomy higher in some cases than EU sectoral legislation?

The EU Taxonomy recognises as ‘sustainable’ those activities that make a major positive contribution to realising the EU environmental objectives. For instance, in the case of climate change mitigation, the EU Taxonomy criteria for substantial contribution to climate change mitigation correspond to levels of performance that actively help the decarbonisation objectives of the EU. Whereas alignment with other EU sectoral policies is an important consideration, there are also reasons why the Taxonomy might deviate from those. Given the huge investment needs and the necessary broad transformation of the EU economy, reaching our green objectives requires more than just knowing whether an investment is going in the right direction (for example “does an investment into an activity reduce emissions compared to the current emissions of that activity?”). We need to also know how good is ‘good enough’ to reach those objectives. For example, will a given level of emission reduction be in line with the 2030 and 2050 targets? The technical screening criteria in the draft Delegated Acts were designed with the EU climate and environmental objectives in mind. And by answering that very question, “how good is good enough?” the Taxonomy helps investors identify the investments that are most needed to deliver on the green transition.

In some cases, existing EU sectoral legislation is not yet updated to support the transition to climate neutrality by 2050 and the new 2030 target. In other cases, mandatory policy instruments affecting all economic actors in a sector may be aimed at those lagging behind, while the EU Taxonomy recognises green performance aligned with the EU transition objectives. Using the Taxonomy as a credible methodology to identify climate- and environment- related investments strengthens the EU’s credibility to achieve the goals set in the EU Green Deal. While the legal framework for sustainable finance recognises also other efforts to green the economy as important, including more marginal greening, the **Taxonomy will be a key reference point for companies and investors on green investment opportunities.**

What does it mean that the Taxonomy and its criteria will be dynamic?

The EU Taxonomy will be developed over time, with delegated acts including further economic activities in the future, as those become relevant and feasible to integrate into the Taxonomy.

But there is also another important aspect: that even for the economic activities covered by the first delegated act, the path to a green transition is by definition a continuously improved performance. In order to reflect the steps needed to achieve the EU’s climate and environmental goals, the sustainability criteria (both substantial contribution and do no significant harm) need to be dynamic, updated regularly in line with technological and scientific evolution. In other words, when a new technology makes improved environmental performance feasible, that will be reflected in such regular reviews of the criteria.

Companies wishing to align with the Taxonomy will therefore continually have to improve their performance to qualify their activities as sustainable, but at any point in time, the taxonomy alignment of an economic activity will be clear to all market actors, and reviews of the criteria are programmed for regular intervals in order to provide predictability. Clearly, there will be costs in the transition.



The Taxonomy provides a clear yardstick for companies to undertake the necessary investments in a timely manner, and help close the funding gap by indicating to financial market participants which investments are most needed to deliver on the green transition.

When will the EU Taxonomy start to apply and what are potential next steps?

The mandatory reporting under the Taxonomy Regulation will apply from **January 2022**, for the climate change mitigation and adaptation objectives, and from **January 2023**, for the other four objectives. But, financial entities and companies can and are already considering use of the Taxonomy framework and will be able to report voluntarily as soon as the first delegated act is adopted.

The Commission will assess **the possibility of extending the taxonomy framework** to cover also significantly harmful activities, in order to help with an orderly transition to the 2050 targets. This extension would provide further guidance to financial markets and industry on how to smoothly transition away from activities that undermine climate and environmental objectives. It could help financial sector risk management and guide both private and public spending. In parallel, the Commission will also look into **the possibility of extending the taxonomy framework to social activities**. Given the importance of the social dimension in managing the green transition, this issue will be given great attention and the assessment will aim to deliver solid results we can use and build on in an inclusive transition.