

European Taxonomy – system of classification for sustainable economic activities 1/5/22



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We are experiencing the consequences of climate change more and more – through extreme weather conditions and changes in nature. To mitigate climate change and tackle problems associated with environmental degradation, the EU has set ambitious goals to achieve a 55% reduction in greenhouse gas emissions by 2030 and to become climate neutral by 2050. The European Green Deal is a strategy designed to help Europe achieve the goal of climate neutrality.

The Green Deal

The European Green Deal aims to improve the health and well-being of citizens and next generations, to promote clean air and water, waste-free production, smart travel, low-emission buildings, and biodiversity, and to encourage the production and use of renewable energy as well as a circular and collaborative economy in order to minimise greenhouse gas emissions and their absorption.

Financing plays a significant role in achieving these goals, as they will take a considerable amount of money to achieve. The European Green Deal Investment Plan provides for mobilising at least EUR 1 billion for investment over the next ten years. The term “sustainable finance” is used when speaking about financing for these goals. The idea of sustainable finance is to strengthen the role of both the private and the public sector by providing cash flows for companies that are now actively engaged in performing sustainable activities or wish to change and adapt by revising their business models, looking for new, more sustainable and environment friendly lines of business to mitigate climate change, and adapting to climate change.

To help the financial institutions, asset managers and the public sector carry out this duty and make financing available for sustainable economic activities and transformation processes, we need reliable, high quality and standardised information that defines what a sustainable economic activity is and helps us achieve our climate goals.

The EU has devised a science-based system of classification for sustainable economic activities, the Taxonomy Regulation,¹ which provides insights into economic activities geared to achieving the EU environmental goals. It recognises as green or environmentally sustainable any business that contributes substantially to achieving at least one of the environmental goals, without causing significant harm to any of the other environmental goals, and provides minimum social guarantees.²

The Taxonomy Regulation evaluates an economic activity against six environmental goals:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Moving to a circular economy
5. Prevention and control of pollution
6. Protection and restoration of biodiversity and ecosystems

The Taxonomy's first Delegated Regulation³ on climate goals has now been adopted, which establishes technical screening criteria for determining conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives. The technical screening criteria are defined according to industries with the greatest potential to promote climate neutrality and climate change adaptation (e.g. energy, forestry, manufacturing, transport, construction and real estate, water supply). Insights into the relevant industries and economic activities can be derived from the Taxonomy Compass.

The technical screening criteria around a "substantial contribution" to achieving an environmental goal help us assess whether an economic activity has a substantial positive impact on the achievement of the environmental goals, for example, it substantially reduces greenhouse gas emissions.

The technical screening criteria around "causing no significant harm" help us assess whether an economic activity hinders the achievement of other environmental goals and whether it has a substantial negative impact on them.

The Taxonomy rules also serve as a tool for ensuring transparency and disclosure that requires the large financial and non-financial companies, which are already required to prepare non-financial statements, to supplement those and state the extent to which their economic activities meet the screening criteria set by the Taxonomy rules. The financial sector participants providing various financial services are required to disclose the extent to which those companies and the economic activities they are financing through those financial products meet the criteria set by the Taxonomy rules. It is expected that in the future the financial sector participants (e.g. banks) might be interested in providing better financing terms to companies whose economic activity is consistent with the Taxonomy's goals, or in limiting the availability of financing to companies failing to meet these requirements. It is also expected that the public procurement procedure might include additional criteria related to sustainability.

The large state-owned companies that are required to prepare a non-financial statement under the Management of Public Shareholdings and Companies Act could benefit from familiarising themselves with the Taxonomy's green classification system and assessing whether and to what extent their business activities are geared to achieving the European environmental goals. Assessing whether the company's business model is consistent with the European environmental goals and identifying its impact will make it possible to respond early and launch any necessary realignment process to save money and become more competitive, as well as identifying ways of using the aid mechanisms activated as part of the Sustainable Europe Investment Plan.

If you have any questions about a Taxonomy compliance assessment or non-financial reporting, please do be in touch with us.

¹ Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

² Minimum social guarantees – a company must conduct its business in accordance with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions and laid down in the ILO Declaration on Fundamental Principles and Rights at Work and in the International Bill of Human Rights

³ Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives