The EU Taxonomy

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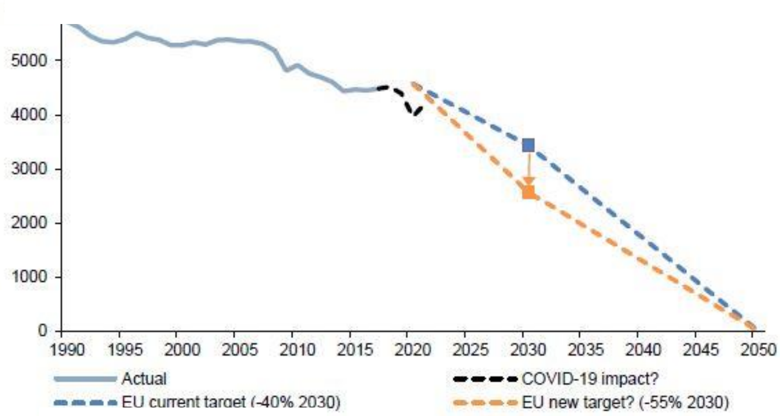
Transitioning our way out of the climate crisis

The EU taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. Setting a common language between investors, issuers, project promoters and policy makers, it helps investors assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change.

In December 2019, the European Commission presented the **European Green Deal**, an overarching framework and program of actions to transform the European economy. A key component of the Green Deal is the proposed 'Climate Law' embedding a legal commitment for the EU **to achieve climate neutrality by 2050**. The EU put a more ambitious strategy on adaptation to climate change on the table, building from the 2013 strategy and the adaptation current key targets are at least 40% cut in greenhouse gas emissions (from 1990 levels), at least 32% share for renewable energy and at least 32.5% improvement in energy efficiency – but more ambitious targets are currently being considered.

Total EU CO2 Emissions



Source: Exane,August 2020

Other core components of the Green Deal are strategies and actions on supplying clean, affordable and secure energy, biodiversity, zero pollution, a circular economy and sustainable food production. These overarching objectives are addressed through financial and real-economy policy, across the public and private sectors.

The adoption of the **Taxonomy** Regulation in June 2020 marks the final step of the legislative process for creating the world's first green classification of sustainable economic activities.

By re-orienting private sector investments to green technologies and businesses, this piece of legislation will serve as guidance for the EU to reach climate neutrality by 2050.

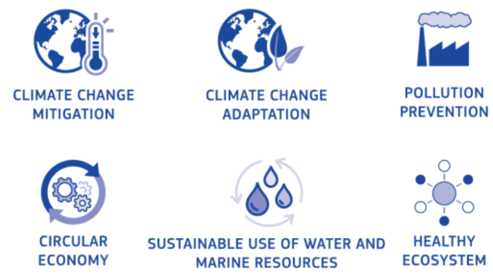
It transforms the European Green Deal into an **actionable roadmap for investors to be in line with the COP 21 targets** and therefore it aims to decarbonize high emitting sectors and grow low carbon sectors.

The EU taxonomy is one of the most significant developments in sustainable finance and will have wide ranging implications for investors and corporates in the EU and worldwide.

To be included in the proposed EU Taxonomy, an economic activity must contribute substantially to at least one environmental objective and do "no significant harm" to the other five environmental objectives set out in the legislative proposal.

The taxonomy includes three layers of green activities that can be taxonomy aligned:

- The first and most obvious layer is **activities that are already low carbon**, such as renewable energy.
- The second layer is **activities that enable emission reduction in other activities**, for example, manufacturing of components essential for renewable energy production ("enabling activities").
- The third layer includes **activities that are not low carbon today, where the techniques required might not exist yet, but can transition to become green** in the future, such as sustainable mobility and transport, best-in-class buildings.



The classification works through technical screening criteria, methodology and guidance described in the EU report on taxonomy which the EU Technical Expert Group (TEG) has been busy designing, together with extensive stakeholder consultations, involving numerous experts from sectors covered by the taxonomy.

This process will help companies, project promoters and issuers access green financing to improve their environmental performance, as well as helping to identify which activities are already environmentally friendly.

In doing so, it will help to grow low-carbon sectors and decarbonize high-carbon ones.

Currently the sectors covered by the EU taxonomy are limited to:

- Agriculture, forestry and fishing
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Water, sewerage, waste and the related remediation
- Transportation and storage
- Information and Communication Technologies (ICT)
- Buildings (construction and real estate activities, with application to other sectors where appropriate)

The recent adoption of the Taxonomy Regulation by the European Parliament marks the last legislative step for creating the world's first classification of sustainable economic activities. It is expected to leverage on private investments to set in motion the transformation of the EU economic activities towards the goals of the European Green Deal.

This implies that a wide array of sectors listed on the stock exchanges such as health care, consumer and financials are currently not covered and require additional ad-hoc in-depth analysis by investors. In addition, the information on the eligibility of the activities of the companies is not always widely available necessitating deep knowledge not only on the company but as well on climate finance.

Beyond climate change

To any sustainable investor the current health crisis has been a litmus test with respect to the way the company has been able to protect its workforce whilst keeping up with production. It has become obvious that any climate change strategy cannot be focused only on emissions but needs to have a social layer as well. This is particularly significant with respect to certain complex areas of the battery supply chain ie the extraction of raw materials such as cobalt which has been red flagged for potential social violations.

Currently, to be taxonomy aligned, activities must meet minimum social safeguards, such as fundamental labor rights, but there is no social taxonomy included in the final version of the framework. However, the report recognizes that a fully comprehensive taxonomy should incorporate social objectives. This opens the door for the development of a social taxonomy in the future and we hope this is going to be implemented as a next step to ensure a truly sustainable investment strategy.

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