



The EU Taxonomy and its implications for your business

What the EU Taxonomy is and where it is coming from



Around the globe, we have started to feel the impact of climate change for years. Scientists, businesses, policymakers and the citizens they represent, have reached overwhelming consensus on what is to come if we cannot navigate the transition to a low-carbon, resilient and resource-efficient economy.

Business, and finance in particular, will prove a critical enabler of this transition. As the OECD estimates that globally 6.35 trillion¹ euro a year will be required to meet the Paris Agreement by 2030, the mobilization of institutional and private capital will have to be unprecedented in terms of speed and direction.

This is the central challenge to which the EU is responding with the EU Taxonomy, because which to be financed economic activities can be classified as sustainable and how can greenwashing be avoided?

In this brief document we aim to share an action-oriented overview of the Taxonomy and highlight what is expected of companies to take a next step in contributing to this transition.

The European Commission (EC) announced its action plan on financing sustainable growth as an important enabler of the EU Green Deal in 2018. It is as part of this action plan that the EC is now introducing the Taxonomy, as a type of dictionary to determine what is actually sustainable - including related thresholds that are known as Technical Screening Criteria (TSC) - to replace myriads of current sustainability definitions.

Economic activities will thus need to be in line with the following three elements to be considered sustainable after the passing of the Taxonomy Regulation:

- a) **Substantially contribute to at least one of the six environmental objectives as defined in the Regulation through the TSC;**
- b) **Do no significant harm to any of the other five environmental objectives as defined in the Regulation through the TSC; and**
- c) **Comply with minimum social safeguards.**

The EC started defining the TSC for six environmental sustainability objectives (please see figure 1 for all six on the next page) at both a sector and economic activity level. Currently, the TSC for climate change mitigation and climate change adaptation are most advanced.

To ensure the TSC encompass all relevant sectors and economic activities, identification is performed against the EU's industry standard classification system NACE ("Nomenclature statistique des Activités économiques dans la Communauté Européenne"). This will be leading for companies to understand what is expected of them by when, depending on the sector they are part of.

¹ OECD. 2017, Investing in Climate, Investing in Growth, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264273528-en>



Figure 1. Six environmental sustainability objectives²

The final TSC are likely to be made available upon the adoption of delegated acts from December 2020 and the Taxonomy is in turn expected to be referenced throughout EU laws on sustainability aspects, such as climate change, biodiversity, and circularity.

The Taxonomy is therefore related to each of the ten areas in the EC Action Plan of Financing Sustainable Growth³ (figure 2), underlining its role as a cornerstone in the harmonization of sustainability-related programmes and what is still to be expected.

The EU Taxonomy and its connection with other EC action plans	1. Establishing an EU Classification system for Sustainability activities (i.e. the EU Taxonomy)
	2. Creating Standards and labels for green financial product
	3. Fostering investment in sustainable projects
	4. Incorporating sustainability when providing investment advice
	5. Developing sustainability benchmarks
	6. Better integrating sustainability in ratings and research
	7. Clarifying institutional investors and asset managers' duties
	8. Incorporating sustainability in prudential requirements
	9. Strengthening sustainability disclosure and accounting rule-making
	10. Fostering sustainable corporate governance and attenuating short-termism in capital markets

Figure 2. The EC Action Plan of Financing Sustainable Growth

What the impact of the EU Taxonomy may be on your business

The Taxonomy will provide an opportunity for companies to demonstrate their performance and progress made towards a more sustainable business model, in a consistent and comparable way.

This will in turn enable financial market players to make more informed investment decisions with respect to their sustainable investments and lending portfolio, and increase transparency to broader stakeholders on these matters as the Taxonomy will require companies to disclose the entire proportion of Taxonomy-aligned economic activities (i.e. through turnover, capital expenditure and operating expenditure indicators).

The Taxonomy Regulation was adopted by the European Parliament in June 2020 and will automatically be binding throughout the EU on the date it enters into force. Under the Taxonomy Regulation, a company that is subject to the non-financial reporting directive (NFRD) will have to disclose the proportion of economic activities that are Taxonomy aligned as environmentally sustainable. This will be disclosed for the climate change mitigation and adaptation objectives in non-financial statements or reports published on or after 1 January 2022 and for the remaining four environmental sustainability objectives, for non-financial statements or reports published on or after 1 January 2023 (following the finalisation of the TSC on 31 December 2021 and 31 December 2022 respectively), and therefore be applicable to FY2021 and FY2022 disclosures respectively.

A delegated act - expected for June 2021 - would further specify the content and presentation of the required NFRD disclosures, including the methodology to be used to calculate the Taxonomy-aligned activities via the same indicators (i.e. turnover, capital expenditure and operating expenditure).

For certain companies in the financial sector, the sustainability-linked disclosures for financial services sector regulation (SFDR) will require them to disclose sustainability-related information on product and entity levels, in periodic reports (e.g. annual reports), pre-contract disclosures and websites applying the Taxonomy whenever referenced. These requirements for companies in the financial sector include integration of sustainability risks; consideration of its adverse impacts and; promotion of environmental and social characteristics and sustainable investments on disclosures from as early as 10 March 2021.

A committee representing the three European Supervisory Authorities for the financial sector⁴ will publish Regulatory Technical Standards for these disclosures. An understanding of the requirements can already be obtained through the consultation paper that entails details with regards to the content, methodology and presentation of disclosures.

On the next page we summarized the timeline of anticipated requirements in figure 3, for companies in and outside of the financial sector respectively.

² Source: Financing Sustainable Growth Factsheet, European Commission (June 2019)

³ EC, 2018, EC Action Plan: Financing Sustainable Growth, https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

⁴ The European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)

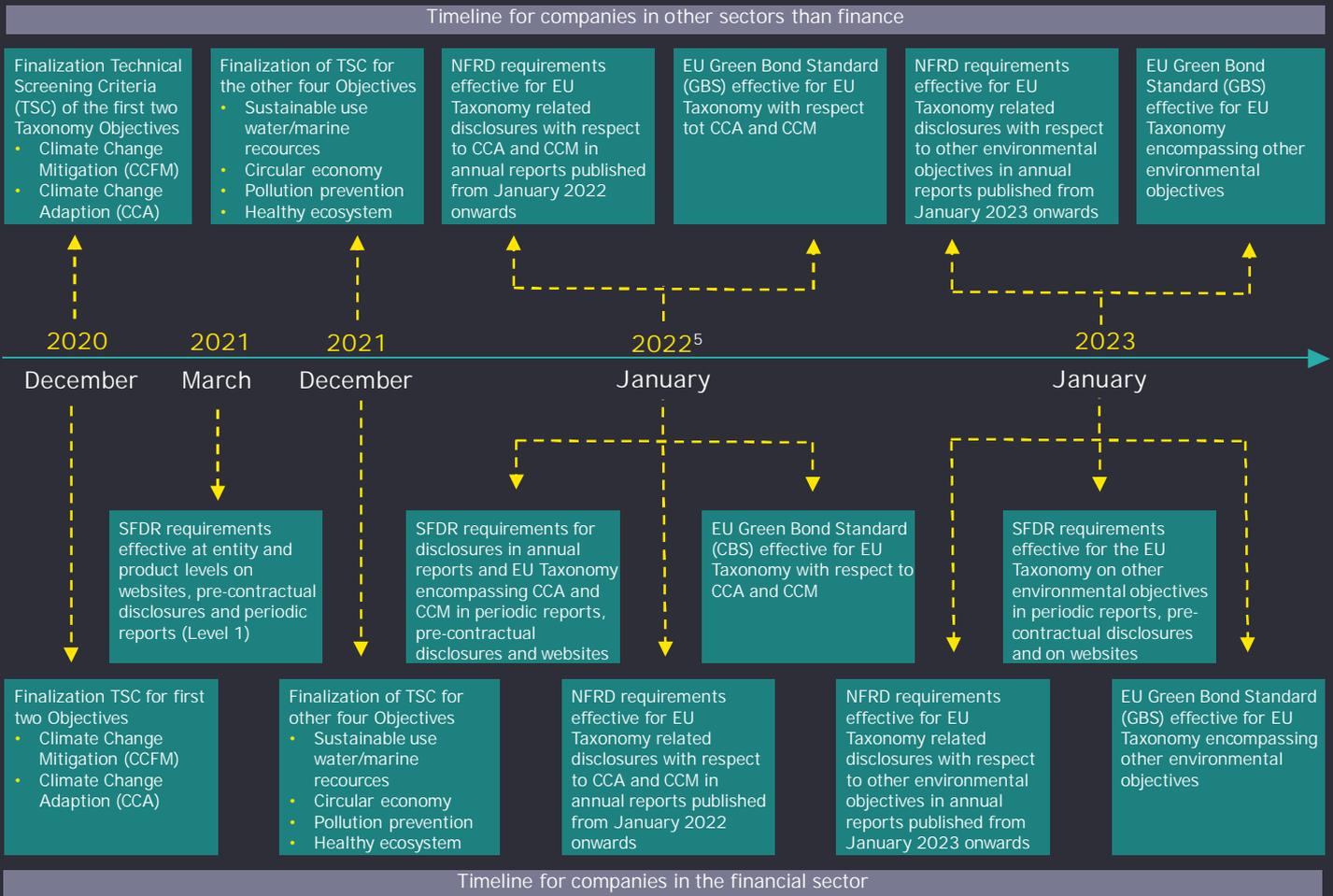


Figure 3. High-level timeline of requirements for companies in and outside of the financial sector

What to do to effectively prepare for the implementation of the Taxonomy

We recommend companies to start assessing their business model and underlying activities' proportion of Taxonomy-aligned turnover, CAPEX and OPEX as soon as possible. Financial market participants will require such data for their investment decisions and disclosures in any case. However, the Taxonomy is not intended to be a mere checklist exercise; instead it is intended as a consistent process to identify and measure against the new TSC and allocate turnover accordingly. In addition, to be able to report reliable Taxonomy-aligned disclosures, new internal controls may

need to be implemented - and even more strategic questions around the future-proofness of one's business model may arise. We therefore recommend companies to start well before the Taxonomy will go into effect.

We suggest the following five-step approach (summarized at a high level in figure 4 below) to support in aligning these legislative requirements with current reporting processes.

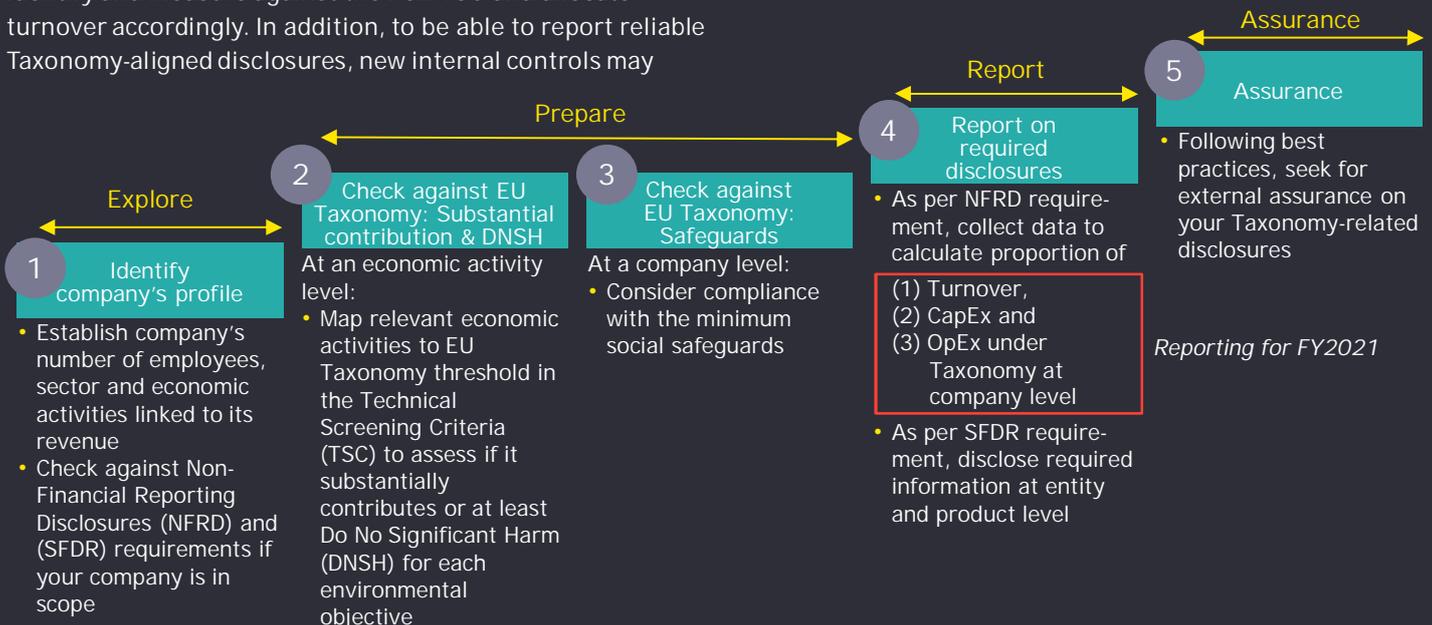


Figure 4. High-level five-step approach to support companies in aligning the Taxonomy-related legislative requirements with current reporting processes

⁵ EU allows its application before the formal adoption of the delegated act anticipated to be on 31 Dec 2020

What is to be expected next ● ● ● ● ●

In addition to the further development of the other nine areas in the EC Action Plan of Financing Sustainable Growth, guidance on activities that contribute to other sustainability objectives (including social aspects) are likely to be established in the coming years. The EC will make announcements on this potential extension of the scope of the Taxonomy Regulation by 31 December 2021. We also anticipate an expansion of the sectors and economic activities in scope of the Taxonomy.

We anticipate further legislation to enhance the quality of Taxonomy-related disclosures. Currently the NFRD only requires that (financial statement) auditors check whether the non-financial information has been provided (with an option for member states to expanding this to require assurance). The 2020 consultation feedback on the NFRD demonstrates a need for assurance and the EC may very well take this into account when revising the NFRD in 2021. Similarly, assurance requirements under the SFDR may be reviewed by 2022. Overall, it is considered lead practice to enhance the quality of disclosures year-on-year and seek independent external assurance where needed, and requirements to this extent are certainly to be expected and prepared for.

While the current focus is on the disclosure obligations created through the Regulation, the Taxonomy will have wider applications that may not all be apparent yet. The Taxonomy will not only impact the companies that are in scope, but its key stakeholders in the reporting chain and wider economy as well. As a minimum, the Taxonomy has already proven to be a wake-up call for the further harmonization of standards throughout companies' investment cycles in and beyond reporting. Since changes in a Regulation, Directive or Delegated Act can be made up to the final publication date, we advise companies to continue to keep abreast of these developments.

Questions on the Taxonomy and how we can support your organization ● ● ● ● ●

Questions may arise as you are looking to understand the implications of the Taxonomy and related regulatory developments, especially since several key elements are yet to be finalized through delegated acts and other measures. We would be glad to support you on this journey, for example in assessing the applicability of the Taxonomy to your company, identifying the required disclosures, assessing your current performance against Taxonomy criteria, designing and implementing appropriate reporting procedures to ensure high quality reporting, as well as providing external assurance on these Taxonomy-related disclosures. In any case, feel free to reach out to our team members for any questions related to the Taxonomy, as we work with many companies on these topics every day in finance and other sectors, and would be glad to assist you.

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