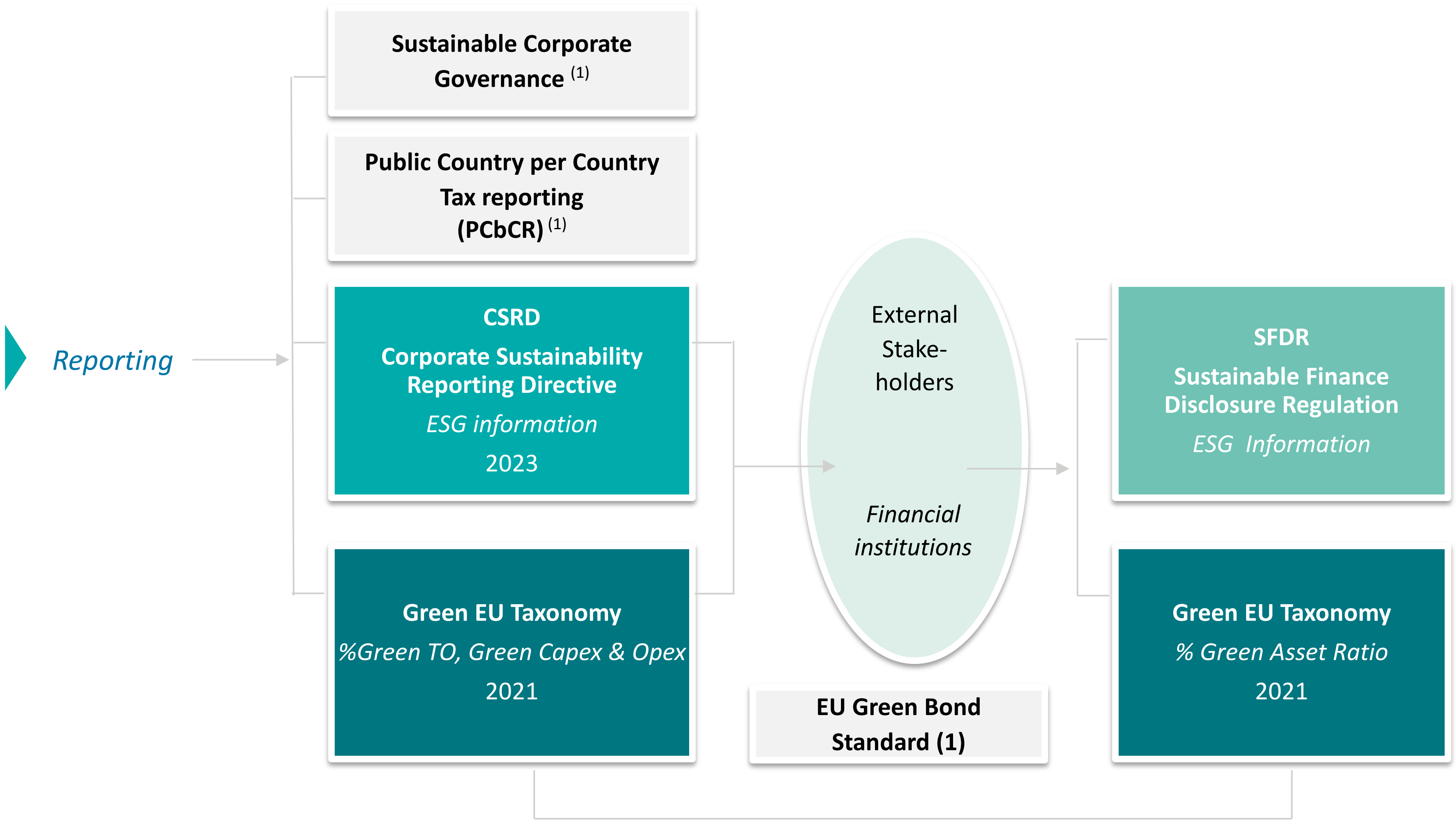
EU Taxonomy in practice

Introduction to the requirements

Anne Randmæl Jones, 17 September 2021

The three pillars of the EU sustainable finance strategy: promoting transparency and reorienting flows towards sustainable investments in the wake of the EU Green Deal and Paris agreement

1. Reorient capital flows towards sustainable investments
2. Systematically integrate sustainability into risk management
3. Promote transparency in economic and financial operations by defining what is green through a “common language”



(1) Ongoing projects

A taxonomy system for “green” activities to reorient capital flows towards sustainable investment

First global system for the classification of sustainable economic activities from an environmental perspective

** Quantitative and qualitative criteria defined by the European Commission*

ENVIRONMENTAL OBJECTIVES

- **Mitigation of greenhouse gas emissions** over the entire life cycle
  - ✓ Activities already considered as low-carbon and compatible with the Paris agreement *(e.g. solar power production, low-carbon transport)*
  - ✓ Transitional activities *(best practices available in sectors unable to achieve zero carbon, such as the steel industry)*
  - ✓ Enabling activities *(sectors which enable the development of zero carbon activities, e.g. manufacture of wind farms)*
- **Climate change adaptation** (reduction of the current or future negative impact of climate change on people, nature and economic activities)
- **Sustainable use and protection of water** and marine resources
- **Transition to a circular economy** (waste prevention and use of secondary raw materials)
- **Pollution prevention and control**
- **Protection and restoration of biodiversity and ecosystems**

What the EU taxonomy IS:

- A list of economic activities and relevant criteria
- Flexible to adapt to different investment styles and strategies
- Based on latest scientific and industry experience
- Dynamic, responding to changes in technology, science, new activities and data

What the EU taxonomy IS NOT:

- A rating of good or bad companies
- A mandatory list to invest in
- Making a judgement on the financial performance of an investment – only the environmental performance

A challenging process in progress requiring to shift from theory to practice

ACTORS IN THE TRANSITION

EU & Member States

- Bedrock of current and future EU policies supporting sustainable finance, such as standards and labels for green financial products *(e.g. the EU Green Bond Standard and EU Ecolabel for financial products)*

Companies

- Applicable to large companies which are required to publish a Non Financial Statement (about 12,000 in Europe)
- Disclosure of the proportion of turnover, CapEx and OpEx aligned with the taxonomy in the non-financial statement (in line with the CSRD)

Investors

(insurance firms, pension funds, asset managers)

- Definition of products that have sustainable investment as their objective or which promote environmental objectives
- Disclosure of the proportion of underlying investments that are taxonomy eligible (all products)

KEY DATES

Link here

March 2020

June 2020: Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020

Link here

October 2020: Platform on Sustainable Finance, an advisory body subject to the Commission's horizontal rules for expert groups

June 2021: Climate delegated act acts on the first two sets of environmental criteria (climate change adptation and mitigation) (4 June 2021)

Link here

July 2021: Delegated act (Article 8) specifying the information to be disclosed by companies subject to the NFRD (6 July 2021)

August 2021: Draft delegated acts specifying the 4 Environmental objectives + delegated acts regarding natural gas agriculture and nuclear energy + social Taxonomy features (3 August 2021)

Link here

From 2022: First company reports and investor disclosures covering FY 2021

(Climate objectives & transition period)

From 2023: Company reports covering FY 2022

(All objectives, full disclosures, unless delay on environmental objectives)

Platform on Sustainable Finance being set up to regularly update the taxonomy and technical criteria

Publication in 2022 of financial KPIs for these “green” activities in the 2021 NFPS

ESMA final report, Advice on Article 8 of the Taxonomy Regulation of February 26, 2021


Final Report
Advice on Article 8 of the Taxonomy Regulation
26 February 2021 | ESMA30-379-471

How it works in practice?

- Gap analysis between commonly used financial KPIs and the EU Taxonomy article 8 definitions
- Analysis and preparation of charts of accounts and systems

% “green” turnover

Turnover satisfying green activity criteria

Total turnover

- **Net turnover** according to Article 2(5) of the Accounting Directive, applying IFRS (Revenue according to IAS 1 §82(a)) or national GAAP when applied by non-financial undertakings with an objective of direct reconciliation with P&L
- **Same scope between financial and non-financial** (e.g. Treatments for Associates and JV should follow IAS 28 and IFRS 11 financial rules)
- Turnover from **climate adaptation** activities where the activity **enables** other activities to undergo climate change (article 11 1(b)) → clarification expected

% “green” capex

Capex on assets and processes relating to green activities

Total Capex

- CapEx defined as (i) **additions to tangible and intangible assets during the financial year before any remeasurements (including revaluations and impairments), depreciation and amortisation charges for the year and excluding fair value changes** and (ii) additions **resulting from acquisitions through business combinations.** (narrowed down to cash effects to ease reconciliation with APMs and cash-flow statement)
- Inclusion of Capex for **investment property** (IAS 40), **biological assets** (IAS 41) and **additions to right-of-use assets** (IFRS 16).
- Approved and published **capex plan** towards taxonomy-alignment in a defined timeframe (e.g. 5 years), approved at the right governance level

% “green” opex

Opex on assets and processes relating to green activities

Total Opex

- OpEx defined as the **research and development, building renovation measures, short-term leases, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of items of property plant and equipment that are necessary to ensure the continued and effective functioning of such assets** → narrow meaning reflecting costs complementing capex.
- **Inclusion of lease costs for non-financial undertakings applying national GAAP** and not capitalising right-of-use assets
- Exclusion of general staff costs, depreciation & amortization. Virtually no reconciliation to APMs possible
- **Direct costs only**

Comprehensive disclosure information required: mandatory detailed standardised content tables with breakdowns by activity, by environmental objectives, by transitional and enabling activities, Y-1 comparison, methodology note, context and changes. Limited number of disclosures for Year 1

Challenges facing European companies today around new reporting requirements

Challenges

Understand Taxonomy and CSRD basics and address upcoming regulatory changes expected in 2021 (climate) and 2022 (circular economy, biodiversity etc.)

Consolidate reliable **non-financial** information by business/project/geography to **identify "green" activites**

Consolidate reliable **financial information** by business/activity/ project to **assess "green " activities**

Meet **expectations of investors and stakeholders** and provide **comparable, reliable and relevant information**

Priorities for companies

1. **Follow discussions** and **share best practices** at industry level and at EU level to better **understand if your activities are eligible and aligned**

2. **Internally mobilise a muliti-disciplinary taskforce** composed of sustainability, accounting/financial and operational teams to start asking questions and finding answers

3. **Adapt or build internal data and control systems** to trace "green" turnover, Capex and Opex per activity, project or geography

4. **Organise and deploy efficient and effective internal processes** for short-term and longer-term reporting, meeting the requirements of the CSRD, including preparing for assurance

Impacts that can be anticipated

Four steps to get prepared

1

Map “green” activities defined by European regulations and “delegated acts”

- Reference the Statistical Classification of Economic Activities in the EU, referred to as **NACE**
- Screening of all **eligible activities** using the technical environmental criteria to determine **qualifying activities**
- Split of activities where relevant

2

Adapt information systems to gather data on green activities

- Traceability of turnover, OpEx and CapEx relating to “green” activities
- Performance of activities vis-a-vis imposed environmental technical screening criteria
- Data on social policy at entity/group level

3

Define financial KPIs for these green activities

- Documentation of the calculation methodology, controls and traceability
- Reconciliation with financial data (including scope of consolidation)

4

Disclose information in the 2021 Non-Financial Statement

- Scope of information
- No PY figures required in the first-year report
- Assurance required according to the Member State option for non-financial statements

Deloitte.