

Regulation (EU) 2020/852 on EU Sustainable Finance Taxonomy

An Overview

January 2022

Why was the EU taxonomy created?

By passing the Green Deal in 2019, the European Union (EU) set the course for more sustainable investments, for example in areas like renewable energy, biodiversity or circular economy. The goal is to reach a climate-neutral economy in the EU by 2050, with a reduction of 55% already implemented in 2030. To achieve these climate goals, the Green Deal includes an investment plan of 1 trillion euros over the next 10 years. Despite this huge investment, the EU depends also on the support of the private sector to achieve the Paris climate agreement.

The EU Taxonomy regulation and the Sustainable Finance Disclosure Regulation (SFDR) are implemented to ensure equal competition and legal certainty for all companies operating within the EU.

Both regulations follow the objective of the Green Deal and have the following key goals:



EU Sustainable Finance Taxonomy

What exactly is the EU taxonomy?

The EU taxonomy regulation describes a framework to classify “green” or “sustainable” economic activities executed in the EU. Previously, there was no clear definition of green, sustainable or environmentally friendly economic activity.

The EU taxonomy regulation creates a clear framework for the concept of sustainability, exactly defining when a company or enterprise is operating sustainably or environmentally friendly.

Compared to their competitors, these companies stand out positively and thus should benefit from higher investments.

Thereby, the legislation aims to reward and promote environmentally friendly business practices and technologies. The focus lays on the following six environmental objectives.

The Taxonomy Regulation establishes six environmental objectives

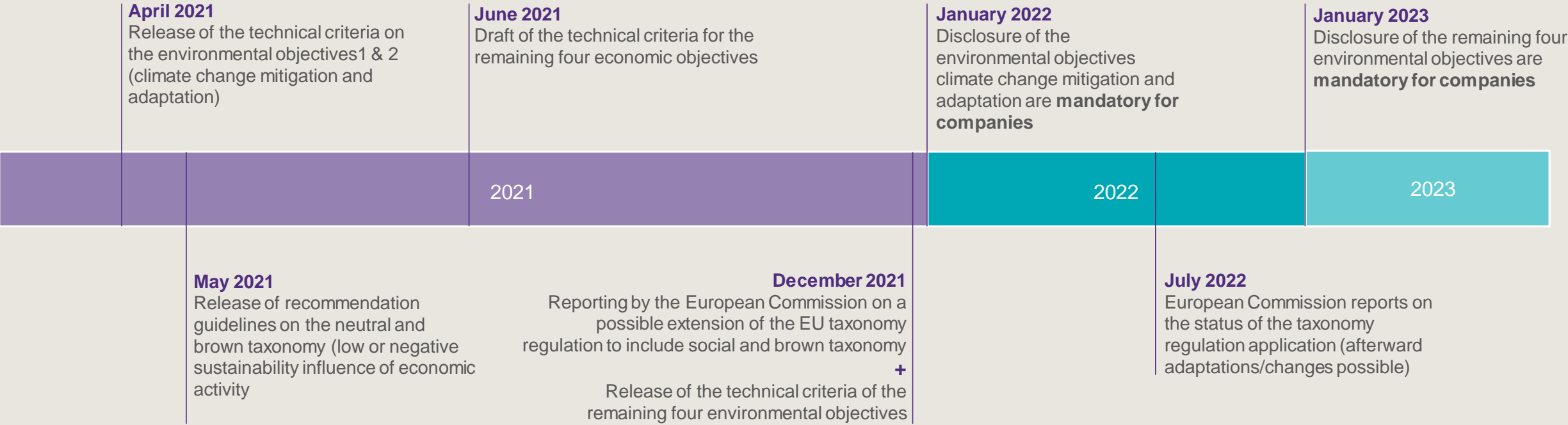
1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy, waste prevention and recycling
5. Pollution prevention and control
6. Protection of healthy ecosystems

EU Taxonomy

Timeline

The EU Taxonomy classification system was published in June 2020 and entered into force in July 2020. The key milestones of the EU Taxonomy’s timeline are presented below:

EU Taxonomy timeline and milestones



EU Taxonomy

Who is affected

The taxonomy report states **three different groups of users** for whom it will be mandatory to comply with the taxonomy regulation.

The groups are as follows:

- **Large companies with over 500 employees** that are already required to report non-financial information under the scope of the Non-Financial Reporting Directive (NFRD)
- The **EU and Member States** when setting public measures, standards or labels for green financial products or green bonds
- **Financial market participants** that offer financial products in the EU

The Taxonomy can be used on a voluntary basis by **credit institutions and other issuers**, such as local authorities.

EU Taxonomy

Timeline

Timeline for release & application of the 6 environmental objectives of the Taxonomy

The Taxonomy Regulation contemplates a phased implementation, with certain rules applying from different dates:

- from 1 January 2022:
Objectives 1 & 2 (climate change mitigation and adaptation)
- from 1 January 2023:
Objectives 3, 4, 5 & 6 (the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystem)

| Environmental objectives | Release date by the EU | Mandatory application date |
|--|------------------------|----------------------------|
| 1. Climate change mitigation | April 2021 | January 2022 |
| 2. Climate change adaptation | April 2021 | January 2022 |
| 3. Sustainable use and protection of water and marine resources | December 2021 | January 2023 |
| 4. Transition to a circular economy | December 2021 | January 2023 |
| 5. Pollution prevention and control | December 2021 | January 2023 |
| 6. The protection and restoration of biodiversity and ecosystems | December 2021 | January 2023 |

EU Taxonomy

Who is affected

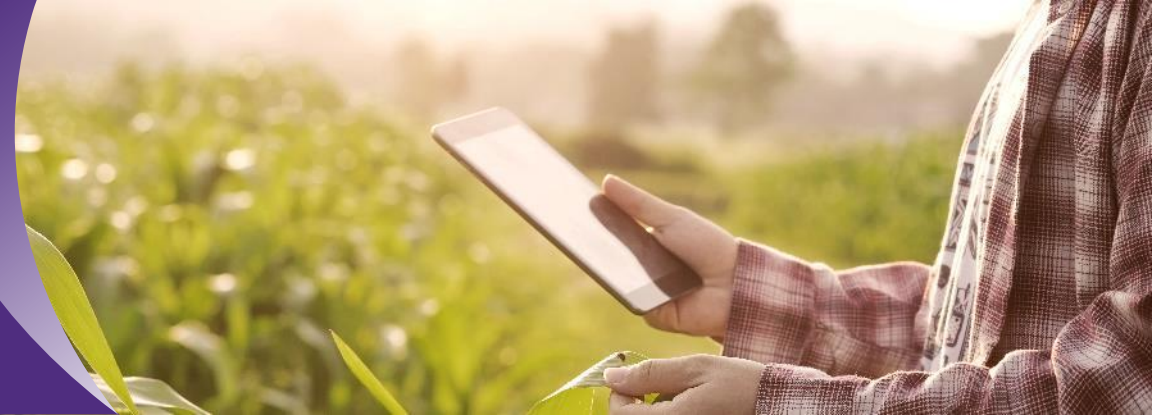
- The requirements for financial market participants and companies that do not offer financial products differ
- Some companies/financial market participants may fall into both categories (depending on size and economic activity)
- All companies concerned must disclose how and to what extent their economic activity considers or includes sustainability based on the taxonomy regulation.

Companies must disclose the following:

- EU taxonomy-compliant share of turnover
- Capital expenditure (CapEx) aligned with the EU taxonomy
- Operating expenses (OpEx) aligned with the EU taxonomy
- Disclosure should be part of non-financial reporting, probably in the annual report or an explicit sustainability report

EU Taxonomy Regulation

Criteria



In order to be classified as a **sustainable economic activity according to the EU taxonomy regulation**, a company must not only contribute to at least one environmental objective but also must not violate the remaining ones*. The classification of an economic activity in terms of sustainability is based on the following four criteria, which base on the previously mentioned environmental objectives:

1

The economic activity **contributes substantially** to one or more of the six environmental objectives

+

2

The economic activity **does not significantly harm** any of the six environmental objectives

+

3

The economic activity complies with the **minimum safeguards** (set out in Article 18 of the Taxonomy Regulation)

+

4

The economic activity complies with the **Technical Screening Criteria ("TSC")**

*An activity aiming to mitigate the climate but at the same time also negatively affecting biodiversity **cannot be classified as sustainable**.

EU Taxonomy

Technical Screening Criteria

The Technical Screening Criteria (the “TSC”) are uniform criteria which will be used to determine **whether economic activities “contribute substantially” to each environmental objective**, and therefore can be considered sustainable. The TSC will also determine whether any of those economic activities **cause significant harm to any of the other environmental objectives**.

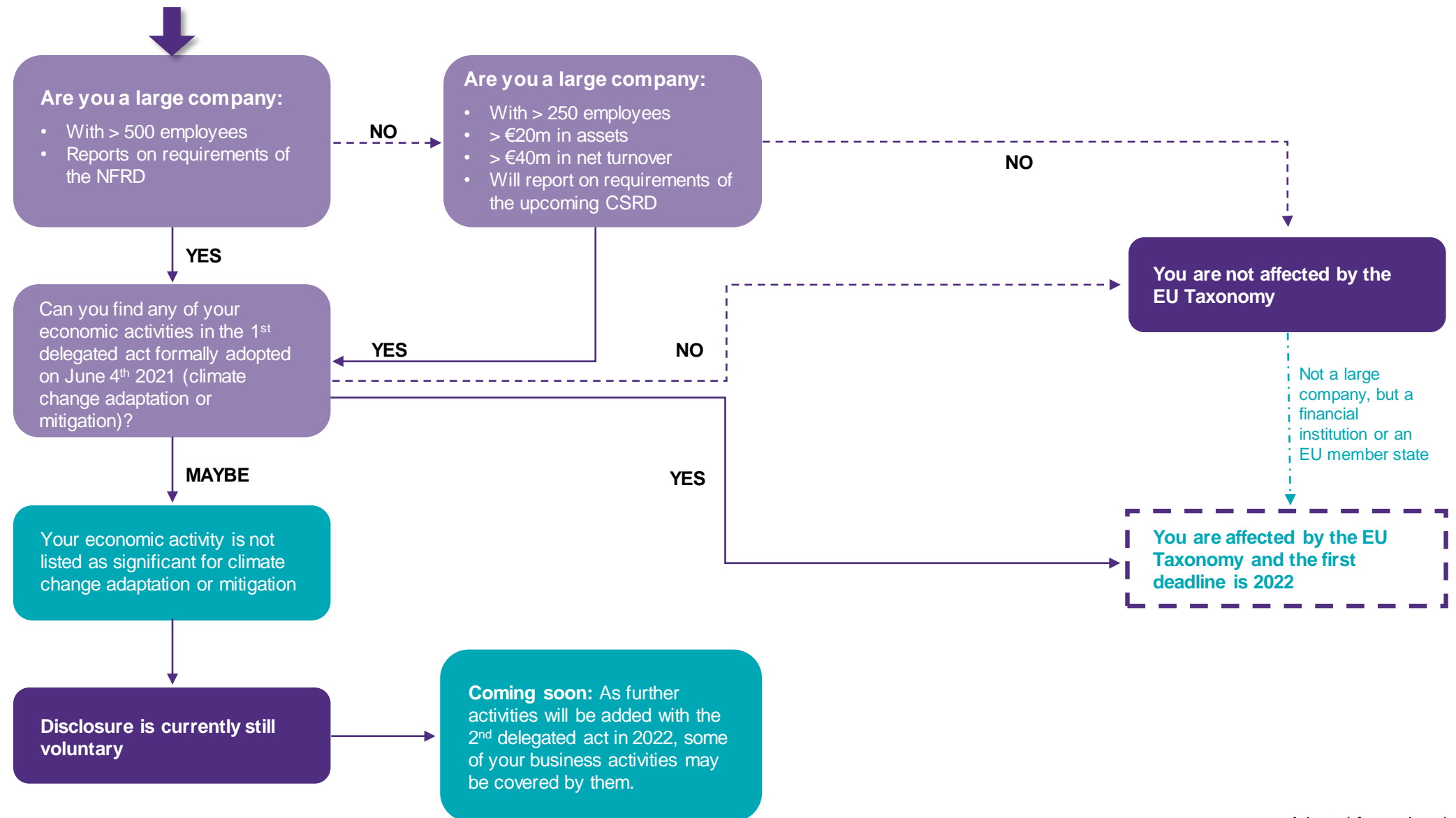
The draft TSC cover the following 13 sectors:

1. Agriculture and forestry;
2. Environmental protection and restoration activities;
3. Manufacturing;
4. Energy;
5. Water supply, sewerage, waste management and remediation activities;
6. Transport (including maritime);
7. Construction and real estate;
8. Information and communication;
9. Professional scientific and technical activities;
10. Financial and insurance activities;
11. Education;
12. Human health and social work activities; and
13. Arts, entertainment and recreation.

EU Taxonomy

Assessment procedure

The following graph helps identify **whether your organization is affected by the EU Taxonomy.**



Adapted from .planetly

EU Taxonomy

Disclosure obligations & alignment with the Sustainable Finance Framework (i.e. SFDR, CSRD)



Financial market participants

- **Reporting in line with the SFDR (Sustainable Finance Disclosure Regulation):**
 - Products with 'sustainable investment' objective, i.e. Activities aligned with the Taxonomy, as included in the definition of 'sustainable investment' (investment contributing to an environmental or social objective)
- The **first set of disclosures** (activities that substantially contribute to climate change mitigation and/or adaptation) are **due by 31 December 2021**.
- An **expanded set of disclosures** (activities that substantially contribute to all 6 environmental objectives) are **due by the end of 2022**.

Large companies

- **Reporting in line with the CSRD (Corporate Sustainability Reporting Directive):**
 - Companies to report the % of their current revenues coming from activities aligned with the Taxonomy and % of their future revenues (capital expenditure) coming from activities aligned with the Taxonomy
- The **first set of disclosures** (activities that substantially contribute to climate change mitigation and/or adaptation) will **be due in the course of 2022**, covering the financial year 2021.
- An **expanded set of disclosures** (activities that substantially contribute to all 6 environmental objectives) are **due in the course of 2023**, covering the financial year 2022.

How we may support

Our proposition for the EU Taxonomy transition



We support our clients to “go beyond” their compliance with the EU taxonomy



As the EU Taxonomy is still on a voluntary basis, we encourage and support our clients to early adopt the upcoming EU regulation and to gain benefits upfront.

The transition to the EU Taxonomy rules is not an easy exercise since it affects the financial and many business units or operational activities of an organization.

Our aim is to support our clients to achieve a smoothly transition and to apply the EU taxonomy rules starting from the Financial Statements disclosures of the year 2021.

Our methodology approach for the first year of the EU taxonomy adoption pertains the below key phases:

Identify the economic activities conducted by the company (e.g., power generation, energy intensive manufacturing or energy storage) that are capable of being aligned, as identified in the Taxonomy's technical screening criteria.

Break down those activities by turnover and, if relevant, capital expenditure and operating expenditure

Test for alignment based on the Technical Screening Criteria (TSC) and DNSH criteria, and compliance with minimum social safeguards

Prepare or review the respective non financial disclosures that will be included in the year's 2021 Financial Statement disclosures

EU Taxonomy transition approach

Assessing alignment with the EU Taxonomy

Phase 1

Identify the economic activities conducted by the company (e.g., power generation, energy intensive manufacturing or energy storage) that are capable of being aligned, as identified in the Taxonomy's technical screening criteria

- The Taxonomy sets performance thresholds for economic activities that make a substantive contribution to one of six key environmental objectives, do not negatively affect the other five and meet minimum safeguards. (EU 2020/852, Article 3)
- The six objectives are: (1) **climate change mitigation**, (2) **climate change adaptation**, (3) sustainable and protection of water and marine resources, (4) transition to a circular economy, (5) pollution prevention and control, and (6) protection and restoration of biodiversity and ecosystems. (EU 2020/852, Article 9)
- To date, the Taxonomy considers economic activities that contribute to climate change mitigation and/or adaptation objectives by outlining **67 business activities** that are linked to **seven NACE macro sectors**.

Illustration showing economic activities contributing to objectives 1 & 2

| Classification | | Environmental Contributions | | | | | | | |
|-----------------------------------|--|---|---------------------|-------------------------|-------------------------------------|-----------------|----------------------------|---------------------|----------------------|
| NACE Macro-sector | NACE Activity | 1. Climate change mitigation (Substantial Contribution) | | | 2. Climate change adaptation (DNSH) | 3. Water (DNSH) | 4. Circular economy (DNSH) | 5. Pollution (DNSH) | 6. Ecosystems (DNSH) |
| | | Own performance | Enabling activities | Transitional activities | | | | | |
| Agriculture, Forestry and Fishing | Afforestation | ✓ | | | ✓ | ✓ | | ✓ | ✓ |
| | Rehabilitation, Reforestation | ✓ | | | ✓ | ✓ | | ✓ | ✓ |
| | Reforestation | ✓ | | | ✓ | ✓ | | ✓ | ✓ |
| | Existing forest management | ✓ | | | ✓ | ✓ | | ✓ | ✓ |
| | Conservation forest | ✓ | | | ✓ | ✓ | | ✓ | ✓ |
| | Growing of perennial crops | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| | Growing of non-perennial crops | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| | Livestock production | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Manufacturing and construction | Manufacture of low carbon technologies | | ✓ | | ✓ | ✓ | ✓ | ✓ | ✓ |

EU Taxonomy transition approach

Assessing alignment with the EU Taxonomy

Phase 2

Break down those activities by turnover and, if relevant, capital expenditure and operating expenditure

- The EU recommends including all capital expenditures (CapEx) and selected operating expenses (OpEx), such as maintenance costs for green assets that either increase the life or value of the assets, as well as research and development costs. Operating costs, such as acquisition costs and leasing costs are normally (with some exceptions) not taxonomy compliant
- **For the two environmental objectives already published, investments are accounted differently**, as shown below. The next detailed explanation by the EU will reveal how investments are accounted for in relation to the remaining four environmental objectives.



| Finances | Climate change mitigation | Climate change adaptation |
|----------------|---|--|
| Turnover | Can be counted where economic activity meets taxonomy criteria for substantial contribution to climate change mitigation and does no serious harm to the other environmental objectives (DNSH criteria) | Turnover can be recognised only for activities enabling adaptation but not for already adapted activities |
| CapEx and OpEx | Can be counted where costs incurred (CapEx and OpEx) are part of a plan to meet taxonomy criteria for substantial contribution to climate change mitigation and relevant DNSH criteria | Can be counted where costs incurred (CapEx and OpEx) are part of a plan to meet taxonomy criteria for substantial contribution to climate change adaptation and relevant DNSH criteria |

EU Taxonomy transition approach

Assessing alignment with the EU Taxonomy

Phase 3

Test for alignment based on the Technical Screening Criteria (TSC) and DNSH criteria, and compliance with minimum social safeguards

- For each potentially aligned activity, **verify whether the company meets the relevant technical screening criteria (TSC)** – e.g., carbon emissions for electricity generation are less than 100 g CO₂e/kWh.
- Verify that the “do no significant harm” (DNSH) criteria** are met by the company. Investors using the Taxonomy would most likely use a due-diligence like process for reviewing the performance of underlying investees. (EU 2020/852, Article 17)
- Conduct due diligence to avoid any breach of the minimum social safeguards specified in the Taxonomy Regulation:** The European Parliament and the Council established that for an economic activity to be Taxonomy-aligned, the activity should be carried out “in alignment with the **OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights**, including the International Labour Organisation’s (**‘ILO’**) **declaration on Fundamental Rights and Principles at Work**, the eight ILO core conventions and the International Bill of Human Rights”. (EU 2020/852, Article 18)

PART F: Technical screening criteria

18. List of activities with technical screening criteria

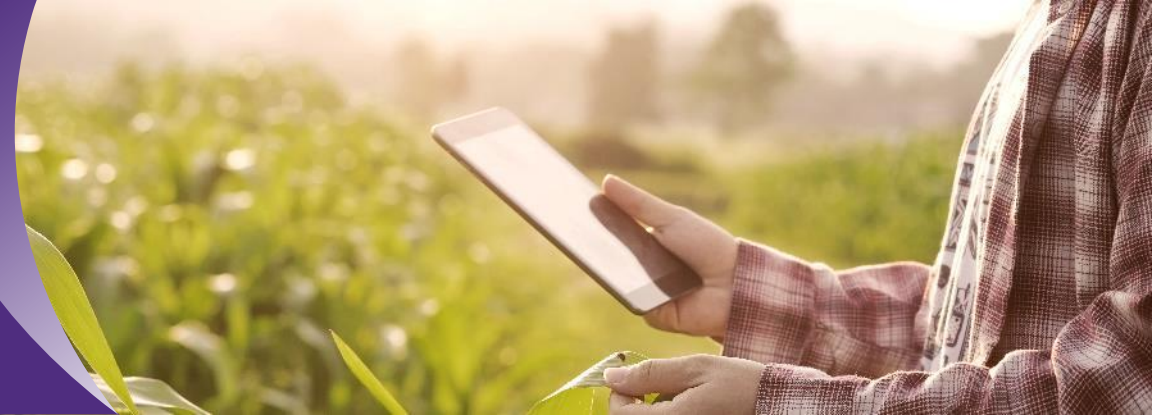
18.1 Summary: climate change mitigation

Technical screening criteria for a substantial contribution to climate change mitigation have been developed for the following activities:

| NACE Macro-sector | Activities |
|---|---|
| Agriculture, forestry and fishing | Growing of perennial crops |
| | Growing of non-perennial crops |
| | Livestock production |
| | Afforestation |
| | Rehabilitation, Restoration |
| | Reforestation |
| | Existing forest management |
| Manufacturing | Manufacture of Low carbon technologies |
| | Manufacture of Cement |
| | Manufacture of Aluminium |
| | Manufacture of Iron and Steel |
| | Manufacture of Hydrogen |
| | Manufacture of other inorganic basic chemicals |
| | Manufacture of other organic basic chemicals |
| | Manufacture of fertilizers and nitrogen compounds |
| Electricity, gas, steam and air conditioning supply | Manufacture of plastics in primary form |
| | Production of Electricity from Solar PV |
| | Production of Electricity from Concentrated Solar Power |
| | Production of Electricity from Wind Power |
| | Production of Electricity from Ocean Energy |
| | Production of Electricity from Hydropower |

EU Taxonomy transition approach

Assessing alignment with the EU Taxonomy



Phase 4

Prepare or review the respective non financial disclosures that will be included in the year's 2021 Financial Statement disclosure's

Under the EU Taxonomy Regulation, companies are required to use specific reporting guidelines and KPIs in order to communicate their sustainability performance and EU Taxonomy alignment to their stakeholders.

We fully support our clients on what to report on and how, ensuring the high quality of their respective disclosures.

Our Approach

- EU taxonomy training / Management awareness sessions
- Data collection and analysis
- Workshops with Management
- KPI's development and estimation
- Text and graphs drafting
- Communication plan preparation

At the first year of transition, the disclosures and KPIs will refer to the climate change mitigation and adaptation, and from the second year and afterwards, the disclosures and KPIs will refer to all six EU Taxonomy objectives.

**For more information
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with our highly
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