EU Taxonomy

The green taxonomy is considered the backbone of the European Commission’s green finance package. The taxonomy offers a robust scheme for identifying and classifying investment opportunities, ensuring investors can ‘reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth’.
The EU Taxonomy, the foundational piece from the action plan on financing sustainable growth, is a classification tool to help investors and companies consistently determine whether an economic activity is environmentally sustainable or not. It provides specific, quantitative thresholds on environmental performance for economic activities to be considered compliant with what the EU considers as environmentally sustainable.

**The EU Taxonomy for sustainable activities is based on 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

By considering the six objectives above, the EU Taxonomy has been created to help ‘investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy’.

Under EU Taxonomy, investments marketed as financing the transition to climate mitigation objectives will require a description or explanation in terms of the Taxonomy criteria.
Who is affected by the EU Taxonomy

From the end of 2021, EU financial institutions have been required to report alignment of their portfolios with the Taxonomy.

There is a need to report “as reported” data but corporates are not all required to report this data, therefore regulation is allowing the use of derived data. Hence, investors can use sound estimates that are based on equivalent metrics reported by the corporates. Financial institutions are also expected to actively engage with the companies in their portfolios, to obtain as much relevant and required information about their alignment with the EU Taxonomy as possible.

Companies in scope of the Non-Financial Reporting Directive are required to report on the activities (portion of revenues, capital expenditures and operational expenditures where relevant) that are aligned to the EU Taxonomy. The focus is on shifting financial flows towards a sustainable economy, which will have major implications for many sectors, not only the financial industry. The expectation is that this will greatly accelerate the transition to sustainable economic and social growth in the future.
How can LSEG help?

LSEG is helping market participants fulfil their compliance obligation and evaluate their portfolio against the Taxonomy.

The data

Underpinning our EU Taxonomy solution is a combination of LSEG and FTSE Russell data.

The FTSE Russell Green Revenues data model is applied to nearly 99% of total global market capitalisation and is a taxonomy used to define and measure the industrial transition to a green economy. The model comprehensively assesses all companies with revenue exposure to green business activities and is the starting point for our EU Taxonomy solution.

The LSEG Business Classifications data is the most comprehensive, detailed and up-to-date sector and industry classification available, covering 250,000 securities in 130 countries to five levels of granularity. The data is important in the EU Taxonomy solution as it is mapped to NACE codes allowing us to translate the business classification back to the taxonomy.

LSEG Fundamentals data is our most comprehensive, accurate and timely Fundamentals offering. The data covers active and inactive companies traded in over 120 countries.

LSEG ESG data is designed to help you make sound, sustainable investment decisions, covering 85% of global market capitalisation across over 630 metrics. Several of these measures are used within our solution, around emissions and a substantial number of controversy-type indicators, for the Do No Significant Harm (DNSH) and Minimum Social Safeguards aspects of the EU Taxonomy.

Our EU Taxonomy data solution utilises equivalent information including “as reported” company data, derived data, and fully transparent estimations.
The solution

With our EU Taxonomy data, we allow financial market participants to identify and report on the percentage of their portfolios that is eligible or aligned to the EU Taxonomy objectives, and therefore identify exposure to climate transition risks and opportunities for investment in companies undertaking green activities.
The first step in providing a data set to help you align with the Taxonomy is to calculate how much revenues of a company is classified as ‘green’. We use FTSE Russell Green Revenues data, which covers 18,000 companies, to make this assessment. If Green Revenues data is not available for a company, we use LSEG Business Classifications and LSEG Fundamentals data to assess the percentage of company’s revenues classified as green.

Once all eligible revenue is identified it is then tested, and our technical screening criteria is applied to verify substantial contribution to two of the six objectives: climate change mitigation and adaption.

We then calculate how much revenue is aligned with Do No Significant Harm (DNSH) guidance, by assessing the revenue against 25 LSEG ESG metrics. Revenue is then assessed for its alignment to Minimum Social Safeguards using LSEG ESG controversies.

The entire process is based on company-reported data, which is auditable and has traceable equivalent information. The output is the proportion of revenues that is aligned to the EU Taxonomy.

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