European Commission

EU Taxonomy and relevance for EU Ecolabel on financial products

Webinar

20 March 2020

Agenda

- Action Plan on Sustainable Finance – context
- Taxonomy – overview and Regulation

1st Q&A (15 min)

- The Sustainable Finance Technical Expert Group (TEG)
  - Taxonomy recommendations
  - Green Bond Standard
- Link between EU Ecolabel and Taxonomy

2nd Q&A (30 min)

Content

Content

1 Action Plan on Sustainable Finance

2 Taxonomy

3 Technical Expert Group

4 Link between Taxonomy and EU Ecolabel

Financing the Green Transition

Ambition

Delivering on the **European Green Deal**, notably reaching climate neutrality by 2050 while ensuring that the transition is just and fair

Large-scale Investment

EU Budget	Commission's target = at least 25% of EU expenditure contributing to climate objectives for the 2021-2027 Multi-Annual Financial Framework
Blended Finance	InvestEU & European Fund for Sustainable Development (EFSD)
Private Finance	**Commission Action Plan on financing Sustainable Growth**

Commission Action Plan on financing sustainable growth

Reorient capital flow towards more sustainable investments

1. Establish a **Taxonomy** of environmentally sustainability activities
2. Create **standards and labels** for green financial products
3. Fostering **investment in sustainable projects**
4. Incorporate **sustainability** in providing investment **advice**
5. Develop sustainability **benchmarks**

Mainstreaming sustainability in risk management

6. Better integrate sustainability in ratings and market research
7. Clarify institutional **investors**' and asset managers' **duties**
8. Incorporate sustainability in **prudential requirements**

Foster transparency & long-termism

9. Strengthen corporate **sustainability disclosure**
10. ↑sustainable **corporate governance** and ↓ short-termism

Action plan on financing sustainable growth -overview

Commission's actions stretch across the whole investment chain

1	**Taxonomy**	Develop an EU classification system for environmentally sustainable economic activities
2	**Standards and labels**	Develop EU standards (such as EU Green Bond Standard) and labels for sustainable financial products (via Ecolabel) to protect integrity and trust of sustainable finance market
3	**Fostering investment in sustainable projects**	Exploring measures to improve the efficiency and impact of instruments aiming at investment support. Mapping on investment gaps and financing.
4	**Incorporating sustainability in financial advice**	Amend MiFID II and IDD delegated acts to ensure that sustainability preferences are taken into account in the suitability assessment.
5	**Developing sustainability benchmarks**	Develop climate benchmarks and ESG disclosures for benchmarks
6	**Sustainability in research and ratings**	Explore how credit rating agencies could more explicitly integrate sustainability in to their assessments. Study on sustainability ratings and research and exploring possible measures to encourage their uptake.
7	**Disclosures by financial market participants**	Enhance transparency to end-investors on how financial market participants consider sustainability
8	**Sustainability in prudential requirements**	Explore the feasibility of reflecting sustainability in prudential rules (where justified from a risk perspective)
9	**Strengthening sustainability disclosures and improving accounting**	Enhance climate and sustainability-related information provided by corporations
10	**Fostering sustainable corporate governance**	Collect evidence of undue short-term pressures from capital markets on corporations and consider steps for promoting corporate governance that is more conducive to sustainable investments.

Content

EU Taxonomy - Overview

Objective

Provide a **classification tool** to help investors and companies to make informed investment decisions on environmentally sustainable activities for the purpose of determining the degree of sustainability of an investment

We need a taxonomy that is **robust, science-based, and ambitious**, in line with our shared environmental objectives, including going towards climate neutrality in line with the Paris agreement

Use: is it obligatory ?

- Obligatory **disclosures** for institutional investors, asset managers and companies covered by the NFRD.
- EU Member States are required to use the EU Taxonomy when creating public labelling schemes for 'green' investment products and corporate bonds

Further voluntary use by a range of actors

What is it?

A list of **economic activities** that are environmentally sustainable.
To be included in the Taxonomy, an economic activity must meet the following conditions:

Substantially Contribute to one objective + Do not significantly harm any of the other 5 obj. + Minimum social* safeguards

Detailed by

\+ Technical Screening Criteria

6 environmental objectives

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use & protection of water
4. Circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

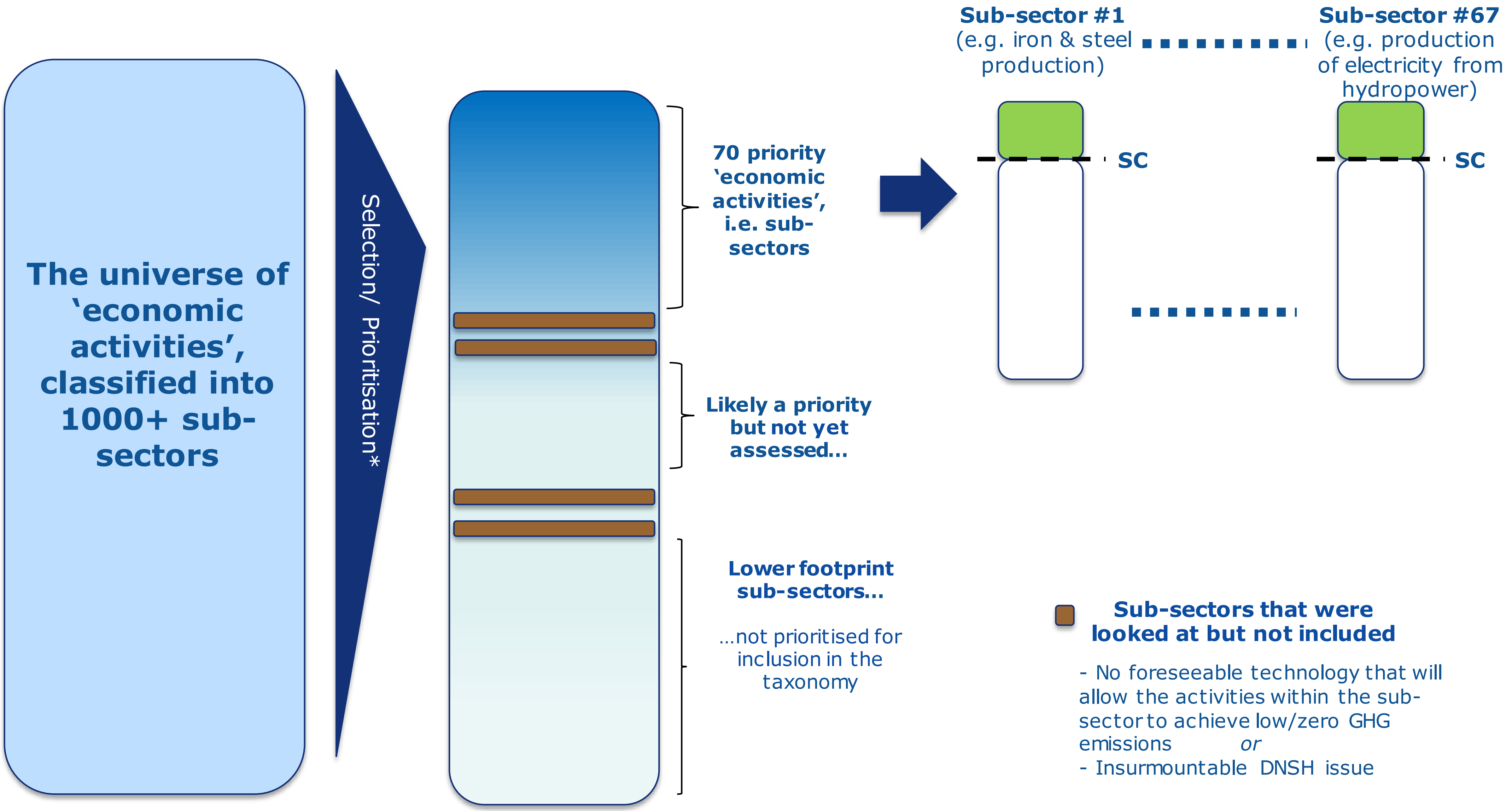
What is it not?

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

* Alignment with OECD Guidelines for MNE, UN Guiding Principles on Business and Human Rights, ILO core labour conventions, International Bill of Human Rights.

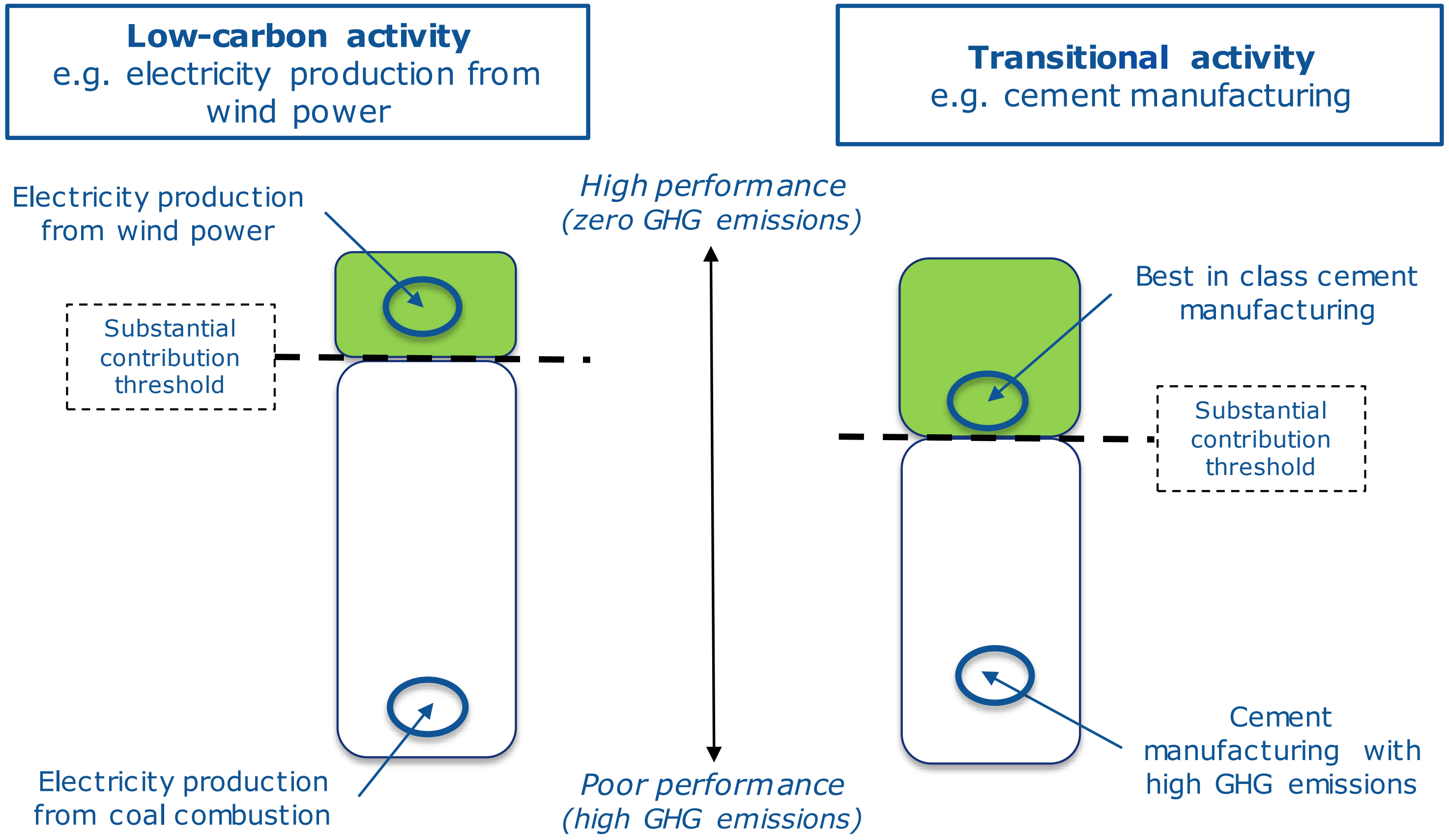
European Commission

Taxonomy design - selection of sectors and setting substantial contribution threshold (climate mitigation)



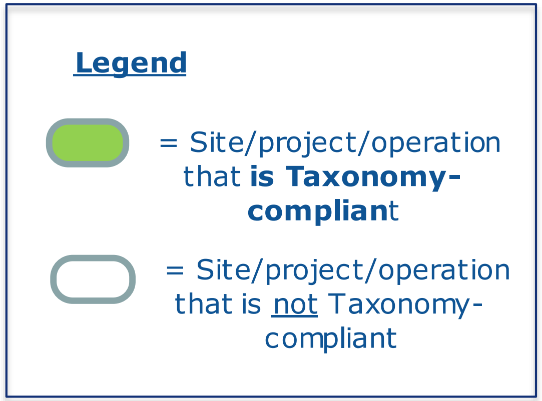
* Prioritisation on the basis of GHG emissions of (sub-) sectors, reduction potential, and/or enabling reductions

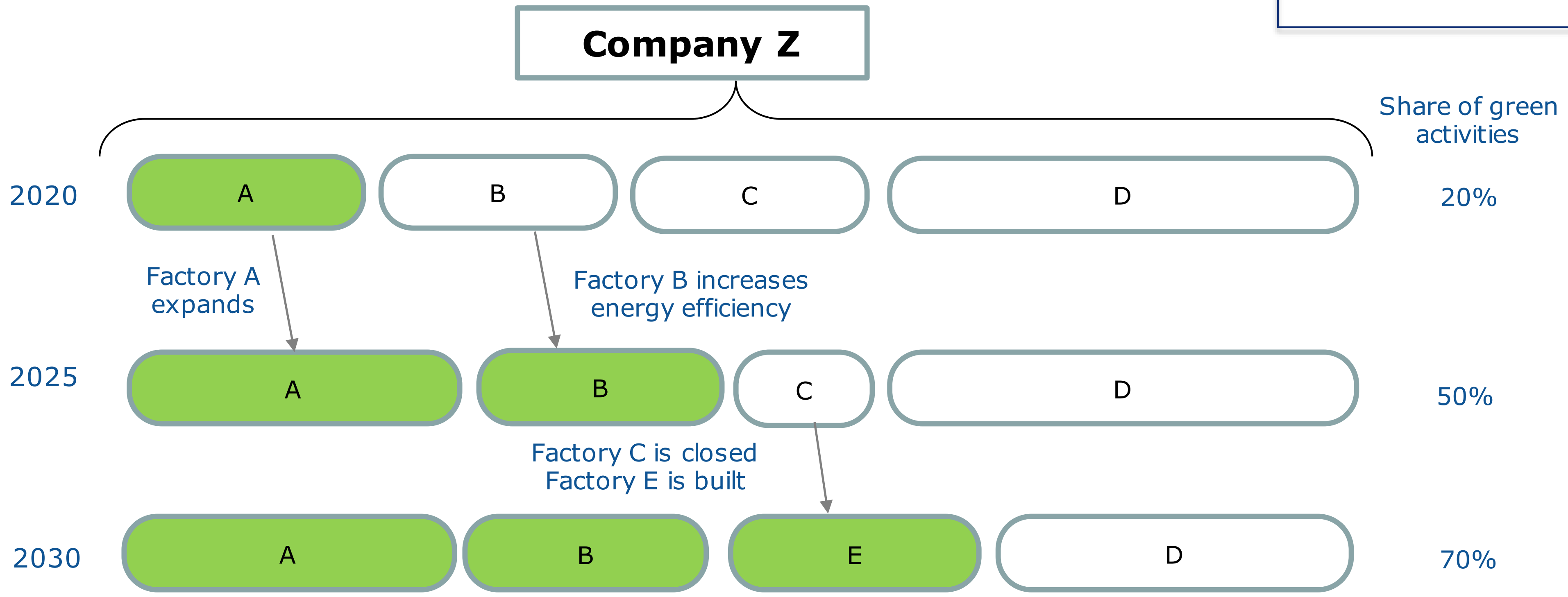
Illustration low-carbon vs transitional activities



How does the Taxonomy enable companies to transition?

- By defining green economic activities, <u>not</u> companies
- The Taxonomy enables companies to transition by gradually increasing their share of green activities





Content

Taxonomy Regulation – Delegated Acts

- The Taxonomy Regulation provides a **framework** for developing the Taxonomy itself (the list of economic activities and corresponding criteria), i.e. the principles, the governance and the disclosure obligation.

- The **Technical Screening Criteria** defining what counts as substantial contribution and DNSH for each activity will be adopted through Delegated Acts ('DAs'):

  - **DA on climate change**
    - Adopted by **31 December 2020** (entry into force one year later)

  - **DA on the other environmental objectives**
    - Adopted by **31 December 2021** (entry into force one year later)

Taxonomy Regulation – Disclosures

Three types of financial products

1. **Art.9 products** (“pursuing environmental objectives”)
2. **Art.8 products** (“pursuing environmental / social characteristics”)

“how and to what extent” the underlying investments support Taxonomy-compliant activities + DNSH (variable scope)

3. **Mainstream products** (i.e. all others)
   - Statement: “The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable investments”.

Disclosure by companies covered by the NFRD

- Taxonomy-aligned activities
  - Proportion of turnover
  - Proportion of CapEx and OpEx

Taxonomy Regulation – enabling activities

Art.11a: "An economic activity shall be considered to contribute substantially to **one or more of the environmental objectives** set out in Article 5

Objectives 1-6

by **directly enabling** other activities to make a substantial contribution to one or more of those objectives,

and where that activity:

(a) does not lead to a **lock-in** in assets that undermine long-term environmental goals, considering the economic lifetime of those assets;

(b) has a substantial **positive environmental impact** on the basis of lifecycle considerations.

Safeguards

Examples from TEG report

Manufacture, sale and installation of highly efficient boilers and micro-renewables.

Taxonomy Regulation - transitional activities

Art.6.1a: "An economic activity for which there is *no technologically and economically feasible low carbon alternative*
shall be considered to contribute substantially to **climate change mitigation** […]

Objective 1 only

where that activity:

(i) has greenhouse gas emission levels that correspond to the **best performance** in the sector or industry;

(ii) does **not hamper** the development and deployment of low-carbon alternatives; and

(iii) does not lead to a **lock-in** in carbon-intensive assets considering the economic lifetime of those assets.

Safeguards

Examples from TEG report

Electricity generation of <100g CO_2/kWh

Cars emitting <50g CO_2/km.

Thresholds will tend to zero over time.

Taxonomy Regulation – Governance

- **Platform on Sustainable Finance**
  - Advises on criteria, among other tasks (Art. 15.2)
  - To be established after formal adoption of Taxonomy Regulation (around Sept 2020)
  - Composition: EEA, ESAs, EIB, EIF, EU Agency for Fundamental Rights + experts representing
    - Private stakeholders (incl. financial and non-financial corporates and industry)
    - Civil society
    - Academia
    - + experts appointed in personal capacity.

- **Member State Expert Group** - role formalised by Taxonomy Regulation

- **Commission adopts Delegated Acts**

Taxonomy Regulation – Fossil fuels, nuclear and incineration

- **Solid fossil fuels –** Explicitly excluded by the text of the Taxonomy Regulation

- **Nuclear**
  - Art.12.d on DNSH: an activity causes significant harm "where the long term disposal of waste may cause significant and long-term harm to the environment"
  - To be assessed at the level of DA – for transition activities, "the Commission shall assess the potential contribution and feasibility of all relevant existing technologies" (art.6.1a).

- **Incineration of waste**
  - Art.12.d on DNSH: "where that activity leads to a significant increase in the generation, incineration or disposal of waste, with the exception of incineration of non-recyclable *hazardous* waste"

1st Q&A

Content

The Technical Expert Group on Sustainable Finance

The TEG assists the Commission in implementing four specific actions.

- Established in June 2018
- Mandate extended until Sept 2020
- 35 experts (17 women) selected from 240 qualified candidates

Working Groups	Mandate
Taxonomy	Technical screening criteria for economic activities SC to climate change mitigation
EU Green Bond Standard	Recommendations for an EU Green Bonds Standard
Benchmarks	Minimum standards for climate benchmarks and benchmarks' ESG disclosures
Corporate Disclosures	Metrics allowing improving corporate disclosure on climate-related information

Stakeholder inclusion and transparency

- Meeting minutes **publicly available** at the Register of Commission expert groups
- **Workshops** and targeted interviews to inform TEG work
- **Open feedback** on TEG reports

The TEG subgroups

Taxonomy

Green Bond Standard

Benchmarks

Disclosures

The TEG final report on taxonomy – March 2020

TEG	Composed of 35 experts from civil society, academia, business and the finance sector, as well as 10 additional members and observers from EU and international public bodies	• All assessments made by TEG were based on scientific evidence, literature and international practice • TEG report deals with activities substantially contributing to climate change mitigation and adaptation
7 macro-sectors, 70 activities	• highest-emitting macro sectors (represent 93.2% of GHG emissions in the EU)	Agriculture and forestry Manufacturing Electricity, gas, steam and air conditioning supply Water, sewerage, waste and remediation Transport Information and Communication Technologies (ICT) Buildings
Screening criteria	• Substantial contribution to one environmental objective (for climate change mitigation → e.g. GHG emission thresholds) • Do no significant harm to any of the other environmental objectives	

Substantial contribution to climate change mitigation

Characteristics	Type of activity	Criteria	Example
Contribution related to own performance	**Already low carbon** (very low, zero or net negative emissions). Compatible with net zero carbon economy by 2050.	Likely to be stable and long term	Electricity generation from solar PV
	Contribute to a transition to a zero net emissions economy in 2050 or shortly thereafter, but are not currently close to a net zero carbon emission level.	Likely to be revised regularly and tightened over time	Manufacturing of steel
Enabling activities	Activities that **enable emissions reductions** in either of the two previous categories.	Some likely to be stable and long term, some likely to be revised regularly	Manufacturing of wind turbines

Activities that undermine the climate change mitigation objective are **not** included.

Example – Climate Change Mitigation

Sector classification and activity	
Macro-Sector	D - Electricity, Gas, Steam and Air Conditioning Supply
NACE Level	4
Code	D.35.1.1
Description	Construction and operation of electricity generation facilities that produce electricity from Hydropower
Mitigation criteria	
Principle	Support a transition to a net-zero emissions economy • Avoidance of lock-in to technologies which do not support the transition to a net-zero emissions economy • Ensure that economic activities meet best practice standards • Ensure equal comparability within an economic activity with regards to achieving net-zero emissions economy target • Where necessary, incorporating technology-specific considerations into secondary metrics and thresholds
Metric & Threshold	[…] Declining threshold: Facilities operating at life cycle emissions lower than 100gCO2e/kWh, declining to 0gCO2e/kWh by 2050, are eligible • This threshold will be reduced every 5 years in line with a net-zero CO2e in 2050 trajectory • Assets and activities must meet the threshold at the point in time when taxonomy approval is sought For activities which go beyond 2050, it must be technically feasible to reach net-zero emissions

Example – Climate Change Mitigation

Do no significant harm assessment	
The main environmental impacts associated with hydropower installations are: - Emissions to water and generation of waste during construction; - Impacts on biodiversity associated with fragmentation of ecosystems and changes to habitat, to hydrological and hydrogeological regimes, water chemistry, and interference with species migration pathways as a result of the establishment of the installation and its operation	
(2) Adaptation	Refer to the screening criteria for DNSH to climate change adaptation.
(3) Water	For new projects: Ensure implementation of a River Basin Management […] and ensure that an appropriate cumulative impact assessment or equivalent study has been undertaken […] Ensure that the conditions outlined in article 4(7) of the WFD are met based on ground evidence. […] Construction of new hydropower should not lead to increase fragmentation of rivers, consequently refurbishment of existing hydropower plant and rehabilitation
(4) Circular Economy	
(5) Pollution	Establishing a River Basin Management Plan (as outlined in the EU Water Framework Directive) and ensure compliance with applicable EU regulations. Reference for outside EU: IFC's and World Bank Group's environmental and social standards. Parameters and acceptable limits/ranges and necessary sampling and measuring frequency are contained in EU Directive 2006/44/EC […]
(6) Ecosystems	Ensure an Environmental Impact Assessment (EIA) has been completed in accordance with […] Ensure any required mitigation measures for protecting biodiversity/eco-systems have been implemented. For sites/operations located in or near to biodiversity-sensitive areas […] ensure that an appropriate assessment has been conducted in compliance with the provisions of the EU Biodiversity Strategy (COM (2011) 244), the Birds (2009/147/EC) and Habitats (92/43/EEC) Directives or in the case of activities located in non-EU countries, other equivalent national provisions or international standards […]

Defining substantial contribution to climate change adaptation

- **Principle 1:** The economic activity reduces all material physical climate risks to the extent possible and on a best effort basis.
- **Principle 2:** The economic activity does not adversely affect adaptation efforts by others.
- **Principle 3:** The economic activity has adaptation-related outcomes that can be defined and measured using adequate indicators.

Substantial contribution to climate change adaptation

Adapted activities
(includes adaptation solution)

Activities enabling adaptation
(provides adaptation solution)

Example – Climate Change Adaptation

<table>
<tr><th colspan="2">Sector classification and activity</th></tr>
<tr><td>Macro-Sector</td><td>Professional, scientific and technical activities</td></tr>
<tr><td>NACE Level</td><td>3</td></tr>
<tr><td>Code</td><td>NACE code: 72.1

CPA codes: 72.1</td></tr>
<tr><td>Description</td><td>Engineering activities and related technical consultancy dedicated to adaptation to climate change for activities and/or assets that are Taxonomy aligned.

This class includes: • engineering design […] • machinery, industrial processes and industrial plant […] • water management projects</td></tr>
<tr><th colspan="2">Adaptation criteria</th></tr>
<tr><td colspan="2">Depending on the primary objective of the activity, refer to:

☐ Screening criteria for adapted activities

☐ Screening criteria for an activity enabling adaptation

Users of the Taxonomy should identify and explain which criteria they are responding to.</td></tr>
<tr><th colspan="2">Do no significant harm assessment</th></tr>
<tr><td colspan="2">The specific activity or activities which are the subject of the engineering or related consultancy service must meet the DNSH criteria for those activities.

That is, the service provider is required to validate that the activity and/or asset the service is being provided in relation to, is compliant with the relevant DNSH thresholds for the activity under cover.</td></tr>
</table>

Avoiding significant harm

“Do No Significant Harm” (DNSH) analysis has been completed for the 70 activities contributing to climate change mitigation. It also serves for activities contributing to climate change adaptation. Adaptation activities that are not included in the climate change mitigation list have their own DNSH criteria.

Why assess significant harm?

- To ensure that the technical screening criteria and the Taxonomy itself does not include economic activities undermining any of the environmental objectives.
- In cases where the TEG could not identify practices or criteria to mitigate potential harm, the activity was not included in the Taxonomy.

What are the criteria?

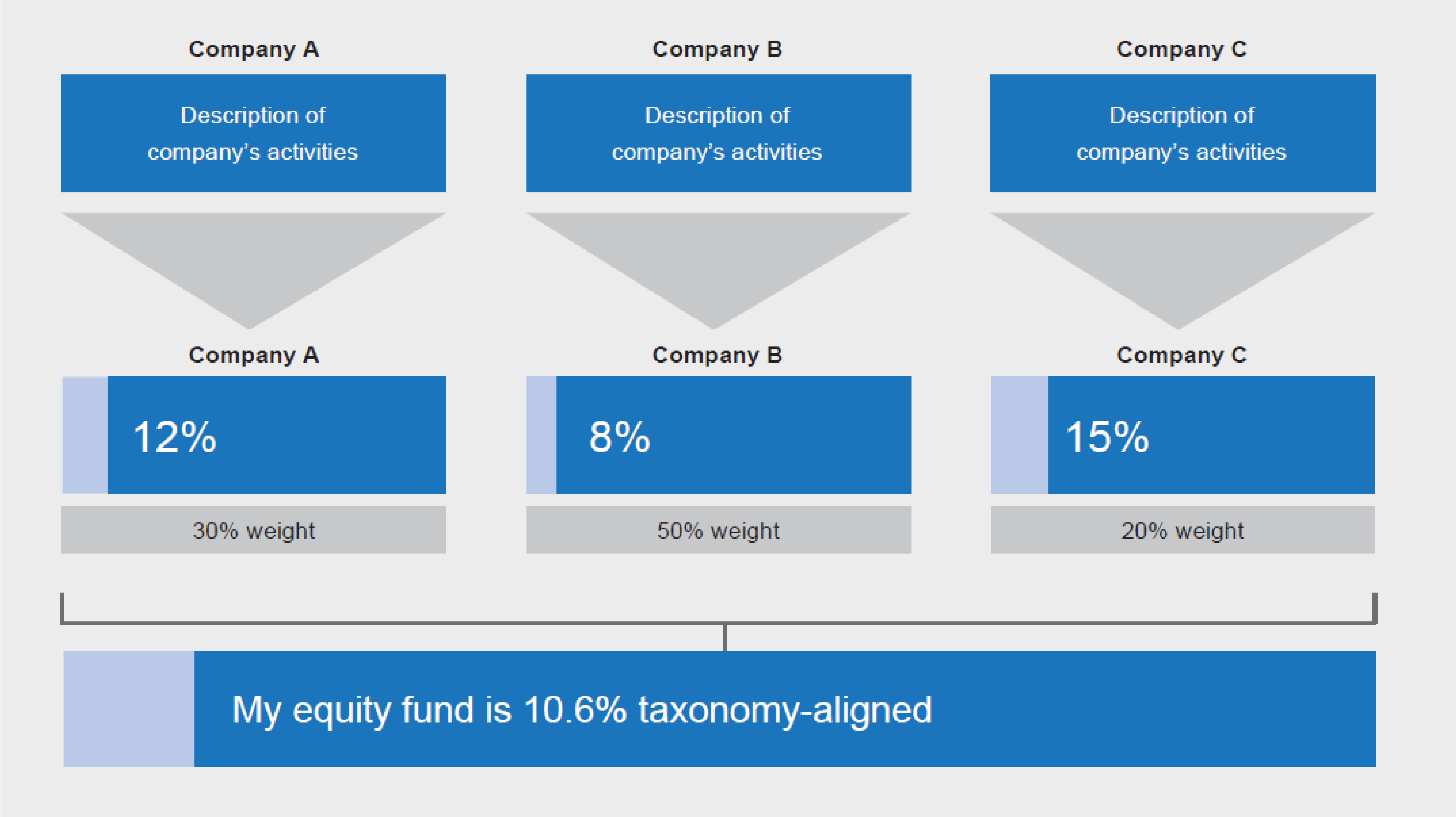
- The vast majority of the screening criteria build from existing EU regulations.
- The remaining DNSH criteria supplement regulatory requirements, taking the form of quantitative or qualitative thresholds.

Five steps to calculate Taxonomy exposure

(based on TEG recommendations)

1	Identify the activities conducted by the company or issuer or those covered by the financial product (e.g., projects, use of proceeds) that could be aligned, and for which environmental objective(s).
2	For each activity, assess whether the activity meets the relevant criteria for substantial contribution e.g. electricity generation <100g CO_2/kWh.
3	Assess that the DNSH criteria are being met. Investors could use a due diligence-type process for reviewing the performance of investees and could rely on the legal disclosures by those investees.
4	Conduct due diligence to avoid any violation to the social minimum safeguards (Art.13 Taxonomy Regulation).
5	Calculate alignment of investments with the Taxonomy and prepare disclosures at the investment product level.

Taxonomy in practice: Equity



The TEG subgroups

- Taxonomy
- Green Bond Standard
- Benchmarks
- Disclosures

EU Green Bonds Standard (EU GBS)

Proposed core components

Alignment with EU taxonomy

Publication of a Green Bond Framework explaining the voluntarily alignment and investment strategy

Mandatory Reporting
Allocation report
Impact report

Mandatory Verification by external reviewer

How would the EU-GBS work?

BEFORE OR AT ISSUANCE

GRADUAL ALLOCATION……………….….FULL ALLOCATION

Publication of Green Bond Framework

- Issuer's Green Bond strategy and alignment with the EU TAXONOMY
- Description of types of Green Projects to be financed
- Description of methodology and processes regarding allocation and impact reporting
- Use of proceeds specified in the legal documentation

Annual Allocation Reports

- Confirmation of alignment with EU GBS
- Breakdown of allocated amounts per project or portfolio
- Geographical distribution of Projects

Final Allocation Report

Impact Report

- Impact reporting at least once (at full allocation), or annually

ACCREDITATION OF EXTERNAL VERIFIERS → DOCUMENT VERIFIED BY ACCREDITED EXTERNAL VERIFIERS

Key elements of the EU Green Bond Standard

Green projects	• Alignment with the environmental objectives and technical screening criteria as defined in the **EU taxonomy** • Physical or financial assets, tangible or intangible: any capital expenditure and selected operating expenditure such as maintenance costs related to green assets that either increase the lifetime or the value of the assets, as well as research and development costs, and relevant public investments and public subsidies for sovereign and sub-sovereigns • Green assets qualify without a lookback period, and eligible green operating expenditure shall qualify with a maximum of three years lookback • The use of proceeds is specified either in the prospectus or in the final terms of the bond
Green bond framework	• Document explaining issuer's alignment with the EU taxonomy and environmental objectives, green bond strategy, project selection, methodologies and processes for allocation and impact reporting of the Green bond or Green Bond program • The issuer must produce it when confirming the alignment with the EU Green Bonds standard
Reporting	• Allocation and Impact reporting become mandatory • Allocation report needs to be published annually until full allocation of the bond proceeds, and Impact report at least once at the full allocation, and both reports thereafter, in case of any material change.
Verification	• Issuers shall appoint an external verifier that needs to be accredited • Verification applies (i) to the Green Bond Framework and (ii) to the Allocation Reporting

How will EU-GBS add clarity and credibility?

1. Reduce uncertainty by aligning with the EU taxonomy: proceeds of the EU Green Bonds should go to finance or refinance projects and investments that **contribute substantially** to one of the EU environmental objectives, while **not significantly harming** the other five objectives

2. Clarify and expand the **definitions of eligible green projects, costs and expenditures**

3. Ensure transparency and accountability by requiring **mandatory** publication of the **green bond framework, allocation and impact reporting**

4. Improve comparability by providing **templates** for the green bond framework and reporting

5. Create credibility by **mandatory verification by accredited verifiers**

Next steps on EU GBS

- TEG delivered recommendations for possible EU Green Bond Standard in June 2019.

- In March 2020, the TEG provided to Commission
  - A user guide on EU GBS for market participants that i.a. provides information on link between EU GBS and EU Taxonomy
  - recommendations providing i.a. for a set-up of a voluntary interim market-based registration scheme for verifiers (VIRS)

- These recommendations will be carefully considered as a basis for next steps taken by the Commission.

- It will inform the work on the content of possible related legislative initiatives or amendments.

Content

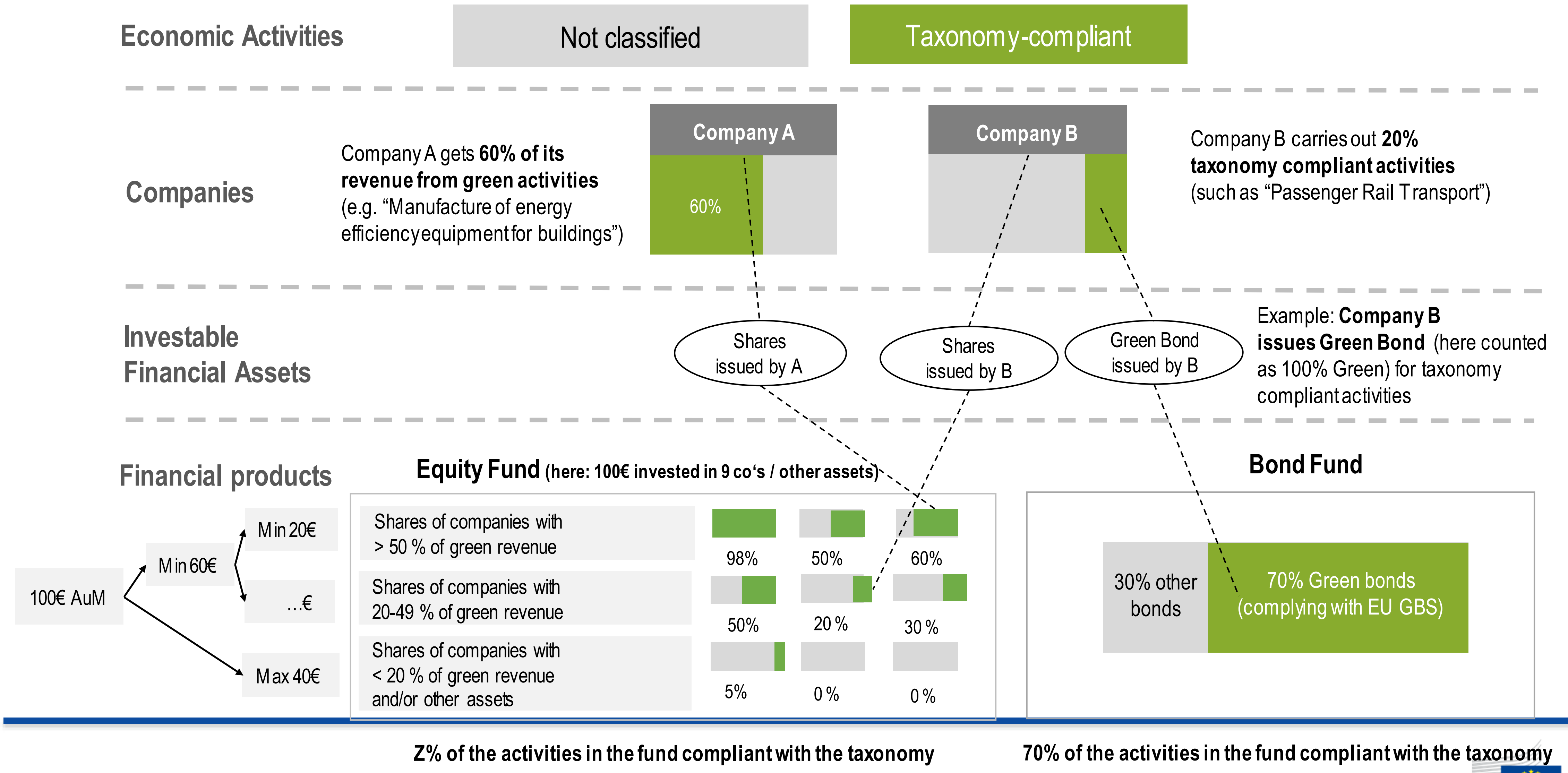
EU Ecolabel criteria refer to Taxonomy-aligned activities

1. Minimum investment

- Under the proposed EU Ecolabel criteria, **Criterion 1 requires minimum investments in Taxonomy-aligned activities**. For example:
  - For **equity funds**, a certain proportion of AuM must be in equity of green companies, i.e. companies with a sufficient share of revenues from Taxonomy-aligned activities
  - For **bond funds**, 70% of AuM must be in green bonds that comply with the EU Green Bond Standard (which itself refers to Taxonomy)
  - For **savings accounts**, 70% of the deposits must be used to make green loans or invest in green bonds.

2. Engagement notably to grow a company’s Taxonomy-aligned activities.

Minimum investment in Taxonomy-aligned activities



Non-inclusion in Taxonomy vs. Exclusions under EU Ecolabel

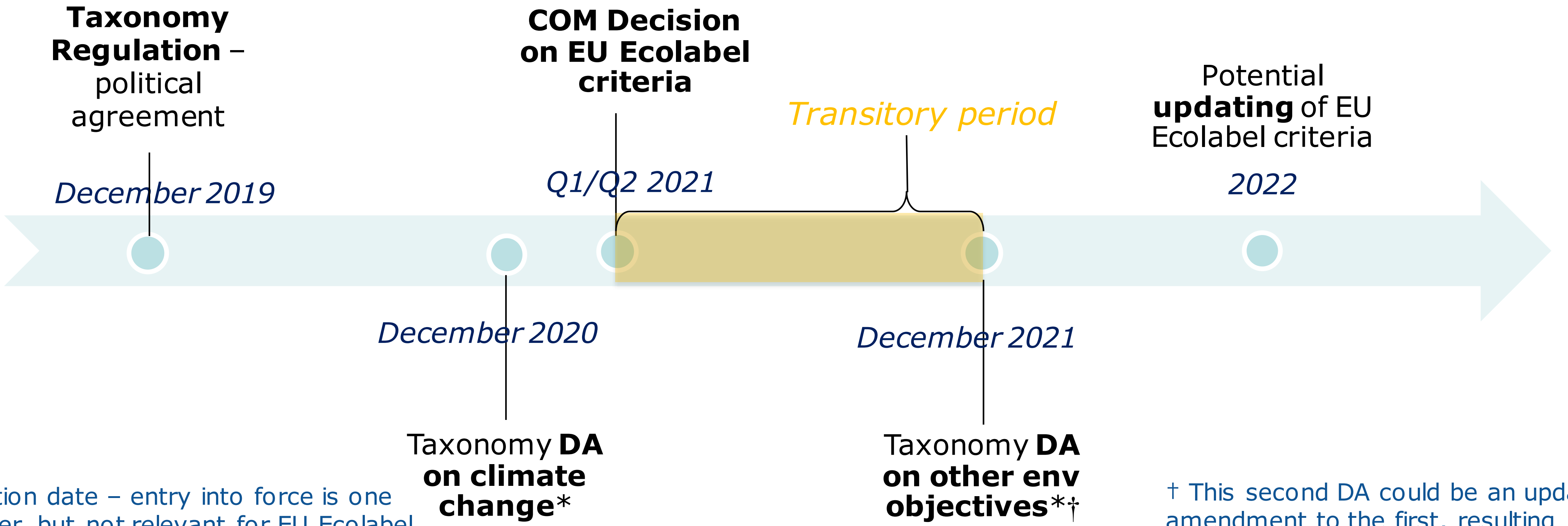
- EU Ecolabel criteria defines a list of excluded activities. If a fund invests in a company undertaking an excluded activity (with a 5% revenue threshold), it cannot receive the EU Ecolabel.
- The Taxonomy defines 'green' activities.

=> **Non-inclusion in Taxonomy does not necessarily imply the activity should be part of the EU Ecolabel exclusion list.**

	Included in Taxonomy	**Not included in Taxonomy nor excluded under EU Ecolabel**	**Excluded under EU Ecolabel**
Examples	Electricity production from hydropower with <100g CO_2e/kWh Agriculture enhancing soil carbon stocks	Electricity production from hydropower with >100g CO_2e/kWh Production of pesticides approved for use in EU	Electricity production from coal Production of pesticides not approved for use in EU

Timelines of Taxonomy DAs vs. Decision on EU Ecolabel

- Difference in timelines imply a **transitory period**, during which the investment universe for EU Ecolabel criteria is smaller (climate-only)



* Adoption date – entry into force is one year later, but not relevant for EU Ecolabel criteria

† This second DA could be an update / amendment to the first, resulting in a single DA.

2nd Q&A

Thank you for your attention

Contact

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