



Technical Expert Group on
Sustainable Finance



EU TAXONOMY

What is the EU Sustainable Finance Taxonomy?

A list of **economic activities** with **performance criteria** for their contribution to **six environmental objectives**.

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

The Taxonomy proposal

Substantially contribute to at least one of the six environmental objectives as defined in the proposed Regulation



Do no significant harm to any of the other five environmental objectives as defined in the proposed Regulation



Comply with **minimum safeguards**

TEG Reports: June 2019



User guide

- Concise guide to key concepts
- Examples
- Overview of the criteria



Technical report

- Full methodology;
- Use cases and case studies;
- 67 economic activities assessed for contribution to climate change mitigation;
- Methodology for adaptation tested on 9 activities.

+ Call for feedback (July 2019)

Why have a Taxonomy?

- A common language for investors, issuers, policymakers, regulators;
- Translate the Paris Agreement and SDGs;
- Put environmental data in economic context;
- Save time and money for investors and issuers;
- Support different investment styles and strategies;
- Avoid reputational risks;
- Deepen the conversation;
- Reward companies.

The Taxonomy:

IS	IS NOT
A list of economic activities and relevant criteria	A rating of good or bad companies
Flexible to adapt to different investment styles and strategies	A mandatory list to invest in
Based on latest scientific and industry experience	Making a judgement on the financial performance of an investment – only the environmental performance
Dynamic, responding to changes in technology, science, new activities and data	Inflexible or static

Who will use the Taxonomy?

The proposed regulation has two mandatory users;

1. Financial market participants

2. EU Member States

Under the Non-Binding Guidelines for Non-Financial Reporting, **Companies** are also encouraged to disclose in line with the Taxonomy.

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

How can the Taxonomy be used by investors?

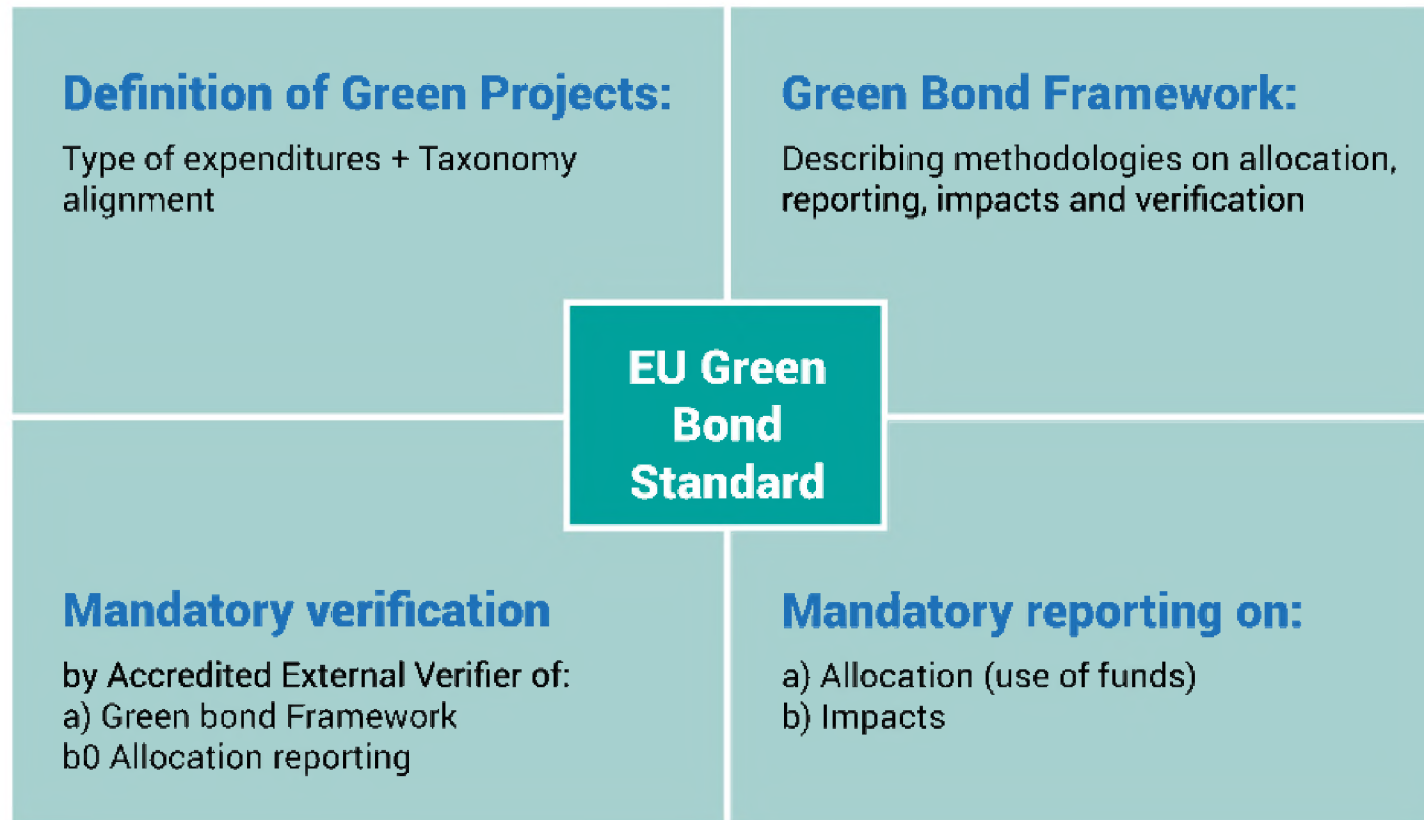
- Expressing investment preferences;
- Selecting holdings;
- Designing green financial products;
- Measuring the environmental performance of a security or product;
- Engaging with investees.

Investment uses

Uses and users of the Taxonomy		
	Disclosure obligations	Optional additional uses
Pensions and Asset Management	<ul style="list-style-type: none"> • UCITS funds: <ul style="list-style-type: none"> • equity funds; • exchange-traded funds (ETFs); • bond funds • Alternative Investment Funds (AIFs): <ul style="list-style-type: none"> • fund of funds; • real estate funds; • private equity or SME loan funds; • venture capital funds; • infrastructure funds; • Portfolio management. 	
Insurance	<ul style="list-style-type: none"> • Insurance-based investment products (IBIP) 	<ul style="list-style-type: none"> • Insurance
Corporate & Investment Banking	<ul style="list-style-type: none"> • Securitisation funds* • Venture capital and private equity funds • Portfolio Management • Indices funds 	<ul style="list-style-type: none"> • Securitisation • Venture capital and private equity • Indices • Project finance and corporate financing
Retail banking		<ul style="list-style-type: none"> • Mortgages • Commercial building loans • Car loans • Home equity loans

Proposed EU Green Bond Standard

Green projects must be Taxonomy-aligned.



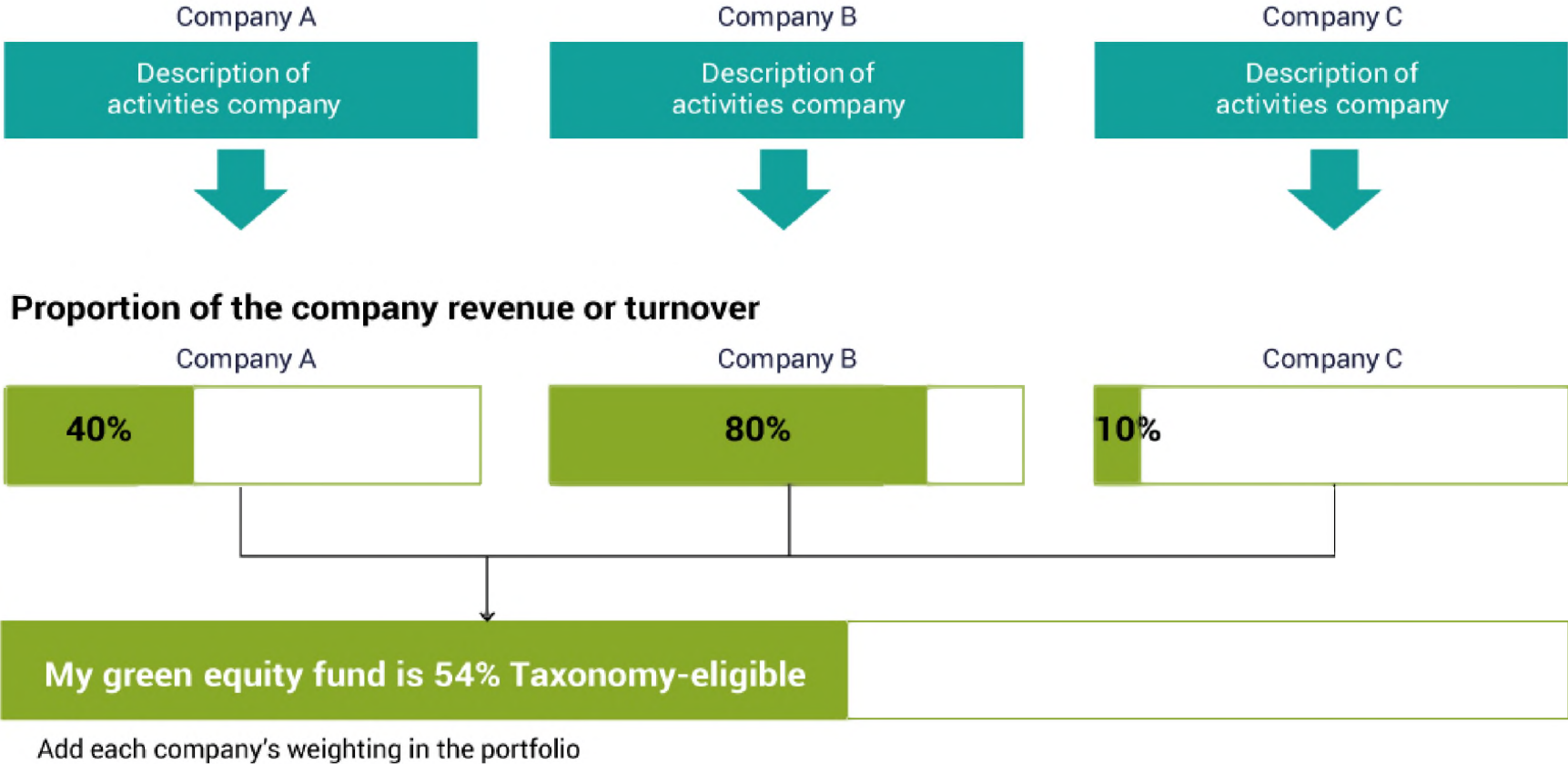
Disclosure obligations for financial market participants

For each relevant product, investors would disclose:

- if and how the Taxonomy has been used to determine the sustainability of an investment; and
- the proportion of investments funding Taxonomy-eligible activities.

The Taxonomy in practice: Equities

How to apply the taxonomy to an equity portfolio



Five steps to calculate Taxonomy exposure

1	Identify the activities conducted by the company, issuer or covered by the financial product (e.g. projects, use of proceeds) that could be eligible.
2	For each activity, assess whether the company or issuer meets the relevant criteria for a substantial contribution e.g. electricity generation <100g CO ₂ /kWh.
3	Verify that the DNSH criteria are being met by the issuer. Investors using the Taxonomy would most likely use a due-diligence like process for reviewing the performance of underlying investees.
4	Conduct due diligence to avoid any violation to the social minimum safeguards stipulated in the Taxonomy regulation (article 13).
5	Calculate alignment of investments with the Taxonomy and prepare disclosures at the investment product level.

How the Taxonomy helps companies raise capital

Example 1: Energy sector

- A coal energy company wishes to raise capital to diversify its energy supply activities.
- The company proposes to allocate funds to build a new electricity generation facility eligible under the taxonomy (like solar or wind) and therefore can issue a green bond that meets the requirement of the EU Green Bond Standard.
- Investors understand the strategy, assess the information provided in the bond documentation, understand the environmental benefits and invest.

Example 2: Manufacturing sector








- An aluminum manufacturer is looking for capital to improve the performance of its manufacturing facility.
- The company can get a green loan from a bank for the expenditure to bring the performance of the facility in line with the criteria of the taxonomy.
- Once the facility meets the taxonomy criteria, the shares of the company can be included in a green equity fund.

Selecting sectors

(1) High-emitting
macro sectors

(2) Enabling sectors



	Agriculture and forestry
	Manufacturing
	Electricity, gas, steam and air conditioning supply
	Water, sewerage, waste and remediation
	Transport
	Information and Communication Technologies (ICT)
	Buildings

What makes a substantive contribution to climate change mitigation?

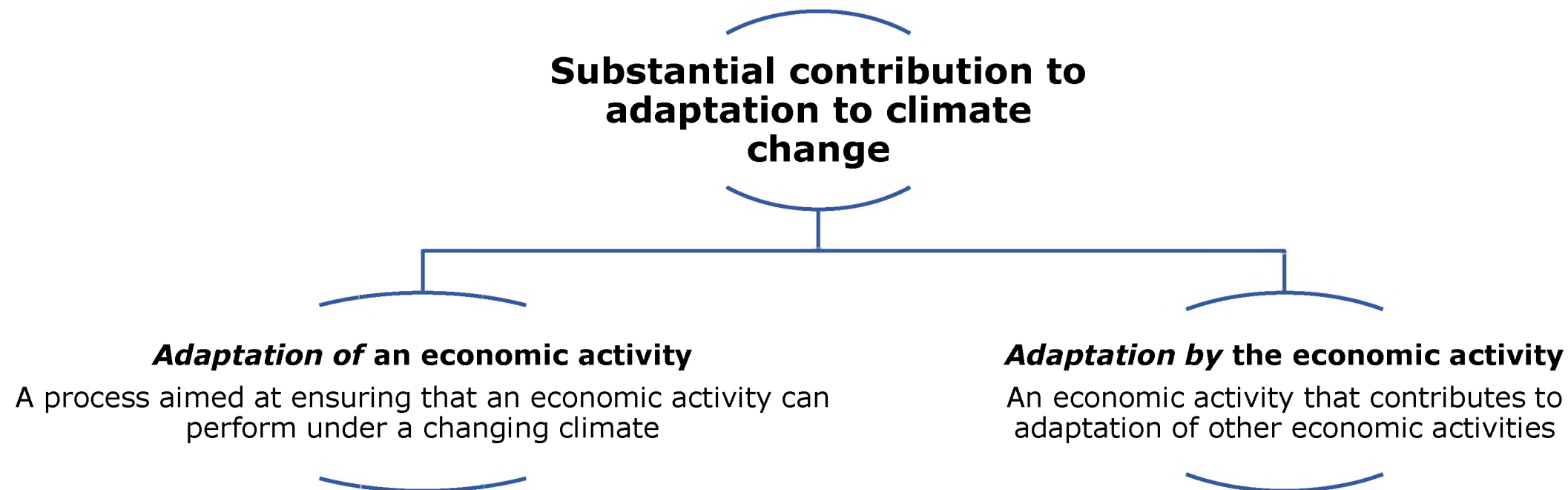
Type of activity	Technical screening criteria	Examples
1) Activities that are already low carbon. Already compatible with a 2050 net zero carbon economy	Likely to be stable and long-term	<ul style="list-style-type: none">• Zero emissions transport• Near to zero carbon electricity generation• Afforestation
2) Activities that contribute to a transition to a zero net emissions economy in 2050 but are not currently operating at that level.	Likely to be subject to regular revision, tending towards zero emissions.	<ul style="list-style-type: none">• Building renovation;• Electricity generation <100g CO₂/kWh• Cars <50g CO₂/km
3) Activities that enable those above.	Likely to be stable and long-term (if enabling activities that are already low carbon) or subject to regular revision tending to zero (if enabling activities that contribute to transition but are not yet operating at this level).	<ul style="list-style-type: none">• Manufacture of wind turbines• Installing efficient boilers in buildings

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.

Defining substantial contribution to climate change adaptation

- A substantial contribution to adaptation can be delivered through
 - ✓ *Adaptation of an economic activity*, and
 - ✓ *Adaptation by an economic activity*



Activities used to test adaptation approach

NACE Macro sector	Activities
Agriculture, forestry and fishing	<ul style="list-style-type: none">▪ Growing of non-perennial crops▪ Silviculture and other forestry activities
Electricity, gas, steam and air conditioning supply	<ul style="list-style-type: none">▪ Production of Electricity from Hydropower▪ Transmission lines
Water, sewerage, waste and remediation	<ul style="list-style-type: none">▪ Sewage
ICT	<ul style="list-style-type: none">▪ Provision of specialised telecommunications applications for weather monitoring and forecast
Finance and Insurance	<ul style="list-style-type: none">▪ Non-life insurance
Professional, scientific and technical activities	<ul style="list-style-type: none">▪ Research and development (natural sciences and engineering)▪ Engineering activities and related technical consultancy

Nine activities in six sectors were selected to test this approach. This initial assessment of economic activities does not represent a judgement on the vulnerability of other sectors to the negative effects of climate change or their contribution to climate change adaptation and resilience.

Avoiding significant harm

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.

Example – Climate Change Mitigation

Sector classification and activity	
Macro-Sector	E - Water supply; sewerage; waste management and remediation activities
NACE Level	4
Code	E37.0.0
Description	<p>“Centralized wastewater treatment systems”</p> <p>Centralized wastewater systems (including collection and treatment), substituting untreated wastewater discharge or treatment systems causing high GHG emissions (e.g. onsite sanitation, anaerobic lagoons).</p>
Mitigation criteria	
Principle	Net GHG emission reduction through centralization of wastewater treatment thus substituting or avoiding decentralized sanitation systems with higher GHG emissions.
Metric	Construction or extension of centralized wastewater systems including collection (sewer network) and treatment is eligible, provided that the new wastewater treatment substitutes the untreated discharge of wastewater to the water bodies or more GHG emission intensive wastewater treatment systems.
Threshold	No threshold applies.
Rationale	
<p>This activity considers collection and waste water treatment line in wastewater treatment plants. The sludge treatment is included in another Taxonomy activity.</p> <p>From common practice (see 2006 IPCC Guidelines for National Greenhouse Gas inventories) it is known that any level of treatment (primary, secondary, or tertiary) achieves significant reductions of GHG emissions when compared with the emissions of the discharge of untreated wastewater in the water bodies or other on-site sanitation systems (such as septic tanks, anaerobic lagoons etc.).</p> <p>Compliance with relevant EU and national law as well as consistency with national, regional or local wastewater management strategies and plans is part of the approving process.</p>	

Example – Climate Change Mitigation

Do no significant harm assessment

Potential harm linked to centralised wastewater treatment is related to:

- emissions to water from wastewater treatment
- Combined sewer overflow in case of heavy rainfall
- Sewage sludge treatment

(2) Adaptation

A1: Reducing material physical climate risks. The economic activity must reduce all material physical climate risks to the extent possible and on a best effort basis. This means the activity integrates physical and non-physical measures aimed at reducing - to the extent possible and on a best effort basis - all material risks that have been identified through a risk assessment. The above-mentioned assessment has the following characteristics:

- considers both current weather variability and future climate change, including uncertainty;
- is based on robust analysis of available climate data and projections across a range of future scenarios;
- is consistent with the expected lifetime of the activity.

A2: Supporting system adaptation. The economic activity must not adversely affect adaptation efforts of others. This means:

- The activity does not lead to increased climate risks for others or hamper adaptation elsewhere
- The activity is consistent with sectoral, regional, and/or national adaptation efforts.

(3) Water

(4) Circular Economy

(5) Pollution

- Ensure emissions to water are within the ranges set in the Urban Waste Water Treatment Directive.
- Implement appropriate measure to avoid and mitigate combined sewer overflow in case of heavy rainfall, such as Nature-based solutions, separate rainwater collection systems, retention tanks and / or treatment of the first flush.
- Ensure sewage sludge is managed/used (e.g, incineration, anaerobic digestion, land application) according to relevant national/EU legislation.

(6) Ecosystems

Example – Climate Change Adaptation

Sector classification and activity	
Macro-Sector	Professional, scientific and technical activities
NACE Level	3
Code	NACE code: 72.1 CPA codes: 72.1
Description	This group comprises basic research, applied research, experimental development in natural sciences and engineering dedicated to adaptation to climate change. See example contributions for further examples.
Adaptation criteria	
These criteria relate to adaptation enabled by this activity. To be eligible for the EU taxonomy, the economic activity must meet the following qualitative screening criteria:	
Criterion B1. Supporting adaptation of other economic activities	The economic activity contributes to adaptation of other activities and/or addresses systemic barriers to adaptation.
B1.1	The activity reduces or facilitates adaptation to physical climate risks beyond the boundaries of the activity itself. This includes activities that: <ul style="list-style-type: none"> a) Promote a new technology, product, practice or governance process or innovative uses of existing practices (including those related to natural infrastructure); or, b) Remove information, financial, technological and capacity barriers to adaptation by others.
B1.2	In the case of infrastructure-based activities, the economic activity must also meet the screening criteria A1, A2 and A3 for adaptation of an economic activity.

What happens next?

