



PLATFORM ON
SUSTAINABLE FINANCE

Transition finance report

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Disclaimer

This report represents the overall view of the members and observers of the Platform on Sustainable Finance. However, it may not necessarily, on all aspects, represent the individual views of member institutions or experts. This report does not reflect the views of the European Commission or its services.

Introduction

About this report

The EU Platform on Sustainable Finance is an expert group established to advise the European Commission on the development of the sustainable finance market, with a particular focus on ongoing development and update of the EU Taxonomy.

In January 2021, the European Commission asked the Platform to provide advice on transition financing.¹ The Commission identified that more work is needed on how the Taxonomy can enable inclusive transition financing for companies and other economic actors working to improve their environmental impact.

The concept of transition is relevant to all of the environmental objectives in the Taxonomy. However, the immediate priority is the finalisation of the first Taxonomy Delegated Act, which pertains to climate change mitigation and adaptation. For this reason, this report focusses primarily on transition in the context of climate change.

This report sets out the Platform's key findings and recommendations, by responding to six questions from the Commission.

The European Union transition challenge

The world is facing a series of urgent and interlinked environmental challenges.

To avoid the most dangerous consequences of climate change, global greenhouse gas emissions must drop by 50% over the next decade.² Even with this reduction, some impacts are already inevitable, necessitating a transition towards climate resilience.

The EU's contribution to the global challenge of greenhouse gas emissions is to reduce emissions by 55% by 2030 and to reach climate neutrality across the whole continent no later than 2050.

This can be illustrated by the energy sector, which has a central role in the transition and contributes the majority of the EU's emissions. There is no single, agreed scenario for transition of the energy sector, but multiple analyses indicate the need for a sharp and sustained reduction in emissions intensity of electricity generation:

Modelling from the European Environment Agency indicates that to achieve the EU's 2030 targets, the average direct³ emissions from electricity generation more than halve on 2019 levels by 2030,

¹ https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/210118-commission-request-transition-financing_en.pdf

² Point C1 of the Summary for Policy Makers of the Intergovernmental Panel on Climate Change (IPCC) Special Report on Global Warming of 1.5°C, <https://www.ipcc.ch/sr15/>

³ The stock of CO₂ and other Greenhouse gases (GHG) which can be emitted before we pass tipping points in the world's climate are extremely limited and this mean that direct and lifecycle emissions in the energy sector are important. Here we use direct emissions as an illustration.

from 275 gCO₂e/kWh to 75-97g CO₂e/kWh⁴. In this analysis, the entire energy system reaches climate neutrality well before 2050.⁵

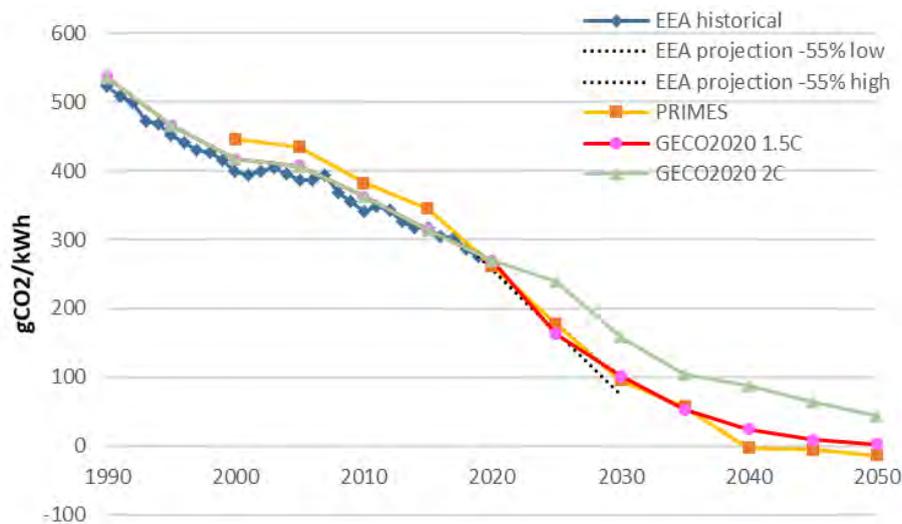


Figure 1 Electric grid emissions intensity in EU, EEA website, GECO 2020, PRIMES

Figures provided by Eurelectric’s Power Barometer study, which are based on future market outlooks and technology utilisation factors rather than specific warming outcomes, indicate a 2030 emission intensity of 158g CO₂/kWh before declining to net-zero by 2045.⁶ This demonstrates that large reductions in emissions are needed this decade, even before the constraints of the EU’s 2030 climate goals are applied. This is why addressing the 2030 climate mitigation goal is necessary to determine substantial contribution criteria under the Taxonomy.

Energy is just one example. The transition trajectory that Europe is facing is steep and front-loaded in the period to 2030, demanding immediate and far-reaching action across all sectors of the economy.

Markets frequently underestimate the scale and urgency of the challenge. While progress has been made in expanding access to low carbon technologies, many activities continue which have the potential to stall or undermine the low carbon transition or become stranded assets.

Clear standards are needed to help the market plan and communicate the transition.

What does transition mean according to the market?

The term “transition” is widely used when talking about the economy, specific sectors, financial portfolios or companies. This understanding of transition is focussed on the transition of a set (after here we use the term “portfolio”) of economic activities or assets. By contrast, the EU Taxonomy is

⁴ Modelling from the European Environment Agency. These values represent indicative intensity levels that would allow the EU to achieve a net 55 % reduction in greenhouse gases by 2030, compared with 1990. They are consistent with scenario ranges in the staff working document accompanying the Commission communication *Stepping up Europe’s 2030 climate ambition - Investing in a climate-neutral future for the benefit of our people*. https://www.eea.europa.eu/data-and-maps/daviz/co2-emission-intensity-6#tab-googlechartid_googlechartid_googlechartid_googlechartid_chart_11111

⁵ In all scenarios analysed by the European Commission for the communication “A Clean Planet for All”, the energy system must reach net-zero energy emissions by 2050. https://ec.europa.eu/clima/policies/strategies/2050_en

⁶ <https://www.eurelectric.org/power-barometer/>

focused on individual economic activities – a more granular concept which requires a slightly different approach to transition.

To understand the wider market perception of transition, the Platform reviewed 12 market-based transition frameworks to identify commonalities in approach.⁷ These frameworks have been assessed because they provide a wide range of market-based perspectives and seek to codify general best practices. However, it should be noted that other frameworks such as industrial roadmaps or current and future legislation are also of critical importance to the transition of specific industries.

One trait shared by all the frameworks is a focus on the emissions performance of a portfolio of activities, and how this evolves over time. Data is aggregated across multiple economic activities or assets – whether this be companies, sectors, portfolios or the whole economy. The success of the transition is typically assessed by the change in average emissions over time for the whole portfolio.

To reduce the average emissions, the emissions of high emitting activities must be progressively improved or substituted with low emitting activities, leading to an overall phasing out of high emissions activities over time (figure 2).

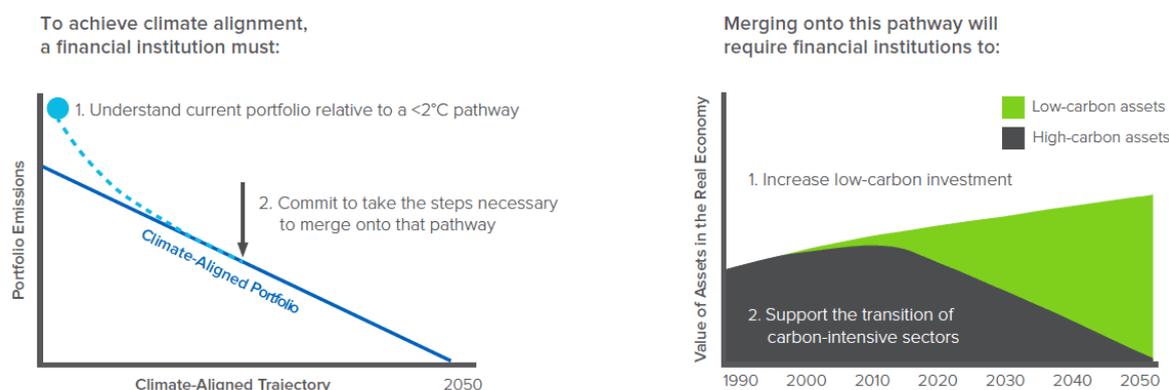


Figure 2. Charts illustrating a portfolio reduction trajectory and the evolution in high and low carbon assets. The trajectory is stylised and does not necessarily represent the EU trajectory or climate goals. Source: Rocky Mountain Institute: Charting the course to climate-aligned finance (2020). The second figure is partially adapted from the Climate Finance Leadership Initiative: Financing the low-carbon future (2019).

This portfolio transition model has some flexibility, particularly in the early stages of a transition. Higher emissions in some parts of the economy or sector may be compensated for by reductions elsewhere. However, this flexibility reduces as the overall proportion of carbon neutral or near-zero carbon activities increases towards 100%. Decisions about new activities or investments will also affect the ease and feasibility of sustaining year on year emissions reductions.

To truly understand the feasibility and ambition of a plan to transition, it is necessary to look at the emissions performance of the individual **economic activities or assets** in the portfolio. The current and potential future contribution to the transition can be understood because most assets have known emissions performance, reduction potential and expected economic lifespan.

⁷ The transition frameworks were: the Climate Transition Benchmark, Mark Carney’s recommendations to implement net zero corporate commitment, Net Zero Asset Owner Alliance, The IIGCC Net Zero Investment Framework, The ClimateAction100+ Net-Zero Company Benchmark, The Race to Zero minimum criteria, the ClientEarth Principles for Paris alignment, the WWF recommendations for alignment with the 1.5°C Paris goal, the Follow This SATIE framework, ICMA: Climate Transition Finance Handbook, MDB Paris Aligned Finance framework and Climate Bonds Initiative: Financing Credible Transitions.

When considered as part of a portfolio average, individual activities which could become stranded or undermine the ambition of a transition plan may be concealed or compensated for by reductions elsewhere in the portfolio. When examined alone, it becomes clear which activities are at risk of undermining the transition.

This necessitates a robust and unambiguous understanding of which economic activities and assets are already consistent with net-zero, which may be necessary for a fixed time at the best available performance, before further performance improvements are required (“transitional activities”), and which activities must be phased out. The current EU Taxonomy can help to identify the first two categories, but it should be noted does not currently assess which activities should be ceased.

The Taxonomy is a tool for assessing the alignment of economic activities with a goal. Exposure to Taxonomy-aligned activities is one type of information that companies can use to plan and communicate their transition. However, the Taxonomy alone is not a suitable tool for communicating details of a company’s overall transition, including improvements in performance which do not result in activities being qualified as substantially contributing as defined by the Taxonomy.

Recognising these activities in the Taxonomy would require creation of additional categories to recognise partial or short-term improvements which ultimately do not meet the definition for substantial contribution to an environmental objective.

The Platform members agree that companies must be supported with additional tools and analysis to communicate their transition plans to the market. Companies will continue to use other tools to communicate their progress and to access transition financing.

How does the EU Taxonomy support the transition?

The EU Taxonomy’s goal is to provide clear guidance on when an economic activity can be claimed to be “environmentally sustainable”. In the case of activities that make a substantial contribution to climate change mitigation, this means performance levels which substantially contribute to the EU’s 2030 and 2050 goals.

Within this, the Taxonomy recognises that some activities are already very low carbon, and that others cannot yet be performed in a way that is consistent with a net-zero economy, and therefore may be considered Taxonomy-aligned for a short time before further performance improvements are required. Activities in this second category are defined as “transitional” activities in Article 10(2) of the Taxonomy Regulation and subject to review every three years. The legal definition is explored further later in this report.

Degree of exposure to Taxonomy-aligned activities or assets can help to communicate the climate transition for a sector, portfolio or company, including indicating clearly which activities are compatible with the low carbon transition. Taxonomy exposure can support target-setting and tracking progress. In this report, the Platform explores a number of ways that the Taxonomy currently enables financiers, investors, investee companies and other economic actors to disclose on their transition efforts.

The Platform also acknowledges some limitations to how the Taxonomy can currently be used for transition financing. Some of the ideas in this report directly respond to these challenges, proposing ways that the Taxonomy framework could be developed further.

For example, while the Taxonomy covers the highest emitting sectors in Europe, not all economic activities that could make a substantial contribution have yet been assessed.⁸ This limits participation by some sectors, companies or other economic actors who may have a valid transition plan. The Platform is already committed to work to extend and develop the existing Taxonomy to provide greater sector coverage.

As it is currently formulated, the Taxonomy tells us which activities are green, but not necessarily which are at risk of causing significant harm. Nor does it identify those which may have a negligible impact on the environment. This report outlines important points currently under consideration regarding a more inclusive Taxonomy that could better represent the different transitions underway.

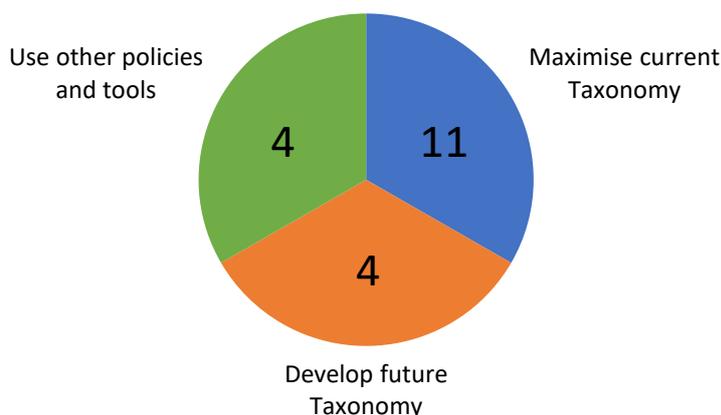
Finally, while the Taxonomy is an important and useful initiative, solving global climate and environmental challenges will rely on a wide range of policies, tools and incentives. The Platform has considered how additional tools could be developed to support the low carbon, climate resilient and environmental transition, as part of a consistent and coordinated policy agenda.

⁸ However, not all sectors can contribute equally and not all may ultimately be judged to be able to make a substantial contribution.

Summary of recommendations

In answering the six questions from the Commission, the Platform makes recommendations that fall into three broad categories: Maximise inclusiveness but maintain the integrity of the current Taxonomy framework; Opportunities to develop the future Taxonomy framework; and utilise other (non-Taxonomy) policies and tools to further support transition finance.⁹ The summary below includes recommendations from Questions 1, 2, 3 and 5.

HOW TO BETTER SUPPORT TRANSITION FINANCE: NUMBER OF RECOMMENDATIONS



Maximise current taxonomy

To maximise the inclusiveness of the current Taxonomy framework - while maintaining its integrity - the Platform provides the following recommendations:

- *Communicate (more) about how the taxonomy already supports transition finance*

To support communication efforts, the Platform provides several insights or additional messages beyond the basic description of the purpose and parts of the Taxonomy framework that should be emphasised with stakeholders.

- *Ensure that reporting requirements enable companies, financiers and investors to communicate their transition plans*

While the details of the Taxonomy reporting requirements are still being resolved, the Platform already sees several opportunities and challenges around reporting that should be considered to better support transition finance:

- Ensure that the reporting requirement for banks under the Article 8 Delegated Act are carefully balanced to ensure that SMEs and households seeking access to green finance are – by extension - not overly burdened with information requirements.

⁹ Maximise the current taxonomy includes recommendations on Communicating about the Taxonomy plus ten additional recommendations numbered 1.1 – 1.4, 2.1, 2.2, 3.1 – 3.4. Develop the future Taxonomy includes four recommendations numbered 2.3 – 2.6. Use other policies and tools includes four recommendations numbered 5.1 – 5.4.

- Provide a coherent view on sustainability reporting obligations under the Regulation on Sustainability-Related Disclosures in the Financial Services Sector (SFDR), Non-Financial Reporting Directive (NFRD) and Taxonomy Regulation.
- Encourage companies to disclose their transition corporate strategies and to specify how the Taxonomy fits within these strategies.
- Ensure that disclosure of Taxonomy-aligned CapEx is given equal importance as disclosure of taxonomy-aligned turnover.
- *Include more enabling activities in the Taxonomy*

The Platform makes two recommendations on enabling activities:

- The Taxonomy should include more enabling activities across different sectors focussed on energy efficiency that can be performed by any company (through CapEx), starting with manufacturing, agriculture, and forestry.
- The Taxonomy should include more enabling activities that recognise the contribution of the entire supply chain around taxonomy-aligned activities by financing, distributing, and selling of taxonomy-aligned products or services or by providing critical materials to taxonomy-aligned activities.
- *Recognise activities that are part of an activity-specific investment plan to meet the Taxonomy criteria, through CapEx, OpEx and related finance*

To provide companies that perform activities that do not (yet) meet Taxonomy criteria with access to transition finance, the Platform recommends, subject to the establishment of criteria for sufficiently robust activity-specific investment plans, that the Taxonomy allows companies to count as taxonomy-aligned investments towards meeting the technical screening criteria in the future. These investments should cover CapEx, OpEx and related finance.

- *Provide clarity to stakeholders on when new activities will be considered for inclusion in the Taxonomy and how they can engage with the Platform*

The Platform recommends prioritising the launch of a feedback loop that gives stakeholders the opportunity to provide suggestions to the Platform on what activities should be considered next for inclusion in the Taxonomy and whether criteria for existing activities should be revised. In addition, the Platform recommends setting out clearer timelines for the assessment of new activities.

- *Update the Climate Delegated Act to recognise similar activities across different sectors*

The Platform recommends updating the Delegated Act to ensure activities have consistent boundary descriptions and similar activities (e.g. repair or service activities) and are recognised consistently across different sectors.

Develop future taxonomy

While the Platform is still working to develop its recommendations as part of ongoing work and cannot yet draw conclusions, the following four ideas on extending the current taxonomy framework are highlighted as potential enablers of transition finance.

- *Develop criteria for activities with no significant impact*

As part of its current mandate, the Platform is considering the potential pros and cons of extending the scope of the Taxonomy to define activities that have no significant impact on the Taxonomy's

environmental objectives. Clarity on what activities have little or no impact could help companies and financiers to make investment decisions towards the transition. The Platform will provide initial recommendations on this by May 2021 and a final report by September 2021.

- *Develop criteria for activities that cause significant harm*

The Platform is currently exploring the extension of the scope of the Taxonomy to define activities that significantly harm the Taxonomy's environmental objectives. This could be an important tool for the transition as it would identify activities and performance levels that companies, financiers and others must move away from. The Platform will provide initial recommendations by May 2021 and a final report by September 2021.

- *Support and define improvements in performance levels between substantial contribution and significant harm*

As part of its work on extending the taxonomy to no significant impact and significantly harmful activities, the Platform is exploring the possibility to support significant improvements in performance of activities towards (but not reaching) the substantial contribution criteria. Recognising these efforts may help companies with reporting on their transition.

- *Include activities that enable companies to stop performing significantly harmful activities*

Closely linked to the work on developing criteria for significantly harmful activities, the Platform is considering the idea of identifying in the Taxonomy activities that could make a substantial contribution by enabling the stopping of activities (through decommissioning or closure) that cannot improve to a level of performance better than significant harm. By defining these activities, companies and financiers can get recognition for these highly necessary transition efforts.

Use other policies and tools

To further support transition finance, the Platform recommends exploring the following policies and tools beyond the Taxonomy framework:

- *Financial product labelling*

The Platform recommends that the Commission confirms and explains the link between the forthcoming EU Green Bond Standard (EU GBS) and the Taxonomy and clarifies how companies can voluntarily disclose the level of compliance of their green bonds with the Taxonomy. Furthermore, the Platform recommends the Commission to indicate whether Taxonomy disclosure obligations might be extended to other financial instruments like bonds. The Platform also recommends that consideration is given to grandfathering arrangements for labels as many investments will extend beyond the time within which the Taxonomy criteria are tightened.

- *Establish activity-specific transition pathways based on Taxonomy criteria*

To support companies to transition from significant harm to substantial contribution, the Platform recommends considering using the Taxonomy criteria to establish transition pathways for certain environmental performance levels, that could be applied to specific economic activities. Performance of the activity would have to improve to substantial contribution over the defined transition timeframe.

- *Utilise metrics and tools outside the Taxonomy, including the Climate Transition Benchmark*

To allow companies to demonstrate their transition plans, the Platform recommends establishing and using other metrics than just Taxonomy-alignment percentage, like TCFD metrics, science-based targets and sector pathways or transition scenarios. In particular, the Platform recommends using the requirements in the Climate Transition Benchmark to define climate transition on company level

Platform recommendations and how they relate to different situations

The Platform has considered how the Taxonomy can support companies in the decisions they make about their own investments and efforts to improve environmental performance. Different companies will face different starting points and may have varying potential to reach the Taxonomy criteria.

Table 1 summarises these cases and how they relate to the options in this report.

Table 1: Company starting points and their relationship to Platform recommendations

Situation	Taxonomy already provides recognition	Taxonomy could provide recognition under options already being considered	Use tools outside Taxonomy
Company activity(s) already meet the SC and DNSH criteria	Y	N/A	Y
Can improve the activity to meet SC and DNSH criteria	Y	N/A	Y
Can implement the enabling activities (measures)	Y	N/A	Y
Can conduct related R&D activity	Y	N/A	Y
Can improve performance at activity level but not enough to meet SC	N	Y	Y
Cannot significantly improve activity performance from the current position	N	Y	Y
Can improve performance across the company, but not to SC at activity level	N	N	Y

Transition and Transitional Activities within the Taxonomy Regulation

What does the term transition mean in the Taxonomy Regulation?

The term “transition” and the term “transitional activities” are different in the Taxonomy regulation and have different meanings.

Transitional activities may be part of an economy in transition, but not all activities that are part of an economy in transition are transitional activities.

1. **“Transition”** is used on multiple occasions in the Taxonomy Regulation to describe changes in economies needed to meet the EU’s environmental goals. For example, Recital 4: “Sustainability and the **transition** to a safe, climate-neutral, climate-resilient, more resource-efficient and circular economy are crucial to ensuring the long-term competitiveness of the Union economy.” This use of the term “transition” is similar to the common use by governments, investors and companies to describe environmental improvements at a portfolio level.
2. **“Transitional activities”** are defined in Article 10(2) (see below) and refer to a specific sub-set of activities making a substantial contribution to climate change mitigation. The term relates to how an activity is performed, not the nature of the activity or the sector within which it sits. The definition was designed with a specific set of climate change mitigation activities in mind but does not preclude transitional activities being relevant for other environmental objectives¹⁰. The Taxonomy Regulation clearly indicates that to count as transitional, an activity must comply with the relevant technical screening criteria. It is not accurate to talk about a whole sector as being transitional (within the meaning of the Taxonomy)

Article 10(2): Transitional activities

For the purposes of paragraph 1, an economic activity for which there is no technologically and economically feasible low-carbon alternative shall qualify as contributing substantially to climate change mitigation where it directly supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1,5 °C above pre-industrial levels, including by phasing out greenhouse gas emissions, in particular emissions from solid fossil fuels, and where that activity:

- a) has greenhouse gas emission levels that correspond to the best performance in the sector or industry;*
- b) does not hamper the development and deployment of low-carbon alternatives; and*
- c) does not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets.*

For the purpose of this paragraph and the establishment of technical screening criteria pursuant to Article 19, the Commission shall assess the potential contribution and feasibility of all relevant existing technologies with a view towards ensuring the final adoption of technology and practices that substantially contribute to climate mitigation.

¹⁰ Noting expanding the term to other objectives would require a revision of the Taxonomy Regulation, given that the definition currently only applies to the climate change mitigation objective.

Question 1

Can the current EU taxonomy framework be used to provide greater support for attracting capital for the transition of companies towards “sustainable” activities, including in ways not yet proposed by the Commission and if so in which ways?

What do we interpret this question to mean?

The wording “current Taxonomy framework” is taken to include:

- The Taxonomy Regulation
- The forthcoming Delegated Act containing technical screening criteria for substantial contribution to climate change mitigation and climate change adaptation
- The forthcoming Delegated Act providing details of undertakings’ Taxonomy disclosures (Article 8 of the Taxonomy Regulation)
- The Regulation on Sustainability-related disclosures in the financial services sector (SFDR)
- the forthcoming EU Green Bond Standard.

The Platform has also considered relevant elements of the Non-Financial Reporting Directive (NFRD).

The Platform is not asked to provide advice on the Technical Screening Criteria within the Climate DA. In responding to this question, the Platform is examining methodological and horizontal aspects of the Taxonomy framework.

On the “transition of companies”, the Taxonomy contains criteria for economic activities performed by companies and is not a classification of companies themselves or of their overall transition pathways. Rather the Taxonomy is a tool that can be used by companies to describe their progress or intentions for their transition to aligning with or contributing to climate goals.

Overview of the response to Question 1

The Taxonomy is new, and many companies are now coming to it for the first time. Further, the reporting requirements for companies with obligations to use the Taxonomy are not yet finalised. We therefore see two areas as being critical to answering question 1: Firstly, communicating with stakeholders about how the Taxonomy already supports transition finance and secondly ensuring that reporting requirements encourage companies, financiers and investors to seek sustainable finance opportunities. Our response focusses on these two areas.

Communicating about the Taxonomy

Points of substance that those new to the Taxonomy may not initially understand should be emphasised in communications about the Taxonomy. These points should be considered as insights or additional messages beyond the basic description of the purpose and parts of the Taxonomy framework.

- The Taxonomy reflects EU climate targets: Clearly state that the Taxonomy is a reflection of the EU’s 2030 and 2050 targets, and that these are difficult to achieve. Substantial Contribution criteria in general need to go beyond current EU legislation to avoid lock-in and

stranded assets¹¹. Weaker criteria will not help companies and investors understand what level of environmental performance is needed to achieve these targets.

- For many activities, the taxonomy anticipates policy measures and regulatory constraints that are inevitable if Europe is to meet its targets. For other activities, the taxonomy thresholds are in line with current expectations. That is the case for many manufacturing activities where thresholds are aligned with the EU ETS. The taxonomy therefore acts as a regulatory risk management tool both for investors and financial institutions.
- Taxonomy increases the space for green financing – in ways that few companies currently have access to, by virtue of including more economic activities and more environmental objectives than have been used in market-based financing green frameworks. It includes activities that have traditionally been automatically excluded from green investment universes such as cement or steel. By including CapEx and OpEx as key variables, it allows for all companies including those with little to no green revenues to access green finance through their investments in greening their activities - hence the importance of CapEx and OpEx as KPIs. CapEx/OpEx investments provide relevant information on the direction of travel of companies' transition strategy. The taxonomy does not decrease access to green financing but it enhances it.
- Emphasise CapEx and debt finance opportunities including green bonds and green loans. Directly commenting on the importance of bank financing for companies and how the Taxonomy could be used to support banks to lend to companies in transition will ease company concerns.
- Emphasise that Taxonomy is for targeting, tracking and communicating progress.
- Explain how the taxonomy can be used for current and forward-looking analysis and how it can be applied to forward-looking financial products such as sustainability-link bonds when an economic actor sets a future taxonomy-link target as part of its transition plan.
- Spell out how companies can use the Taxonomy to access financing for new activities and transition their business model, including for enabling activities and measures.
- Strengthen narrative on ways investors can use the Taxonomy to contribute to the transition, including capital allocation, corporate engagement and voting.
- The Substantial Contribution criteria of the Taxonomy indicate which activities warrant particular support, not which activities do not. Importantly, what is not green is not automatically unsustainable.
- While acknowledging concerns from companies, check evidence on access to financing.
- The Platform must be credible when it talks about inclusivity: not all activities can continue to operate to achieve climate goals, such as power production that uses solid fossil fuels. The Taxonomy can be a tool though for those economic actors even if the activities they conduct today do not have a place in a carbon-neutral economy. However, it is not necessarily the task of the Taxonomy to achieve this directly and the Taxonomy should be understood alongside other parts of the policy framework and market practices. The Taxonomy cannot answer every question about climate change mitigation related economic transition.
- Clear signalling of future development of Taxonomy criteria, including options for contribution to additional objectives and future sectors to be included.
- Distinguish environmental, security of supply and cost considerations: Recognise different objectives Member States seek to balance (energy security and grid stability, economic

¹¹ Bearing also in mind that several EU policies are under revision due to the recently increased climate targets (e.g. ETS, RED II or EED), and that EU sectoral pathways will be further developed, therefore the final level of ambition of such policies will evolve.

transition and environmental performance) and be clear that the Taxonomy does not attempt to incorporate all three criteria. Rather Taxonomy is a guiding tool to be used alongside economic and energy security considerations and complement existing and future legislative rules.

- Recognise disagreement on transition pathways and explain how the Taxonomy relates to these. The Taxonomy is based on the precautionary principle and the idea of making a substantial contribution, which is a high confidence threshold for environmental performance.
- Note that public financing objectives may differ from private finance objectives. This can be a concern for Member States and has potential implications for Corporates as well.

Ensure reporting requirements enable companies in communicating their transition plans

Platform members expect that once reporting requirements are resolved under Article 8 of the Taxonomy Regulation, stakeholders will be able to see much more clearly how to use the Taxonomy to support transition finance.

The Platform is considering the effect of future reporting obligations under Article 8 of the Taxonomy Regulation as part of their mandate and has been exchanging directly with the European Supervisory Authorities on Article 8. To guide the thinking of the Platform on reporting requirements, we have relied on six reporting principles:

1. Proportionality
2. Integrity
3. Relevance
4. Consistency
5. Predictability
6. International application.

When applying these principles to future corporate reporting requirements, we consider the following would assist with access to transition finance:

- Consistency between the reporting obligations created by the Taxonomy Regulation (Art. 8, Art, 5 and 6) and other reporting frameworks
- Additional narrative disclosures that enhance the understanding of companies' reported taxonomy-aligned ratios
- Voluntary disclosures that give companies the opportunity to explain how the taxonomy fits within their transition strategies and get credit for their overall efforts
- Complementary disclosures geared to facilitate eligibility to different financial products e.g. sustainability-linked bonds and future taxonomy-related targets
- Gradual introduction of reporting requirements where required e.g. loans of SMEs
- Emphasising the importance of CapEx disclosures as a key performance indicator for financial market participants to consider
- The reporting of plans to meet taxonomy criteria over time, allowing related CapEx and OpEx to be counted as taxonomy-aligned.
- Facilitating the use of the taxonomy and reporting, including the international application e.g. estimations and proxies, equivalence tables.

Building on these approaches, the Platform sees additional reporting opportunities that could be considered to better respond transition finance needs of the market. They are described below.

1.1. Ensuring bank finance can be accessible for companies

Banks provide critical financial support to the EU economy. Roughly 80% of the EU’s external funding is covered by bank loans and leases.

It is critical to encourage the development of specific financial products to finance taxonomy-aligned or to-be-aligned activities, beyond green bonds, green loans and other financial products such as sustainability-link bonds or structured funds. However, most of the finance will continue to be channelled through general purpose lending. It is therefore critical that banks encourage their clients to undertake the necessary steps – including investing in upgrading their plants and assets – to transition to sustainable activities and voluntarily disclose these plans and increase their transparency to attract private investments.¹² As explained further in our response to question 6, while for green loans and bonds the focus will be on the use of proceeds in line with the taxonomy, for general purpose lending, credit institutions are expected to analyse a company’s transition strategy using several metrics and measures such as emission reductions targets and progress on them. In terms of reporting, a general purpose loan will be taxonomy-aligned to the extent that the revenues (and CapEx when available) of the borrower are taxonomy-aligned (expressed as a percentage).

Lastly, as banks will have to report on the alignment of their lending and investment portfolios, banks will be encouraged to progressively increase the proportion that is taxonomy-aligned. They will also have to start collecting the information from clients – especially for those that do not publish the information - for new origination of loans. A step in the process for companies when accessing finance will be providing banks with the necessary information about their transition strategies and the taxonomy. The classification structure of the taxonomy makes it a useable tool for banks to expand their support to environmentally sustainable activities.

Proposed reporting requirements for banks under the Article 8 DA require therefore careful formulation. Reporting obligations for banks lead directly to requirements on companies, including SMEs seeking loans, and on households asking for mortgages or car leases. The Platform will examine carefully how to support SMEs that want to benefit from accessing sustainable finance and households interested in green mortgages. Ensuring the accessibility of sustainable finance for SMEs is an essential component of transition finance.

In this report we provide tables to show which part of the Taxonomy framework, or beyond, could be used to implement the recommendation and further support transition finance.

Climate DA	Article 8 DA	Review TR
✓ Clarify in public communication around Taxonomy how bank finance can be accessible for private and public entities	✓	

¹² The EBA advice to the Commission on Article 8 of the Taxonomy Regulation provides further detail on how reporting by banks on Taxonomy alignment helps to understand how banks are transitioning and how they help their counterparties to transition. See: https://www.eba.europa.eu/sites/default/documents/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20Advice/2021/CfA%20on%20KPIs%20and%20methodology%20for%20disclosures%20under%20Article%208%20of%20the%20Taxonomy%20Regulation/963616/Report%20-%20Advice%20to%20COM_Disclosure%20Article%208%20Taxonomy.pdf

1.2. Coherence of sustainability reporting concepts and frameworks

The Platform recommends that the end goal should be to have a single, coherent view on the relationship of SFDR, NFRD and Taxonomy reporting obligations to double materiality concepts. This might imply calibrating the concepts of harm and positive contribution and the various terms used to describe these concepts.

The Platform is mapping all reporting requirements arising from the different sustainable finance regulations, to ensure consistency and coherence. The Platform has contributed twice to the EFRAG Taskforce on the EU Non-Financial Reporting Standard chaired by Patrick de Cambourg, which recently published its final recommendations. The EFRAG Taskforce supports the need for coherence of EU sustainability reporting requirements and proposes to clarify various concepts in the framework of the NFRD revision, which is a major opportunity for coherence.

Climate DA	Article 8 DA	Review TR/SFDR
✓ Set out view in public communication around Taxonomy		✓ Examine and align the legal concepts through reviews of TR and SFDR

1.3. Encourage forward looking disclosure by companies, on a voluntary basis

To reassure investors of the solidity of their transition efforts, companies are encouraged to disclose their transition corporate strategies and to specify how the Taxonomy fits within these strategies. Voluntary, forward looking disclosures relating to taxonomy alignment can help to provide that longer-term vision.

The Platform has considered proposals including a series of forward-looking disclosures that companies can report on voluntarily regarding the company's targets against the taxonomy. In the same way that many companies report the emission reduction targets they have set as part of their transition strategies, companies could be invited to establish and publicly share targets to align their activities to the Taxonomy to the extent possible (except for those activities that fall out of the scope of the Taxonomy, at least for the time being). These could include the targeted proportion of CapEx Taxonomy alignment in the future. Some companies already disclosed future CapEx targets against the Paris Agreement Goals.

Reporting on strategies to diversify company portfolios towards taxonomy-aligned activities that they might not conduct today, would further assist the market.

Investors will particularly appreciate companies establishing targets for their capital investments (CapEx alignment) for the short, medium and long-term. More importantly, companies are encouraged to explain how their targets fit within their overall objectives and transition strategies, whether they have been approved by the Board and to report annually on progress achievement. Narrative disclosure in addition to reporting percentage of taxonomy alignment would help companies tell their story and reporting users to understand the transition intentions of the company and better assess their robustness, especially to those companies that conduct more than one activity.

Disclosure of strategies and targets alone is not sufficient to demonstrate progress in environmental performance. Investors and financiers may decide to finance companies whose strategies seem solid. However, they will require evidence that their commitments are being duly pursued. The taxonomy

provides a perfect tool for companies to provide that evidence over time that will reassure investors and financiers. Reporting on the progress achieved is essential.

Importantly, the additional, voluntary disclosure should be clearly separated from the mandatory taxonomy KPI reporting, to avoid confusion. Article 8 will specify which ratio (s) is (are) to be used by investors and in which cases for calculating taxonomy-alignment at fund-level in line with their obligations under article 5 and 6 of the Taxonomy Regulation.

Committing to meeting taxonomy-based targets in the future, when future revisions to Taxonomy criteria are uncertain, may limit the ability of companies to develop robust investment plans and therefore undermine their willingness of companies to use this approach. This uncertainty should be reduced by providing more clarity on revisions on future tightening criteria, for example on a three-year cycle for transitional activities as required by Article 19(5) of the Taxonomy Regulation.¹³ It will provide more predictability, which will help companies to better anticipate and hence accelerate their transition.

It is equally important to ensure that taxonomy thresholds are consistent with sectoral decarbonisation pathways, to ensure a science-based approach. It would be relevant to explore how future taxonomy thresholds may evolve based on sectoral decarbonisation pathways (e.g. until 2030 at least), to provide sufficient visibility for market participants.

It is also recommended to consider the creation of a legal safe harbour for forward-looking disclosures, to mitigate company perceptions of the risk of legal liability (e.g. arising from evolution of plans). This will allow companies, voluntarily, to complement their taxonomy reporting and targets by providing the pathways to achieve them, on the basis of shared and scientifically determined decarbonisation trajectories. These could include, for instance, deadlines or determined durations for the achievement of intermediate objectives per activities or operations.

1.4. Ensure that CapEx disclosures are prominent and accessible

CapEx disclosures should be treated with similar importance to turnover disclosures. The primary ratios of all actors – financial and non-financial – should be reported both in terms of turnover alignment as well as CapEx alignment to the extent possible. Financial products that fall under the scope of the Taxonomy Regulation should strive to disclose alignment using both financial metrics¹⁴.

CapEx disclosures should enable companies to better demonstrate their progress and provide relevant information to users of company reporting. This may include examining how CapEx disclosures could be used to support debt finance for debt products beyond green bonds, or to help companies to set taxonomy-based targets (see section 1.3).

Climate DA	Article 8 DA	Review TR
	✓	

¹³ Criteria can also be drafted in a way which provides predictability – for example, the draft criteria for passenger cars indicate that the emissions threshold will reduce in 2026.

¹⁴ For banks, the EBA advice is recommending a green asset ratio to disclose their taxonomy alignment.

Question 2

Can the EU taxonomy framework support finance for companies undertaking activities that do not yet meet, or may be unable to meet, the substantial contribution criteria? And how can this be done?

What do we interpret this question to mean?

We interpret this question to include companies that can improve the performance of their economic activities to reach or work towards the substantial contribution criteria. This type of company transition is already supported in the Taxonomy framework. The question also includes companies whose activities do not have a viable way to meet the substantial contribution criteria but may still be able to reduce their emissions partially.

Overview of the response to Question 2

The Taxonomy Regulation already has several ways to support activities that do not meet the criteria. There are also several options for supporting the transition of companies whose activities do not have a viable way to meet the substantial contribution criteria yet. In the response to this question, we focus on the limits of the Taxonomy Regulation, which requires the establishment of environmental performance criteria to provide the basis of company reporting.

How the Taxonomy supports companies with activities that can reach the substantial contribution criteria

In answering this question, we consider there are three potential approaches in which the Taxonomy may include enabling activities and measures that result in improvements to performance of an activity, where CapEx investments may be considered as taxonomy aligned:

- a) Activities which are not limited to one sector and can be performed by companies in most sectors, through CapEx, effectively becoming an enabling activity in those sectors. A clear example being building construction or renovation where SC criteria defined for the buildings or building components e.g. individual building renovation measures (see 7.3 in Draft Delegated Act).
- b) Individual measures or renewal/renovation/upgrades that improve performance, for which specific SC technical screening criteria are defined but are not dependent on reaching the SC threshold for the wider activity. These can be either:
 - individual measures such as energy efficiency measures delivering SC (such as for building renovation but may also be defined in other sectors); or
 - renewal activities for existing assets (which can consist of a series of different enabling activity measures put together into a renewal activity for which SC technical screening criteria are based on a relative performance improvement, but that does not reach the SC threshold for the construction and operation of the whole activity e.g. renewal of water collection, treatment and supply systems (see 5.2 in Draft Delegated Act); and
- c) Enabling activities that are incorporated into a single investment plan within a determined time frame that outlines how all of the measures in combination will enable the activity to meet the overall SC and DNSH thresholds for the activity.

Section 2.1 below covers a) and b), whilst section 2.2 covers c).

A topic for consideration for the future is whether clarifying the terminology used for the different types of activities above might be useful for future communications.

2.1 Identification of further individual measures and renewal activities

- a) Activities which are not limited to one sector and can be performed by companies in most sectors, through CapEx, effectively becoming an enabling activity in any sector (subject to some caveats). A clear example being building construction or renovation where SC criteria defined for the buildings or building components can be applied to CapEx spent on buildings by entities in any sector provided that they are not covered by exclusion clauses (in case of buildings, excluding buildings or activities dedicated to fossil fuel). Other possible “across all sectors” enabling activities could be examined and made clearer (with similar caveat as buildings or others as deemed necessary). Purchase of electric vehicles could be examined as one such cross-sectoral activity and others may subsequently be recommended for inclusion in this category.
- b) Individual measures and renewal activities, for which CapEx may be counted, and for which SC and DNSH criteria are set, are already included for certain sectors and activities in the draft DA. The development of similar approaches in other sectors, for example other manufacturing sectors not yet covered, agriculture and forestry should be considered as an important next step, and then in other sectors where it is determined that such individual energy efficiency or other enabling measures and /or renewal/renovation/upgrade activities are valid to be counted as making a SC. In all cases, robust decisions should be made as to which types of enabling activities can be included in forthcoming DAs, noting that this will need to be done with careful consideration, sector by sector, together with robust Article 16 analysis. Communication on Climate DA should clearly indicate that this work will continue aiming for the next DA for sectors considered as a priority. The choice of which approach to use is dependent on what is most relevant and justified for clear SC in each sector.

Ideas for development

Work on the following ideas is in progress within the Platform. The Platform cannot make any final recommendations or conclusions with respect to the topics raised under sections 2.2 to 2.6 at this stage, as such conclusions are pending on future deliverables and endorsement of the Platform. The work is ongoing and could be part of the Commission’s public communication around the Taxonomy.

2.2 Activities that are part of a single activity-specific investment plan to meet the technical screening criteria.

- c) The Taxonomy provides an important transition financing option for companies who perform activities that do not yet meet the Substantial Contribution (SC) criteria, but who make an activity-specific investment plan, to reach SC environmental performance levels for one of the two Climate Change objectives (as covered by the Climate DA). These measures/investments to transform a given economic activity and make it reach SC and DNSH criteria could be counted as taxonomy aligned CapEX - regardless of the starting climate related performance level of the activity – subject to the establishment of criteria for sufficiently robust investment plans, which still need to be developed by the Platform, and that need to be stringent enough to prevent greenwashing. In general, such investment plan would be foreseen as up to 5 years with some cases where up to 10 years would be appropriate, dependent on the nature of the planned investments. The whole activity itself would only be green upon achieving the SC to climate change mitigation or adaptation plus DNSH criteria and provided it also met minimum social safeguards.

It is recommended that this provision is outlined in the **Commission communication around the Taxonomy**, thereby indicating that it can be used by all types of entities disclosing their activities against the Taxonomy criteria (e.g., municipalities, public utilities), as well as in the forthcoming **Article 8 Delegated Act**. We highlight that Subgroup 5 is preparing recommendations related to the Article 8 Delegated Act that the Commission is preparing on the basis of ESAs advice. The Platform cannot make any final recommendations or conclusions with respect to details of such investment plans by companies, and their oversight, at this stage, as such conclusions are pending on future deliverables of the Platform.

We consider that it is important that the TEG’s recommendations for manufacturing are put into the next DA to set the legal precedent. This will then establish clearly that these methods already provide important transition financing options for companies who perform activities who are investing to reach SC level of performance for Mitigation or Adaptation.

For ensuring clarity, the Taskforce raises the importance of distinguishing:

- **The corporate-level transition strategy**: the Taskforce makes recommendation for voluntary disclosure about it (see section 1.3). Such a broad transition strategy encompasses the entire business model of the company. The strategy can help the company to ‘tell its transition story’ but has no impact on mandatory capex KPI reporting.
- The **activity-specific investment plan** to reach SC and DNSH for a specific activity: this is the plan that is referred to in this section. Such an activity-specific investment plan focuses on a specific activity that is clearly presented from the start.

2.3 No-significant impact criteria

The current Taxonomy framework does not at this stage incorporate activities that have no significant impact on climate objectives, but the Platform has already been asked to consider the benefits and implications of developing such criteria in future.

For example, this may include identifying activities which have no significant environmental impact do (noting these are not activities with performance levels between substantial contribution and significant harm). Removing any doubt about the status of these activities from an environmental performance perspective could potentially assist both finance and corporations on sustainable finance allocation questions, by increasing transparency in reporting in sectors in which activities have little or no environment impact i.e. are not material to environmental sustainability.

The Platform is investigating in significant detail the potential for extending the scope of the Taxonomy beyond activities substantially contributing to environmental objectives. This includes evaluating the range of potential advantages and disadvantages of developing no-significant impact definitions and will provide initial recommendations by May 2021 and Final Report September 2021. The Commission should clarify this point including the timing through its public communication.

Climate DA	Article 8 DA	Review TR
✓ Set out timeline of PSF deliberations in public communication around Taxonomy		✓

2.4 Significant harm criteria

In addition to the option of developing no-significant impact criteria (2.3 above), the Platform is investigating the potential to extend the taxonomy to define significantly harmful activities/criteria, beyond the scope of activities in the EU taxonomy for which Do No Significant Harm criteria are established. Should this option be developed in future, it should clearly have important links to transition by identifying activities and performance levels that companies and other entities must move away from. However, as the Platform is examining this issue in detail, no recommendations are put forward in this report. As mentioned above, the Platform will report on their findings later in 2021. Commission should clarify this point including the timing through its public communication.

Climate DA	Article 8 DA	Review TR
✓ Set out timeline of PSF deliberations in public communication around Taxonomy		✓

2.5 Give a clear and encouraging description supporting improvement in performance levels between SC and SH

The question of how to deal with climate change mitigation performance between substantial contribution (SC) and doing no significant harm (DNSH/SH ref Article 17 of TR)), and indeed whether this space can and should exist in all sectors, is covered in work being done by the Platform. Discussions include the possibility to support certain kinds of renewal/renovation/upgrade activities, of which examples are already included in the draft Climate DA (renovation of buildings, renewal of water supply systems), as well as how to support significant improvements of activities that due to their nature may not be able to reach SC in the foreseeable future (e.g., historical buildings). Any such activities and their relevant criteria would be identified based on a careful sector by sector analysis.

Recognising a company's efforts to move its economic activities towards (but not reaching) substantial contribution criteria does not necessarily depend on the full extension of the Taxonomy, with a "colour labelling": a company could use the methodology/metrics included in the technical screening criteria for the Taxonomy's six environmental objectives to signal the "significant improvements" of its activities (i.e. bringing activities closer to significant contribution criteria, but aiming to reach significant contribution criteria in a longer time-frame based on a credible plan).

Future Platform recommendations may provide a useful starting point for broader discussions and analyses including how such ideas may further help reporting by companies and entities who are "transitioning". Commission should clarify this point including the timing through its public communication.

Climate DA	Article 8 DA	Review TR
✓ Set out timeline of PSF deliberations in Commission's public communication		✓

2.6 Establish that Taxonomy criteria could identify activities that cannot improve to a level better than DNSH criteria and incentivise appropriate responses

This potential option relates to the identification of certain activities that could substantially contribute to climate change mitigation (or potentially other environmental objectives) by enabling the stopping of a significantly harmful activity. In the same way that renovation activities are included in the Draft Delegated Act e.g. in buildings, it may be possible to identify decommissioning activities that lead to the closure of an asset which is well before the end of its useful lifetime but cannot transition out of, or away from, a level of performance which is causing Significant Harm.

This idea is closely linked to the considerations around Significant Harm criteria, and as such is part of the ongoing work of SG 3 in the Platform. Therefore, the Platform is unable to provide recommendations on this general option at this stage, however it can recommend to consider inclusion of “decommissioning/closure of” activities listed in Art. 19(3) of the TR, as this legal document already establishes such activities that would never qualify as environmentally sustainable (power generation activities that use solid fossil fuels). Appropriate SC and DNSH technical screening criteria would need to be established should such “decommissioning/closure” activities be included in the taxonomy.

The criteria for deciding which further exiting (decommissioning/closure) activities may be identified would need to be carefully developed in future work of the Platform/TWG. This exercise would need to consider advantages and disadvantages on both socio-economic and environmental aspects. In line with the objective of the Taxonomy, criteria would only aim at providing transparency, but not give advice on who should pay for potential decommissioning measures or make a recommendation for their subsidisation. It may not be necessary to amend the TR itself, as it may be possible to add “Decommissioning of...” in the next Delegated Act, similar to the activities such as “Renovation of...” or “Renewal of ...”.

As mentioned in 2.3 above, the Platform will report on their findings on Significantly Harmful activities later in 2021. Commission should clarify this point including the timing through its public communication.

Climate DA (revision)	Article 8 DA	Review TR
✓		✓

Question 3

Can the current EU Taxonomy framework support finance for companies active in sectors that are not covered in the Taxonomy Regulation's Delegated Act?

What do we interpret this question to mean?

We interpret this question to mean companies that operate economic activities that may be able to substantially contribute to climate mitigation goals but have not yet been considered for inclusion in the Taxonomy. Companies that are unlikely to be prioritised for substantial contribution criteria because they have low emissions are addressed in question 2. Companies that operate economic activities that have been excluded from the Taxonomy are also included in question 2.

Overview of the response to Question 3

Taxonomy aligned financing should only be provided for activities covered in the Taxonomy Regulation Delegated Acts. However, we believe there are opportunities to modify the Delegated Acts without requiring additional Technical Screening Criteria (TSC) to be written to include for a broader array of sectors and activities.

3.1. Create more enabling activities to recognise horizontally linked economic activities

The Commission could propose Taxonomy criteria to be utilised by those performing horizontally linked activities in order to describe their contribution to sustainable activities, e.g. distributors or financiers of products and services that meet Taxonomy criteria.

The Taxonomy currently considers “directly enabling” activities, and typically those upstream of the substantial contribution. This misses out the importance of buyer power for those activities who sit downstream, and the equity influence on those holdings or seller contribution by upstream materials value chains.

Currently the technical screening criteria either relate to the end product (in the case of zero emission vehicles) or the production process (in the case of manufacturing of chemicals, metals and cement, and power and heat/cool generation).

The Taxonomy could be expanded to sectors downstream of the substantial contribution, without any amendment to the TSC, where it related to the product (and not the process) and where the TSC can therefore be demonstrated across the value chain. For example:

- The sale (notably for used) eligible vehicle types under Transport (NACE G 45)
- The financing (credit) for vehicle owners in moving from petrol/diesel to electric fuelled vehicles (NACE K 64.9)
- Repair centres for their work in maintaining eligible vehicle types (NACE G 45.2)

In addition, Data-driven solutions for GHG emissions reductions (Art. 8.2 of DA Annex 1) and Research, Development and Innovation (RD&I) activities (Art. 9.1 of DA Annex 1) should be considered as enabling activities across all economic sectors without the specific reference to technical screening criteria of other activities in the DA.

Climate DA	Article 8 DA	Review TR
✓	✓	

3.2. Launch Taxonomy criteria feedback loop process as soon as possible

The Platform is already mandated to recommend how a feedback loop from the market on activities to be considered for TSC could work. Such a feedback loop will assist companies and financial actors to see how and when additional activity can be considered in future. This could be announced shortly, although new proposals for new activity criteria could not be addressed until later this year.

Climate DA	Article 8 DA	Review TR
✓ Announce and set out timeline in Commission’s public communication on Taxonomy		

3.3. Set out a clearer timeline for assessment of new economic activities

Set out a clearer timeline for assessment of new economic activities for the Taxonomy so that companies and financial market participants know when their activity will be considered. The Taskforce agrees with this recommendation, coupled with a clear process by which companies or industry associations can approach the Platform for consideration in creating Taxonomy TSC.

Climate DA	Article 8 DA	Review TR
✓ Set process and timeline in Commission’s public communication on Taxonomy		

3.4. Updating the Delegated Acts to recognise similar activities across sectors

The Taxonomy lists activities, based on NACE classification, that can be considered eligible for testing. Such activities appear to be inconsistently applied across the Taxonomy today within and across sectors. These suggested NACE codes could be included under the relevant section without the need for new TSC.

- a) DAs include NACE 52.22 ‘Service activities incidental to water transportation’; but not 52.21 ‘Service activities incidental to land transportation’
- b) DAs include NACE 77.11 ‘Rental and leasing of cars and light motor vehicles’ and 77.12 ‘Rental and leasing of trucks’ but not 77.34 ‘Rental and leasing of water transport equipment’ or 77.39 ‘Rental and leasing of other machinery, equipment and tangible goods n.e.c.’ (which includes motorcycles, caravans, railroad vehicles)
- c) Support services for Transport are included but support services for Agriculture are not (NACE 1.6)
- d) Metal Stamping (NACE 25.5) is not included; but auto-metal stamping (NACE 29.2) is listed in the Delegate Acts under Manufacture of low carbon technologies for transport.
- e) Aluminium foil is included under NACE 24.42 in the DA; aluminium cans under NACE 24.53 ‘Casting of light metals’ are not included in the DAs (yet casting of steel and iron is included under NACE 24.51 and 24.52).
- f) Repair is inconsistently included in the DA (under energy, transport and construction) but not for all activities listed in ‘Manufacture of energy efficiency equipment for buildings’ (e.g.

Household appliances) where repairs in NACE 95.21 and 95.22 should be listed under 'Installation, maintenance and repair of energy efficiency equipment'. Repairs to machinery in NACE 33.12 is also not included.

- g) 'Manufacture of energy efficiency equipment for buildings' includes NACE 23.2 'Manufacture of refractory products' (e.g. Bricks, blocks, tiles) & NACE 23.32 'Manufacture of bricks, tiles and construction products, in baked clay' does not include NACE 23.61 'Manufacture of concrete products for construction purposes' which includes tiles, flagstones, bricks, boards, sheets, panels, pipes, posts etc.
- h) Electrical equipment is included in 'Manufacture of energy efficiency equipment for buildings', but electrical installation under NACE 43.21 is not included in the Construction section (only included in Transport). This needs to be updated in Construction to tie the sectors together.
- i) Vinyl flooring under NACE 22.23 is included in Manufacture of energy efficiency equipment for buildings, as is flooring blocks in clay (NACE 23.32) but carpet under NACE 13.9 is not and wood/cork flooring under 16.22/29 is also not. For wood, other carpentry is included in 16.23 (e.g. doors, windows, shutters and their frames). The inconsistency of wood being included for the building structure but excluding the floor could be confusing.
- j) Moving services (NACE 49.42) is not included in transport.
- k) Extension of the activities covered by the sector criteria currently associated with the sector "9.1. Research, development and innovation". This sector is currently restricted to NACE codes M71.1.2 and M72.1. It should be possible to extend this field to all research and innovation activities, including those of entities not dedicated to this sector, which would make it possible to valorise R&D efforts for alignment with the taxonomy, drawing the line where R&D efforts are only applicable to sectors covered in the Taxonomy and where the output of R&D is in line with the TSC.

Corrections:

- a) NACE 17.11 (Pulp) is included in 'Manufacture of energy efficiency equipment for buildings' but with no substantial contribution testing criteria - do we intend to pass pulp with no TSC?
- b) NACE 35.30 (air conditioning) is mapped to 'Installation of electric heat pumps' in the DA, installation of equipment is under NACE C 33.

Climate DA	Article 8 DA	Review TR
✓		

Question 4

How does the use of key terminology such as “sustainable”, “green” and “harmful” compare across the taxonomy framework and other relevant sustainable finance frameworks and how can it be clarified and harmonised?

What do we interpret this question to mean?

We interpret this question to examine conceptual and definitional overlaps and potential misalignment between different sustainable finance regulations.

Overview of the response to Question 4

Below we provide our interpretation of key concepts and definitions in the Taxonomy Regulation (TR) and the Regulation on Sustainability-Related Disclosures in the Financial Services Sector (SFRD).

We will work with the Commission to resolve an understanding and public communication to provide greater clarity about each of these terms, how they relate to each other and whether further harmonisation steps should be taken in future.

4.1. Definition of “green” finance

Green finance is a commonly used term in financial markets, from green banks and green bonds to green loans, green mortgages and other uses. Green finance is generally understood to be targeting the positive agenda towards climate and the environment and the term is used in the markets for products, instruments and finance purporting to be focussed on, and/or dedicated to, environmental objectives.

Green finance is defined in a number of different financial frameworks used in Europe and globally. Some frameworks such as the Green Bond Principles supported by ICMA lay out high level definitions, some list specific assets such as in the China Green Finance Catalogue, whilst others such as OECD’s Rio Markers tracking system for climate, biodiversity and anti-desertification finance are published with extremely detailed guidance documents.

Without commenting on the quality of any individual green finance system, it is widely understood that the growth in green finance without robust, or in some cases any, definitions led to the invention of the pejorative term: “greenwashing”.

Sustainable finance also exists as a term in wider frameworks such as finance for Sustainable Development Goals, UNEP Inquiry, and others. It often has a wider meaning and inference than green, not only because it can cover social as well as economic and financial sustainability and governance, but because it can also mean identifying finance for both the positive agenda and that which is undermining environmental objectives.

The terms “green” and “sustainable” clearly do have different meanings in different frameworks and may not always describe the same finance. It is worth noting that a proposal for an EU Green Bond Standard has been published and is expected to be brought forward by the Commission during 2021. The proposed standard refers to the Taxonomy Regulation, which is widely understood in the markets to be a “green” Taxonomy, but the Regulation does not in fact refer to the term ‘green’.

Properly assessing the implications of the different uses of the terms “green” and “sustainable”, how they relate to one another, and deriving recommendations on how they can be clarified and

harmonised within the EU's own sustainable finance frameworks is an important task that the timescale of this report has not allowed. The Platform intends to continue work on this topic later in its mandate.

4.2. Definitions of “sustainable” in EU sustainable finance legislation

Neither the SFDR or TR defines the terms “sustainable” or “green” in general terms but these regulations do provide definitions of how a type of activity can be judged to be sustainable. Key definitions are described below.

Sustainability factors

SFDR (Article 2(24)) provides a broad definition for the types of sustainability factors which may influence investment decision-making and impact. Sustainability factors refers to “*environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters*”.

Sustainability risks

SFDR (Article 2(22)) defines sustainability risks in financial terms: sustainability risks mean an “*environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment*”.

Sustainable economic activities

For the purposes of establishing the degree to which an investment is environmentally sustainable, the Taxonomy Regulation defines sustainable economic activities as those which:

- a) Contribute substantially to one or more environmental objectives, which are further defined in the regulation (Articles 10 to 16).
- b) Does not significantly harm any of the environmental objectives, with further definitions of harm provided for each environmental objective defined in Article 17.
- c) Is carried out in compliance with the minimum safeguards; and
- d) Complies with technical screening criteria.

Climate change mitigation

The Taxonomy Regulation defines six environmental objectives. Below, climate change mitigation is used as an example.

Article 2(5) defines climate change mitigation as: “*the process of holding the increase in the global average temperature to well below 2 °C and pursuing efforts to limit it to 1,5 °C above pre-industrial levels, as laid down in the Paris Agreement*”.

Substantial contribution to climate change mitigation

Article 10 begins by specifying that: *An economic activity shall qualify as contributing substantially to climate change mitigation where that activity contributes substantially to the stabilisation of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system consistent with the long-term temperature goal of the Paris Agreement through the avoidance or reduction of greenhouse gas emissions or the increase of greenhouse gas removals [...].*

The definition provides a range of eligible methods to achieve this, including but not limited to expanding production and use of renewable energy, energy efficiency, switching to more sustainable raw materials, increasing the use of negative emissions technologies and practices and enabling these actions in other parts of the economy.

Article 10(2) also defines “transitional activities”. This definition is analysed in detail elsewhere in this report and so is not replicated here.

4.3. Analysis

The terms “sustainable” and “environmentally sustainable” have been widely used for many years, with varying interpretation and meaning. The Taxonomy Regulation is designed to provide a common language around sustainability by introducing robust and commonly agreed definitions.

The Taxonomy definitions have several features which may distinguish them from a pre-existing understanding of these terms:

- The definitions directly relate an activity making a “substantial” contribution to global and EU environmental objectives, such as The Paris Agreement. This means that activities making incremental or small contributions, which may previously have been described as sustainable, do not meet the regulatory definition. Activities with limited or neutral environmental footprint may also not meet the definition.
- The definitions are linked to the performance of individual economic activities. It is expected that companies and investors will aggregate their exposure to eligible economic activities to calculate their Taxonomy exposure.
- To claim that an economic activity is environmentally sustainable, it must demonstrate compliance with legally defined technical screening criteria, which should be quantitative wherever possible.
- To be considered environmentally sustainable, it is expected that an activity must avoid harm to all environmental objectives and meet minimum safeguards as well as contribute substantially to one or more objectives.

The definitions serve the specific aims of the regulation. Nonetheless, they may differ from the way these terms have previously been interpreted in the market.

The Platform is considering the role of additional types of criteria within the Taxonomy framework. This is already discussed in response to question 2.

4.4. Definitions of sustainable investment and environmentally sustainable investment

The overarching definition for “sustainable investment” is provided by the Regulation on Sustainability-Related Disclosures in the Financial Services Sector (SFDR). This is supplemented by a more precise definition for environmentally sustainable investment provided by the Taxonomy Regulation.

SFDR Article 2(17) defines sustainable investment as *“an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance”*.

Article 2(1) of the Taxonomy Regulation defines “environmentally sustainable investment” as “investment in one or several economic activities that qualify as environmentally sustainable under this Regulation” (see discussion above of these definitions”).

4.5. Sustainable financial products: Article 8 and Article 9 SFDR

The SFDR defines two types of sustainable investment product:

- Financial products promoting environmental and/or social characteristics (“Article 8 products”)
- Financial products with a sustainable investment as their objective (“Article 9 products”)

Products meeting these definitions must disclose additional information regarding the sustainability performance of their funds. Investment firms select their own KPIs to describe the contribution made, although they may rely on pre-defined indicators when disclosing how significant harm has been avoided (the Principal Adverse Impact indicators).

The Taxonomy Regulation draws from these definitions, but financial products are only required to disclose against the Taxonomy where they are promoting environmental characteristics or have an environmentally sustainable investment objective.

The ESAs draft consultation paper on Taxonomy disclosures for financial products¹⁵ does not seem to make a choice yet on whether products with environmentally sustainable investment objectives have to be aligned with the Taxonomy or whether they can resort to other methodologies.

4.6. Analysis

The definition of “sustainable investment” in SFDR can be considered an overarching definition, supplemented by the definition of “environmentally sustainable investment” in the Taxonomy Regulation.

The definitions have several points in common:

- Both focus on investment in qualifying economic activities.
- Both definitions expect that an activity makes a (substantial) contribution to one or more objectives while avoiding significant harm to other objectives (social and governance objectives are not defined in the Taxonomy Regulation, but the minimum safeguards serve this purpose.)

There are also several differences:

- The SFDR definition of “sustainable investment” is a broad set of principles encompassing the widest possible range of sustainability issues. By contrast, the definition of “environmentally sustainable investment” defines six specific environmental objectives. However, it should be noted that financial products with an environmentally sustainable investment objective (Article 9 products) are required to disclose to what environmental objective(s) as defined in the Taxonomy Regulation the product contributes.
- While the Taxonomy Regulation requires a ‘substantial contribution’ to one or more objectives, the SFDR requires a ‘contribution’.

¹⁵https://www.esma.europa.eu/sites/default/files/library/jc_2021_22_-_joint_consultation_paper_on_taxonomy-related_sustainability_disclosures.pdf

- The SFDR requires the sustainability contribution of an economic activity to be measured and disclosed using KPIs but gives flexibility to the discloser to determine the KPIs. The Taxonomy definition provides precise criteria for assessing when an activity can be considered compliant.

A large number of products will be required to provide SFDR and Taxonomy disclosures. Greater harmonisation of these terms would reduce confusion and streamline reporting.

4.7. Significant harm, Adverse impacts and minimum safeguards

The regulations define several similar concepts: significant harm, principal adverse impacts and minimum safeguards.

Significant harm

The concept of avoiding significant harm is expressed across both SFDR and Taxonomy.

In SFDR, it is a condition of a sustainable investment that it avoids significant harm across all sustainability objectives. Further guidance is given through the draft Regulatory Technical Standard, discussed below.

In the Taxonomy Regulation, an economic activity must also demonstrate avoidance of significant harm. Definitions of significant harm are established for each environmental objective. In the context of climate change mitigation, an activity is deemed to cause significant harm where it leads to significant greenhouse gas emissions, on a lifecycle basis. These definitions underpin technical screening criteria for demonstrating avoidance of significant harm. The draft “Do No Significant Harm” (DNSH) criteria in the Taxonomy delegated act draw heavily from EU environmental regulation.

Principle Adverse Impacts (PAI)

The concept of Principal Adverse Impacts (PAI) is expressed in SFDR, and refers to the impact of investment decisions and advice that result in negative effects on sustainability factors. This concept can apply at both an entity (financial market participant) and financial product level.

Recital 18 SFDR states that when considering PAI, Financial Market Participants should consider the Responsible Business Conduct for Institutional Investors guidance, a framework for conducting due diligence.

Sustainability indicators in relation to adverse impacts on sustainability factors by investee companies may be disclosed to measure the environmental or social characteristics or the overall sustainable impact of the financial product.

Specific indicators for disclosing PAIs will be provided in a forthcoming Regulatory Technical Standard. These are designed for entity level disclosure but can also be relied on for product-level disclosures around PAIs.

Minimum safeguards

For an activity to qualify as Taxonomy-aligned, it must be carried out in accordance with minimum safeguards. Article 18 defines these as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

4.8. Analysis

There are significant overlaps between these concepts, which is recognised in the regulations.

Conceptually:

- The Taxonomy regulation clearly relates the concept of minimum safeguards to do no significant harm (at an investment level). For example, Recital 35: *When complying with those minimum safeguards, undertakings should adhere to the principle of ‘do no significant harm’ referred to in Regulation (EU) 2019/2088, and take into account the regulatory technical standards adopted pursuant to that Regulation that further specify that principle.*
- This is further reinforced in the empowerments to the ESAs, as described in Recital 36¹⁶ which state that the new RTS specifying the disclosures required around the principle of “do no significant harm” should be consistent with the content, methodologies and presentation of the RTS specifying PAI disclosures, and with the fundamental conventions which underpin the minimum safeguards.
- The draft Regulatory Technical Standard underpinning SFDR recognises that significant harm is conceptually related to principal adverse impacts. *Financial product disclosures relating to the ‘do not significantly harm’ principle should explain how the indicators for adverse impacts have been taken into account. Furthermore, as these disclosures are closely linked to Regulation (EU) 2020/852 (Taxonomy Regulation), it is appropriate to require additional information on the alignment of the investments with the minimum safeguards set out in that Regulation¹⁷ (Draft RTS, Recital 33).*

Practically:

- The PAI indicators have drawn inspiration from the Taxonomy environmental objectives and DNSH requirements.
- The minimum safeguards expressed in the Taxonomy have been reflected as part of the core indicators for PAIs and within the RTS specifying the Do Not Significant Harm principle in Article 8 or Article 9 product disclosures under the SFDR.
- The PAI indicators are at investment level, not at economic activity level.

However, there may be room to further harmonise and clarify these concepts. A large number of financial products will be required provide SFDR and Taxonomy disclosures. Greater harmonisation of these terms would reduce confusion and streamline reporting.

¹⁶ *In order to ensure consistency between this Regulation and Regulation (EU) 2019/2088, this Regulation should amend Regulation (EU) 2019/2088 to mandate the European Supervisory Authorities established by Regulations (EU) No 1093/2010¹⁶, (EU) No 1094/2010¹⁶ and (EU) No 1095/2010¹⁶ of the European Parliament and of the Council (collectively, the ‘ESAs’) to jointly develop regulatory technical standards to further specify the details of the content and presentation of the information in relation to the principle of ‘do no significant harm’. Those regulatory technical standards should be consistent with the content, methodologies, and presentation of the sustainability indicators in relation to adverse impacts as referred to in Regulation (EU) 2019/2088. They should also be consistent with the principles enshrined in the European Pillar of Social Rights, the OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights, including the ILO Declaration on Fundamental Principles and Rights at Work, the eight fundamental conventions of the ILO and the International Bill of Human Rights.*

¹⁷ https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

Question 5

What further avenues could be explored to enable financing the transition through development of the taxonomy framework and beyond?

What do we interpret this question to mean?

We interpret “development the Taxonomy framework” to mean the future Taxonomy Regulation review. By “and beyond” we focus on the future sustainable finance strategy, the second climate delegated act and other sustainability related financial regulation.

5.1. Financial product and instrument labelling

Financial **products** in the Taxonomy regulation are portfolios of investments. While a Taxonomy Alignment metric provides an aggregate environmental performance value, it is not a financial product label, which has a specific meaning and legal constraints. Bonds do not fall under the definition of a financial product under SFDR or the Taxonomy Regulation, as they are financial **instruments**, but Green Bonds are directly linked to the Taxonomy through the proposed EU Green Bond Standard (GBS) and through inclusion in certain funds. The relationship between the Taxonomy and financial product, or potential wider financial instrument labelling is that the Taxonomy provides the environmental performance criteria to communicate and compare different labels. Green Bonds, which according to the EU GBS proposal should be in 100% alignment with the Taxonomy, and other disclosures in relation to alignment with the EU taxonomy under the TR, can already include **Transitional** activities which are included as green and sustainable in the Taxonomy.

Beyond this, market participants may wish to issue other products or instruments under other labels relating to *transition* more or less closely, and they are free to do so, and if done for instruments, this would be outside the current scope of taxonomy disclosure. Such labels should be distinguished from labelling of activities substantially contributing to environmental objectives in alignment with the EU taxonomy i.e. green finance. As the disclosure of the level of Taxonomy alignment for instruments is not currently covered by the Taxonomy Regulation, this may be seen as creating a disclosure gap in “sustainability” capital markets. In future such disclosure requirements for financial instruments promoting environmental characteristics, including or only for bonds, could be linked to disclosure against Taxonomy, which would be possible without any new label creation. It should be highlighted that prior to any decision, it would be important to assess the rationale, and methodology, for linking Financial Instruments such as bonds with the Taxonomy.

Any development of additional labelling schemes for financial products or instruments would require careful consideration and must also take account of existing labels, particularly the EU Ecolabel, and would require consideration of grandfathering issues as was done in the GBS. Additional labels may add opportunities but may also add to market confusion and therefore additional labels should only be justified when they help consumers / investors with decision making, taking into consideration that a plenitude of labels is counterproductive to this purpose.

The clarification on Green Bonds as mentioned above may not be possible in the Commission communication because the EU Green Bond Standard is not yet developed, and only the TEG proposal is in the public domain. Nevertheless, a positive message about it should be put in the Commission communication: clarifying how the GBS would and could cover use by companies and other issuers for “Low-carbon”, “Transitional”, “Adaptation” and “enabling” activities – we recommend some good examples of each case to assist with this communication story.

Information on what might be possible regarding disclosures of levels of compliance with the Taxonomy for financial instruments such as use-of-proceeds bonds, could be included in Commission communication – indicating that this might be a useful, voluntary disclosure by companies who wish to show level of compliance of their Green Bonds with Taxonomy. This may require some analysis on further details such as, but not limited to, clarifying what are the requirements, or not, for non-EU GBS Financial Instruments, in relation to Taxonomy, and if use of terminology in Taxonomy Regulation may indirectly create disclosure obligations or risk of legal liability in relation to Taxonomy Regulation.

Disclosures against Taxonomy for financial instruments such as use-of-proceeds bonds which are promoting environmental characteristics may be looked at in future, for consideration as part of the upcoming

Criteria trajectories and grandfathering

- Building trust in taxonomy-related financial instruments and products requires predictability on ambition levels of future SC and SH criteria. Defining trajectories for technical criteria that forward-looking instruments/products can report against, reduces risks of investments into stranded assets and the need for later adjustments. If science-based trajectories for SC and SH criteria are defined wherever possible, issuer’s trust should be preserved by allowing for grandfathering of the affected product or instrument.
- In practice, especially where investment plans are issued to meet technical screening criteria, financial products that are issued as Taxonomy aligned will always be able claim that it was issued as such even if technical screening criteria change later. However, if technical screening criteria are changed (likely tightened) during the life of the plan, the asset or the financing, it would be necessary for the issuer of the financial product to transparently disclose about the adjusted environmental performance of the underlying investments.
- For the avoidance of doubt, refinancing of economic activities would require application of the most recent taxonomy version.

Climate DA	Article 8 DA	SFDR / Revised Sustainable Finance Strategy
✓		✓

5.2. Introduce a phase out trajectory from ‘Significant Harm’ (SH) to improve in alignment with ‘Substantial Contribution’ (SC) over a defined transition timeframe

The Commission could use an alternate mechanism that draws on the Taxonomy criteria to establish transition pathways for certain environmental performance levels, that could be applied to specific economic activities. Alignment would mean investing in the best available technology during the trajectory, with a possibility to upgrade the invested assets when the technology improves during the period and potentially, a third-party verification, to prevent green washing and stranded assets. Subject to ongoing work within the Platform a significant harm criterion could track performance levels – with a trajectory - to align with substantial contribution criteria over a period of 5 years or, dependent on the nature of the planned investments, in some cases 10 years.

Unless the performance of the relevant economic activity improved to SC level over the transition timeframe, based on grandfathered most recent Taxonomy criteria at the time of embarkation on a pathway for the sake of planning reliability, it would fall into a significantly harmful / no-significant

impact performance assessment under the Taxonomy and would no longer be transition compliant. Monitoring and compliance capacity would also be needed here.

Climate DA	Article 8 DA	Revised Sustainable Finance Strategy
		✓

5.3. Establish or utilise tools or metrics outside the Taxonomy to allow companies to demonstrate their transition plans

Taxonomy alignment percentage provides a clear and useful metric about the proportion of a portfolio that substantially contributes to climate mitigation goals. But other metrics can be better suited to reporting transition in terms of emissions reductions or the financial implications of company transition. Sectoral decarbonisation pathways are another critical opportunity for companies to clarify how they own transition is consistent with the transition required at sectoral level and demonstrate robustness.

Widely used tools include:

- Emissions reduction targets and performance.
- Methodologies and metrics for assessing and reporting emissions reductions include:
 - Recommendations of the Taskforce on Climate-Related Financial Disclosure (TCFD), which call for the use of scenarios).
 - Sectoral decarbonisation approaches (SDAs)
 - Recommendations of the Science-based targets initiative¹⁸

The market would benefit from companies seeking sustainable finance, voluntarily incorporating the taxonomy when reporting at corporate-level on their transition strategies. For instance, their reports could include the following: description of their transition and/or sustainability strategies, implementation plans, how they relate to the Taxonomy. Ensuring coherence of company reporting that is provided line with the TCFD framework would also assist the market.

The market would also benefit from clear sector pathways / transition scenarios, which explain the implications e.g. the pathways for each sector to reach net zero before 2050, consistent with the 2030 target. The use of these pathways in the market should be further explored, although it should not be assumed that incremental emissions reductions in the short term are equivalent to making a substantial contribution.

Climate DA	Article 8 DA	Revised Sustainable Finance Strategy
		✓

¹⁸ The Science-Based Target initiative helps companies set tailored voluntary science-based targets, validated independently, with a requirement for annual reporting against target. Almost 1200 companies committed /set such a target globally in 60 countries and 50 sectors. <https://sciencebasedtargets.org/>

5.4. Consider relating to the *Climate Transition Benchmark* which includes transition requirements for companies

This provides a related EU sustainable finance regulation through which to explore how to define climate transition at corporate level, though it should be noted that the Benchmark regulation provision in question is applied on a financial portfolio level. Noting this is not a Taxonomy approach, but an alternate metric. Most relevant elements in the Benchmark Regulation include:

“(23a) “EU Climate Transition Benchmark” means a benchmark which is labelled as an EU Climate Transition Benchmark and fulfils the following requirements:

(a) for the purposes of point 1(b)(ii) of this paragraph and of Article 19b, its underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonisation trajectory;

(b) it is constructed in accordance with the minimum standards laid down in the delegated acts referred to in Article 19a(2);

(23c) “decarbonisation trajectory” means a measurable, science-based and time-bound trajectory towards alignment with the objectives of the Paris Agreement by reducing Scope 1, 2 and 3 carbon emissions as referred to in point (1)(e) of Annex III.”

In addition, the delegated act C(2020) 4757 of 17/07/2020 on Climate Transition Benchmarks requires in its Article 6:

“Article 6: Companies setting and publishing GHG emission reduction targets

Administrators of EU Climate Transition Benchmarks and administrators of EU Paris-aligned Benchmarks may increase in those benchmarks the weight of the issuers of the constituent securities that set and publish GHG emission reduction targets, where the following conditions are fulfilled:

(a) the issuers of the constituent securities publish consistently and accurately their Scope 1, 2 and 3 GHG emissions;

(b) the issuers of the constituent securities have reduced their GHG intensity or, where applicable, their absolute GHG emissions, including Scope 1, 2 and 3 GHG emissions, by an average of at least 7 % per annum for at least three consecutive years.

For the purposes of the first subparagraph, Scope 3 GHG emissions shall be construed in accordance with the phase-in implementation period set out in Article 5.”

Climate DA	Article 8 DA	Revised Sustainable Finance Strategy
		✓

Question 6

Can we clearly address the concerns that the taxonomy will be used to prevent financing of transitional activities, while at the same time ensuring that we are not facilitating “green-washing”?

What do we interpret this question to mean?

This question refers to two issues:

1. Concerns that the Taxonomy will be applied by investors and other financiers in simplistic or highly restrictive ways, leading to a reduction in capital available for the necessary transition;
2. Ensuring that the Taxonomy-aligned financing truly contributes to the achievement of the EU Green Deal and associated environmental targets.

Overview of the response to Question 6

The concern that the Taxonomy will be used to prevent financing of transitional activities pre-empts use of the tool in the market, as does the concern that the taxonomy will facilitate greenwashing. While it is not possible to use evidence of Taxonomy implementation to reinforce or eliminate this concern at this stage, there is substantial market experience on the use of environmental screens or exclusion factors in financial products.

How financial market participants and financial institutions will use the taxonomy for transition finance and the impact it will have in actual financing will depend on two factors:

1. Reporting: Taxonomy reporting indicators, transition-related reporting and how the taxonomy fits within the latter. The Platform has made a series of recommendations already relating to reporting requirements (see earlier sections of this report).
2. Type of finance or investment: Different financial products, instruments, the investment objectives and strategies – including general purpose lending as opposed to purpose lending, and labelled financial products and instruments.

Varying definitions of sustainability may continue, as compared with those foreseen by the Taxonomy. The Platform may assist in response to market doubts about how to categorise and respond to the co-existence of differing views and definitions of sustainability by potentially recognising that alternative views on sustainability may persist, as compared with the Taxonomy Regulation. Markets are nonetheless encouraged to recognise that the Taxonomy helps to establish a science-based, objective benchmark for sustainability, and that the Taxonomy is expected to evolve over time. Where markets are in doubt as to the interpretation of the Taxonomy Regulation, it is recommended to seek dialogue with the appropriate regulator. Separate guidance on engagement protocols could be made available.

Type of finance or investments

Taxonomy-reporting is mandatory for financial products that claim to either have an environmental objective or environmental characteristics.¹⁹

¹⁹ See Articles 5 and 6 of the Taxonomy Regulation: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852>

Below we provide an overview on how the most common financial instruments typically approach environmental performance investment. This is not a comprehensive or detailed list. The purpose is to provide a few examples on how the taxonomy can be used, and to demonstrate that the Taxonomy is unlikely to prevent financing of transitional activities.

Loans

When companies seek a general purpose loan, banks will assess the creditworthiness of the company. This includes not just their credit history, but also the intended purpose of the loan and the company's ability to pay off the loan. There is no reason to believe that this practice will be cease because of the Taxonomy. The Taxonomy will not change this, but it may complement one of the criteria in the credit assessment. Over € 1 trillion in financing via (syndicated) bank loans²⁰ has been agreed in 2020 and hence there is clearly sufficient financing available for activities that may not qualify for the taxonomy.

In terms of environmental performance, for a general-purpose loan, a bank with advanced practices may assess companies against a range of factors, including the company's overall climate transition strategy, their transition plan, the targets set for greenhouse emission reductions, the governance of climate change within the company, and their risk management policies. The Taxonomy can be used as an additional factor for general loans.

If companies ask for a green loan, with the specific intention that the loan is supporting an environmentally friendly investment, then there may be a requirement for the company to meet or demonstrate planned improvements to meet Taxonomy criteria.

The Taxonomy can support design of certain types of banking loans, which would qualify as taxonomy aligned. As part of this, banks might introduce e.g. sustainability-linked loans, clearly supporting the goal of transition. This would motivate companies in providing the relevant data to obtain such financing, including detailed transition plans, in particular if these loans potentially have differentiated concessions, e.g. preferential interest rate linked to progress towards Taxonomy criteria/eligibility.

Overall, banking loans will be responsible for the largest pool of funding. If we exclude financials, bank loans accounted for around 45% of total non-financial corporation (NFC) debt financing in 2018, down from around 60% in 2007.²¹

Fixed Income – Bonds

The bond market has a crucial role to play when it comes to financing – obvious in its sheer size: Globally, there are tens of trillion € of corporate bond debt outstanding.²² Equivalently to bank loans, there is clearly sufficient financing available for activities that may not qualify for the Taxonomy.

On corporate bonds, banks also analyze the issuer's financial situation. Most important is the issuer's credit rating. Other factors considered include what the funds will be used for (e.g., activities, buyback, opportunities) and other traditional financial metrics, e.g. bond maturity, liquidity, cash flow, business plans. Often investors will have their own credit ratings process to gauge the quality of the issuer's bond. More commonly these days, investors are increasingly applying ESG filters when making investment decisions on corporate bonds to ensure that minimum thresholds are met. The Taxonomy can be used as one of the selection criteria applied to a number of their funds by investors.

²⁰ Source: Dealogic.

²¹ ECB, Assessing bank lending to corporates in the euro area since 2014, Economic Bulletin, Issue 1/2020

²² Source: Bloomberg

Green bonds are tied to the bond's use of proceeds towards green activities as defined under existing green bond frameworks. Demand for green bonds may increase rapidly in response to new policy measures that incentivise green financial products, making them ideal financial instrument to raise large amounts of funding in capital markets. Bonds that meet the requirements of the forthcoming EU GBS as soon as available will be prioritised by European investors as they guarantee a 100% taxonomy-alignment.

The green bonds market continues to grow, especially in Europe. In the first half of 2019, Europe was responsible for 47.7% of the global green bond market.²³ Other types of sustainable bonds will also continue to grow alongside the EU GBS such as non-EU GBS green bonds and sustainability-linked bonds. The market for sustainable bonds is growing very rapidly with issuance reaching nearly USD 600bn in 2020.

Sustainability linked bonds typically tie sustainability KPI's or targets to a bonus/ malus applied to the bond's coupon rate. During the life of the bond, test date(s) are defined to measure the predetermined KPI and the bonus/ malus is applied depending on whether or not the KPI targets are met. In the future, sustainability linked bonds could attach their sustainability requirements to a taxonomy-related target. The market for bonds that finance environmental improvements, even if an activity is not yet Taxonomy-aligned, is expected to remain modest. For example, Moody's estimates that use-of-proceeds Green, Social and Sustainable bonds may represent 8%-10% of total global bond issuance in 2021. This still leaves 90% of the bond market for all types of 'transition' finance.

Equity

While debt and lending products (bank loans leading) can help raise funds for activities and assets that are not yet taxonomy-aligned and therefore are ideal instruments to finance the transition, equity rewards those companies which have already made efforts in greening their activities. Equity may help raise funds to expand alignment to other activities or improve those already green. Index investing and other type of specialised investments do likewise.

At fund-level, while equity might tend to prioritise revenue-alignment, and fixed income likely to favour CapEx/OpEx-alignment, both KPIs, if used together, provide useful information to financial institutions to finance companies that are improving their performance, rather than requiring that Taxonomy-alignment has already been achieved. This report sets out a series of ideas for how this can be facilitated.

Further, there is no minimum requirement for taxonomy alignment by a company or financial product: it will be down to investors to decide for their different funds and investment strategies what level of alignment on revenues and capex they expect. Fund labels may require pre-defined Taxonomy alignment levels e.g. the forthcoming EU Ecolabel for financial products, especially for the retail market in which retail investors need very accessible and understandable information.

While it is too early to give conclusive numbers, early estimates based on voluntary adoption of the Taxonomy suggest that a typical diversified equity portfolio will reach around 5-20% alignment with the EU Taxonomy. This suggests that a simple Taxonomy-alignment screen would be too restrictive for the majority of funds, and therefore concerns that the Taxonomy will restrict financing are premature.

²³ <https://www.refinitiv.com/perspectives/market-insights/tracking-the-growth-of-green-bonds/>

Other asset classes

Other relevant asset classes such as real estate, private equity, infrastructure debt have not been addressed in this report. Note that the Taxonomy may also be used in defining the green and transitional nature associated with these and other asset classes. More specifically for example for project financing, the CapEx KPI and the disclosure of future investment plans would be useful in determining alignment. More examples need to be flushed out on how Taxonomy could be applied in the various asset classes.

Linking more diverse financial instruments (beyond sustainability-linked or transition bonds/loans) to the transition criteria of the Taxonomy, may turn the latter into a pivotal instrument in the development of an ambitious transition finance. The objective would be to encourage the emergence of innovative tools to accompany the growing interest of investors, banks and borrowers in responsible investment and borrowing to finance transition plans. The Taxonomy as explained will also be attached to entity-level forward looking and holistic financial instruments, offering a comprehensive picture of companies' carbon neutrality strategies.

Avoiding greenwashing

The purpose of the Taxonomy is to provide a robust and unambiguous understanding of which economic activities and assets can make a substantial contribution to the EU's environmental goals.

Exposure to Taxonomy-aligned activities is one type of information that companies can use to plan and communicate their transition. However, the Taxonomy alone may not be a suitable tool for communicating details of a company's overall transition, including incremental improvements in performance which do not result in activities being aligned to the Taxonomy.

Throughout this report, the Platform sets out a series of concepts and proposals which could increase access to transition financing for economic actors with a range of starting points, while retaining the integrity and credibility of the Taxonomy technical screening criteria.