

EU TAXONOMY FOR SUSTAINABLE ACTIVITIES

-

SKYDIVING KIT



GREEN & SUSTAINABLE **HUB**



EXECUTIVE SUMMARY

As of September 2020, there are four months left before the **publication by the Commission of the first round of the so-called “Taxonomy Delegated Acts”**. These legally binding acts are long awaited because they will encompass Taxonomy’s **technical screening criteria** (i.e. metrics, thresholds, etc.) on climate change mitigation and adaptation¹. They will detail implementation specifics and technicalities of the Taxonomy Regulation. It should be recalled that all the previous work done including from the Technical Expert Group (TEG) consists only of non-binding recommendations.

This report is a skydiving kit to prepare investors and issuers for the great leap into the “Taxonomy era”. In June 2020, the [Taxonomy Regulation](#) was published in the Official Journal of the European Union. The Regulation establishes a **precise EU-wide classification framework to identify economic activities and investments that can be treated as environmentally sustainable**². The final piece of the puzzle are the Delegated Acts. In October 2020, a draft will be published for feedback before adoption of the definitive version by 31 December 2020. Once Delegated Acts are published, the clock will be ticking before the Taxonomy enters into force. **First companies’ reports and investors’ disclosures using the EU Taxonomy are due by the end of 2021.**

The Taxonomy, as an authoritative dictionary of what is sustainable, could **play an ever more decisive role following the agreement by the European Council on the EU’s recovery plan**³. In the wake of the economic downturn triggered by the COVID-19 pandemic, the European Commission’s €750 billion recovery fund will be geared around climate action to bring Europe to net zero by mid-century. Albeit precise mechanisms

ensuring funds are channeled to climate-friendly expenditures are still unknown, **the EU Taxonomy seems to be the most suited engine or compass**. Moreover, the crisis calls for an international coordinated response supporting sustainable economic frameworks governed by harmonized criteria. Europe’s first large-scale fiscal stimulus plans is a chance to spur the use of the Taxonomy that would in return prevent a brown or a pale green recovery.

The Taxonomy is a European legislation that creates a comprehensive classification system for sustainable economic activities that investors and companies will be required to use when investing or developing activities allegedly green. **This report especially comments the latest and final TEG’s Reports released last March**. As a reminder, the Platform on Sustainable Finance, the successor of the TEG, will be appointed and operating by autumn 2020. We also analyzed **public answers to some of the Taxonomy-related question of the consultation on EU’s Renewed Sustainable Finance Strategy**.

Is the Taxonomy fit for purpose and are its architecture and operating rules appropriate? Or is it creating unbearable and unnecessary requirements based on unreachable thresholds?

First comes usability. **We believe the TEG’s latest guidance make it more user-friendly but still demanding and calling for unprecedented transparency**. It is somehow cumbersome but necessary due to the transformative ambition of the Taxonomy Regulation. Sustainable finance mainstreaming cannot be effortless. Abiding by the Taxonomy will require significant auditing and information systems changes for companies, new skills and training for employees, staff bandwidth, external support, etc.

Climate change adaptation: Sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; protection of healthy ecosystems.

³ For further details, see our recent article [“Historic deal reached on the EU recovery package and budget”](#)

¹ As a reminder, the Taxonomy sets technical screening criteria for economic activities which: make a substantive contribution to one of six environmental objectives; do no significant harm (DNSH) to the other five, where relevant meet minimum social safeguards

² The six environmental objectives encompassed in the Taxonomy Regulation are: Climate change mitigation;

If we were to choose one word to describe the TEG's March 2020 reports, it would “tools”. The TEG has clarified how to use the Taxonomy and to deal with challenges such as interim period, temporary lack of technical screening criteria, social minimum safeguards, do no significant harm assessments or challenges arising from activities outside the EU. In addition, new activities were reviewed, some thresholds and metrics have been modified in the March 2020 version.

As of today, it is impossible for investors and banks to report consistent and verified Taxonomy-related data without the raw data that can by nature, only be collected and processed by organisations themselves. A few companies have started assessment such as Acciona, which was the first company releasing the level of alignment of its business to the criteria suggested by the TEG⁴. The revision of the non-financial reporting directive (NFRD) can be decisive provided it is set to require extensive use of Taxonomy and spur large-scale appropriation.

Secondly, **stringency**. Overall, **we consider that the technical screening criteria proposed by the TEG are rather stringent**, although variable from an activity to another in practice. They might serve as a safeguard against green washing in the finance sector. The metrics and thresholds are reportedly backed by the consistency with the climate objectives of the European Union. It just so happens that the envisioned objective of 50% to 55% emission reduction by 2030 compared to 1990 and the net zero emission objectives by 2050⁵ are ambitious. It is crucial to bear in mind that the Taxonomy disclosure obligations encourage to report not only on the activities that already meet the screening criteria, but also on the progress of those on their trajectory towards meeting them.

The answers to the [public consultation](#) on [EU's Renewed Sustainable Finance Strategy](#) reveal

that there is a growing consensus that setting demanding thresholds without providing intermediary levels may have unintended consequences and is not really encompassing the necessary close monitoring of transition. The Taxonomy thresholds exclude *de facto* the bulk of companies and facilities within high emitting sectors because of thresholds calibrated on aspirational performance levels. In an attempt to provide leads for future consideration of this major limitation, the TEG has formalized in its 2020 March Reports two proposals to mitigate the adverse effects of the binary nature of the Taxonomy⁶ and its stringency. The two proposals are:

- Introducing “**a three-performance structure**” that would differentiate activities that can make a “substantial contribution” (**green**), do “significant harm” (**brown** or red) or can be classified in a “middle category of **neither** substantial contribution nor significant harm”.
- Consider as eligible, i.e. Taxonomy aligned, “*the financing of **improvement measures that are part of an implementation plan to meet activity threshold over a defined time period***” (forward-looking eligibility).

Although these two options were neither in the strict remit of the TEG⁷, nor enshrined in the final text of the Taxonomy Regulation (there is only a mere mention of a “brown taxonomy” in the review clause, see herein), they deserve attention. We paid heed to these proposals because the final political agreement on the Taxonomy Regulation includes a review clause for year-end 2021. It tasks the Commission to set out in a report the provisions that would be required to extend the current taxonomy to “brown’ activities”⁸. Furthermore, following the public consultation held this summer by the Commission on its “Renewed sustainable finance strategy”⁹ and given the political momentum to tackle climate

therefore eligible or fail it all. It passes or not, there is no nuances.

⁷ Indeed, the TEG was mostly tasked with the mission of defining criteria for “substantial contribution”

⁸ According to the exact wording activities that significantly harm the environment, see §59 of the Taxonomy Regulation.

⁹ Within the present publication, we have selected the relevant questions related to the Taxonomy and developed our analysis after having outlined the main trends in answers which were published on the European Commission's website.

⁴ Acciona carried out a classification report of its activities using the criteria of the EU Taxonomy. The company states “93% of CAPEX, 83% of EBITDA and 58% of sales classified as low carbon according to the European Commission's Taxonomy of sustainable activities” Available [here](#).

⁵ The EU will bring forward a comprehensive plan to increase the EU 2030 climate target to at least 50%.

⁶ Under the overall Taxonomy scheme an activity can either meet the threshold and various criteria and being

change, the Taxonomy Regulation might be revised earlier to expand its scope and officially decide to create a brown taxonomy.

The review clause also requires the European Commission to publish a report by 31 December 2021 on **extending the scope of the Taxonomy to social objectives** (§59 of the Taxonomy Regulation). Prior to the COVID-19 crisis outbreak, we believed a Taxonomy of social activities was a pipe dream, but the pandemic has dramatically reshaped what is feasible¹⁰ and we believe there is a both a need and political room for introducing a social classification inspired from the 2030 Agenda and the SDGs.

Interestingly, we note that the EU's agenda on sustainable finance may also be influenced by "taxonomy-like" developments overseas.

In Canada for instance a taxonomy is poised to be released in September¹¹. In China the 14th five-year plans are being drafted and efforts towards unification of discrepant taxonomies (called "Catalogues" in China's context) are being made¹².

Lastly, in the United States the results of the Presidential Election might bring back the U.S. to the climate finance table and reinvigorated international competition for setting sustainable finance standards¹³.

We hope you enjoy the read.

Natixis CIB Green & Sustainable Hub



¹⁰ See our editorial "Covid-19: a new (sustainability) model in the making?" Available [here](#).

¹¹ The Canadian taxonomy is due to be published in the first half of September, according to Peter Johnson, chair of the working group developing the taxonomy under the aegis of the Canadian Standards Authority (CSA). It will first include a list of "activities and sub-activities" in the energy, utilities, and forestry sectors,

¹² See our article "A Greener Green Bond Catalogue: The incoming China's unified Taxonomy notches new win". Available [here](#).

¹³ We are preparing a special report on the potential consequences on climate change of the possible election of Joe Biden as the 46th President of the United States of America.

OUR OPINION

The EU Taxonomy Regulation tries to establish a science-based dictionary defining what is (hopefully unambiguously) sustainable and sets disclosures requirements for various financial actors and corporates about the extent to which they abide by this dictionary (revenues, investment, etc.).

It covers with rich technicalities a broad scope of economic activities usually not considered as part of the “traditional green economy”. We believe it may provide a boost in mainstreaming green & sustainable finance through wider scope of activities considered as well as common language.

High emitting sectors are indeed provided with criteria to determine under what conditions they can be considered as environmentally sustainable. However, the current stringency calibration of the criteria makes it an instrument only practicable for the very few forerunning companies. Therefore, we would be in favor of in the introduction of intermediary level(s) of green as well as of the definition of technical criteria with thresholds defining “brown” or harm.

The EU Taxonomy allows various uses beyond what is legally required. It can inform and underpin the design of sustainable products, funds, financing programs or even supervisors and central banks’ interventions. It can serve purposes beyond financing or investing activities, such as Public or private procurement requirements, industrial policies, etc.

On average, the technical screening criteria proposed by the TEG, which are likely to be embedded into the legislative acts, are stringent. They sometimes require actual measurement rather than estimations. In itself, data collection by companies to evaluate their activities against Taxonomy criteria is demanding. Companies’ processes and information systems must be reshuffled to be able to feed the metrics and produce compliance information.

The Taxonomy defends a comprehensive sustainability model. It is not single topic focused on climate change. Contribution to its mitigation or adaptation must not be at the expense of biodiversity or blind to social concerns. Although the practicality of “do no harm” criteria and the assessment of the minimum social safeguards seems still challenging.

A tremendous work has been achieved with around 70 economic activities covered but there are still some activities orphaned of criteria. Above all, criteria will be adjusted and refined regularly. Criteria for contribution to other environmental objectives¹⁴ are to be developed by the future Sustainable Finance Platform. The governance of the overall scheme will be decisive, it must avoid being captured by vested interests and strive to find a balance between on one hand sophistication and usability and on the other hand integrity and inclusiveness.

As an ever-evolving scheme, managing interim periods will be crucial. Some actors – namely verifiers, auditing firms, banks in their structuring and underwriting functions – will play a key role in filling in the gaps especially until full completion of technical screening criteria is achieved.

There are still areas of uncertainty regarding the procedural requirements to demonstrate compliance with taxonomy criteria. However, we would not recommend to wait-and-see. The Taxonomy is a matter for today not for tomorrow. It will enter into force in a very short lapse of time. Preparing to abide by it will be demanding. The first set of disclosures are required to be complete by the end of 2021.

We invite market participants to seize the opportunities offered by the Taxonomy and not to see it as a burdensome additional transparency requirement. A strategic use of the Taxonomy for companies aiming at adapting their business models is possible. Taxonomy KPI dashboards on revenues, CAPEX (including R&D) and OPEX can be a compass in their transition journeys. In return, the policy-makers must closely monitor the effects of the Regulation, be able to adjust, and feed their decisions with active feedback from market participants. Until now, transparency and dialogue have been remarkable.

¹⁴ Sustainable use and protection of water and marine resources; transition to a circular economy, waste prevention and recycling; pollution prevention and control; protection of healthy ecosystems.

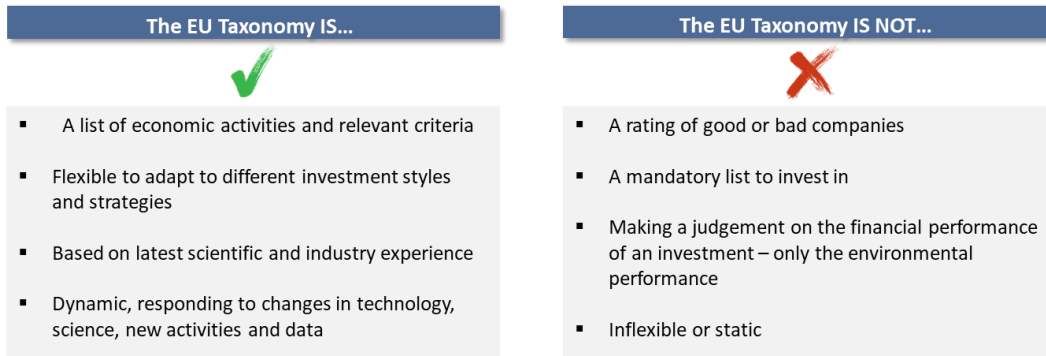


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REMINDING THE BASICS





As a reminder, a Taxonomy is a classification tool to help investors and companies make informed investment decisions on environmentally friendly economic activities. It is supposed to establish market clarity on what is sustainable.



The EU Taxonomy is a list of economic activities with performance criteria for their contribution to six environmental objectives. To be Taxonomy-eligible, an economic activity must go through four steps:



The EU Taxonomy scope covers a rather universal remit.

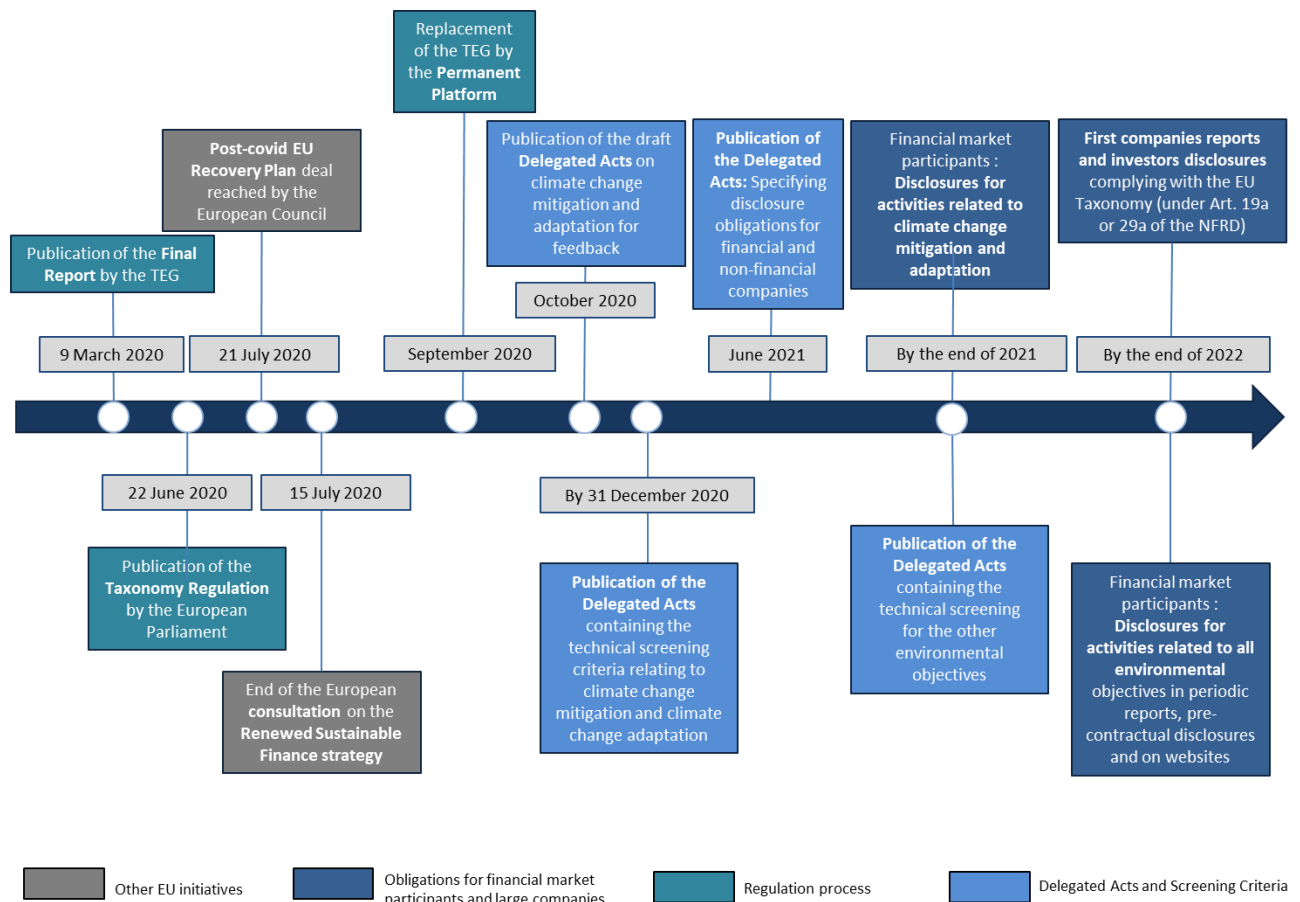
Members States & the Union	Large companies	Investors
 <p>Members States & the Union will be required to apply the Taxonomy when adopting measures (labels or standards) setting requirements on financial products or corporate bonds presented as “environmentally sustainable”.</p> <p>Examples:</p> <ul style="list-style-type: none"> Energy Transition Labels Non-Financial Reporting Directive (NFRD) Update on the French Art 173 <p>Other options:</p> <ul style="list-style-type: none"> Tax incentives, public Procurement ECB’s climate-related interventions 	  <p>Issuers subjected to the Non-Financial Reporting Directive (NFRD), which applies to roughly 6,000 large companies and groups across the EU.</p> <p>They will be required to disclose the proportion of :</p> <ul style="list-style-type: none"> Turnover Total investments (CAPEX) Expenditures (OPEX) <p>... that are compliant with the EU Taxonomy criteria (breakdown low carbon, transition and enabling activities)</p> <p>NB: A specific delegated act will address large financial companies</p>	 <p>Institutional Investors (insurers, asset managers, pension funds), selling in Europe:</p> <p>A. Financial products allegedly or labelled as “ESG/SRI/Green/Sustainable” (pre-contractual disclosures and periodic reports should disclose information on <i>how and to what extent</i> the investments that underlie the product meet the taxonomy technical criteria)</p> <p>B. “Mainstream” financial products not marketed as green: a “<i>comply or explain</i>” requirement, which requires an explicit statement if the Taxonomy is not used “The investments underlying this financial product <i>do not</i> take into account the EU criteria for environmentally sustainable investments.”</p>

LEGISLATIVE PROCESS AND FORTHCOMING MILESTONES

1. WHERE DO WE STAND IN THE TAXONOMY ADOPTION AND ENTRY INTO FORCE PROCESS?

As explained before, on March 9th 2020, the TEG released three documents before the **Taxonomy Regulation** (EU 2020/852) which was finally published in [the Official Journal of the European Union in June](#). This Regulation specifies that the European Commission shall adopt the **Delegated Act containing the technical screening criteria related to climate change mitigation and climate change adaptation objectives by 31 December 2020**. These Delegated Acts, after being adopted by the European Commission, are submitted to the Parliament and the Council. **The first companies' reports and investors' disclosures using those criteria are due at the end of 2021**. For the rest of the environmental objectives pursued by the Taxonomy Regulation, the Delegated Acts are due by 31 December 2021 with a date of application by 31 December 2022. The timeline below details the different steps classified by the type of process and of actors.

Figure 1: The EU Taxonomy timeline - Legislative process and entry into force



2. IS THE 2020 MARCH TEG’S REPORT THE FINAL VERSION OF THE EU TAXONOMY?

No, it is not. The only official and legal reference of the technical screening criteria to be implemented will be the **Delegated Acts** to be adopted by the Commission based on the recommendations and advice from the TEG and the Platform on Sustainable Finance (to be launched Q3 2020).

On March 9th 2020, the Technical Expert Group on Sustainable Finance (TEG) published its final reports intended to assist the European Commission in implementing the Taxonomy Regulation (the official name being “[Regulation on the establishment of a framework to facilitate sustainable investment](#)”). Three documents were released in March 2020:

- **The “Taxonomy: Final report of the Technical Expert Group on Sustainable Finance”** (67 pages): it presents the framework and environmental objectives for the Taxonomy, as well as requirements under the Taxonomy Regulation provisional agreement for financial market participants, large companies, the EU and Member States. It contains **recommendations relating to the overarching design of the Taxonomy, guidance on how users of the Taxonomy can develop Taxonomy disclosures and a summary of the economic activities covered by the technical screening criteria.**
- **The “Taxonomy Report: Technical Annex”** (591 pages): it contains **updated criteria** – 70 for climate change mitigation and 68 for climate change adaptation economic activities – and enriched recommendations, including criteria for “do not significant harm” to other environmental objectives.
- **The Usability Guide on the Green Bond Standard** (52 pages): it is a **voluntary standard proposed to issuers who wish to align with best practices in the market.** It builds on market best practices such as the Green Bond Principles (GBP), developed by the International Capital Market Association (ICMA).

The TEG has also published [an Excel tool](#) that aims at helping with the implementation of the Taxonomy owing to a clearer classification system depending on the type of economic activity.

The table below shows an extract of the Excel tool with available criteria and metrics:

Table 1: Metrics and criteria available on the Excel sheet

MITIGATION CRITERIA			
Activity NACE Code & description	Principle	Metric & Threshold	Rationale
	XXX	XXX	XXX

DO NO SIGNIFICANT HARM ASSESSMENT					
Activity NACE Code & description	Adaptation	Water DNSH Regulation	Circular Economy DNSH Regulation	Pollution DNSH Regulation	Ecosystems Ecosystems DNSH Regulation
	XXX	XXX	XXX	XXX	XXX

The March 2020 reports **supersede the two previous ones**, i.e. the “Early feedback report” (December 2018) and the “Technical report” (June 2019). They are final recommendations of the TEG addressed to the European Commission and provide complements and consolidation, notably a batch of adaptation activities, new elements on the minimum social safeguards and explanations on how to abide by the “Do No Significant Harm” principle. In addition, the Commission is reportedly working on an IT-tool to make the Taxonomy more user friendly and understandable including for retail investors.

3. WHEN AND HOW WILL THE FINAL TECHNICAL SCREENING CRITERIA BE ADOPTED?

The detailed technical screening criteria - metrics, thresholds - will be included in the Delegated Acts from the Commission to be adopted in **two phases**:

1. **Climate change mitigation or adaptation**: the contributing technical screening criteria for activities that substantially contribute to climate change mitigation or adaptation will be adopted by the end of 2020 and enter into application by the end of 2021.
2. **Other environmental objectives**: the criteria to determine contribution to the other four environmental objectives¹⁵ will be developed by the Platform on Sustainable Finance and adopted by the European Commission by end 2021 and enter into application by end 2022 (See question n°1).

4. SHOULD WE EXPECT MAJOR CHANGES BETWEEN THE TEG'S FINAL REPORT AND THE DELEGATED ACTS?

Some thresholds have already been adjusted and/or lowered in the latest and final TEG's report (See question n°29). **We do not believe important methodological changes will occur even though thresholds adjustments could be made** by the European Commission (concerning natural gas for example). Furthermore, some modification could be requested from lobbies or governments. Otherwise, several suggestions from the TEG are not in the scope of the Regulation and are simply advice for the future Permanent Platform and thought for future regulatory initiatives or adjustments.

Regarding the EU Green Bond Standard, a public consultation is under way until end of October 2020. The primary goal of this consultation is to collect the views and opinions in order to inform the establishment of an EU Green Bond Standard, but this could also lead to minor changes in the Delegated Acts.

5. IS THE TEG'S MISSION OVER AND WHAT WILL BE THE ROLE OF THE SUSTAINABLE FINANCE PLATFORM?

The TEG's mandate is extended until September 2020 and will be **replaced by the Permanent Platform on Sustainable Finance**. Its creation is enshrined in the [Article 20 of the Taxonomy Regulation](#), and it will be composed of maximum 57 experts representing both the public and the private sector. The Platform will have four main tasks:

1. Advise the Commission on the **technical screening criteria** including on the usability of the criteria
2. Advise the Commission on the review of the Taxonomy Regulation and on covering other sustainability objectives, including **social objectives** and **activities that significantly harm the environment**
3. **Monitor and report** on capital flows towards sustainable investments
4. Advise the Commission on sustainable finance policy more broadly

The Commission launched a call for applications for the selection of the members of the Platform on sustainable finance on June 2020 that is closed now, and the results will be disclosed soon. The first term of mandate of the members will be two years (from Q3 2020 to Q3 2022).

¹⁵ The objectives being: sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; protection and restoration of biodiversity and ecosystems.

6. WHAT ROLES WILL VERIFIERS PLAY DURING THE “INTERIM PERIOD”?

There will be a lapse of time called “interim period” until the full completion of the technical screening criteria for all the environmental objectives (beyond climate change mitigation and adaptation) and the setup of accreditation process under the supervision of ESMA. During this interim period, **verifiers** (also called “Second Party Opinion providers”) will play a decisive role:

- **To kick in until completion of screening criteria for not yet reviewed activities on climate change mitigation/adaption**
- **To assess substantial contribution for other environmental objectives, meaning they will create a sort of jurisprudence**

SPOs already did so before, producing a sort of jurisprudence, but **their views or opinions will be under greater scrutiny** and **feed the work of the Permanent Platform** that will work concomitantly on defining criteria for the other four environmental objectives defined by the EU Regulation¹⁶. Such role will provide verifiers with a significant say and influence and probably higher scrutiny from Regulators. The voluntary interim registration process for verifiers of EU Green Bonds is meant to last up to three years.



¹⁶ The other objectives being: sustainable use and protection of water & marine resources; transition to a circular economy; pollution prevention and control; protection and restoration of biodiversity & ecosystems.

THE BIG PICTURE: EU'S EFFORTS TO GREENING ITS FINANCIAL SYSTEM

7. WHAT ARE THE OTHER SUSTAINABLE FINANCE KEY INITIATIVES FROM THE EU?

The European Commission has launched [a consultation on its Renewed Sustainable Finance strategy](#). It is based on previous initiatives and reports:

- The EU Action Plan on Financing Sustainable Growth (2018)
- The final report of the High-Level Expert Group on Sustainable Finance (2018)
- The [Communication of the Commission on 'The European Green Deal'](#) (2019)
- The [Communication of the Commission on 'The European Green Deal Investment Plan'](#) (2020)
- The [Reports published by the Technical Expert Group on sustainable finance \(TEG\)](#) with regard to an EU Taxonomy of sustainable activities, an EU Green Bond Standard, methodologies for EU climate benchmarks and disclosures for benchmarks and guidance to improve corporate disclosure of climate-related information.

Overall the EU sustainable finance agenda is strengthening financial institutions' disclosure requirements (Taxonomy Regulation, Sustainable Finance Disclosure Regulation, Climate-related benchmarks Regulation, CRR2/CRD5 package), which sometimes overlap (the Delegated Acts proposed under the SFDR and the Climate-related benchmarks Regulation for example both set up a list of different ESG-related KPIs).

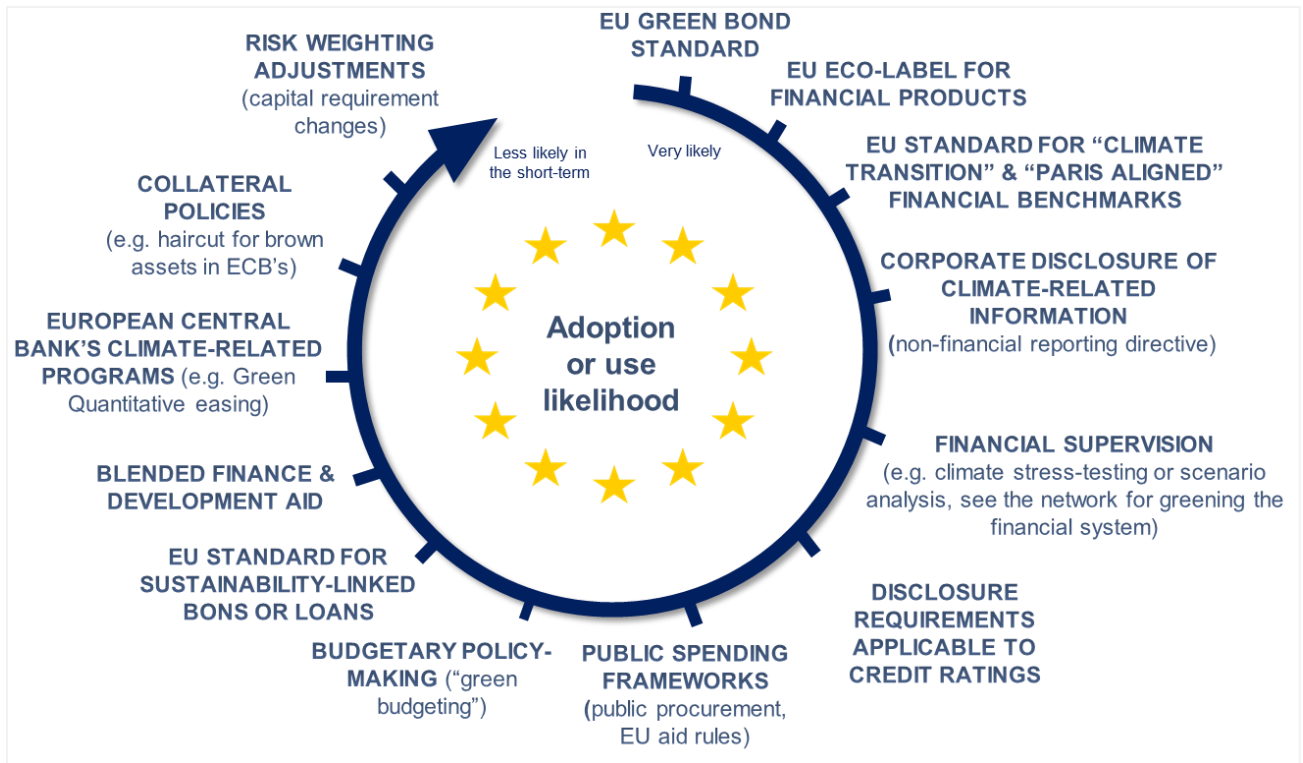
8. WHAT ARE THE LATEST USE-CASES OF THE TAXONOMY ENVISIONED BY EU POLICYMAKERS?

The potential “**universal**” **scope** of the EU Taxonomy has been envisioned recently. Indeed, the European Commission looks for confirmation in its consultation on its Renewed Strategy on whether the EU Taxonomy is suitable to be used:

- by the European Union institutions:
 - in the context of public spending frameworks at EU level (i.e. EU spending programs such as EU funds, Structural and Cohesion Funds and EU state aid rules): more specifically it can ensure funding goes to climate-friendly schemes
 - to develop standard using the EU Taxonomy for target-setting sustainability-linked bonds or loans (make use of the EU Taxonomy as one of the key performance indicators, see question n°10 for more details on Natixis' answer to this question in the consultation)
 - to develop climate benchmarks and ESG disclosures for benchmarks
 - to examine the feasibility of reflecting sustainability in prudential rules from a risk perspective
 - to support the European Central Bank's policies, especially Taxonomy-based Green Quantitative Easing
 - to develop labels for sustainable financial products, *via* Ecolabel
- by the public sector, for example in order to classify and report on green expenditures
- by the public sector in the area of green public procurement
- by Member States, through the future EU Green Bond Standard, for the issuance of sovereign green bonds
- by development banks, when crowding in private finance, either through guarantees or blended finance for sustainable projects and activities in emerging markets and/or developing economies

- by financial market players, to develop green finance instruments based on Taxonomy thresholds and metrics for example, and enable them to identify sustainable investments for risk management and strategic purposes

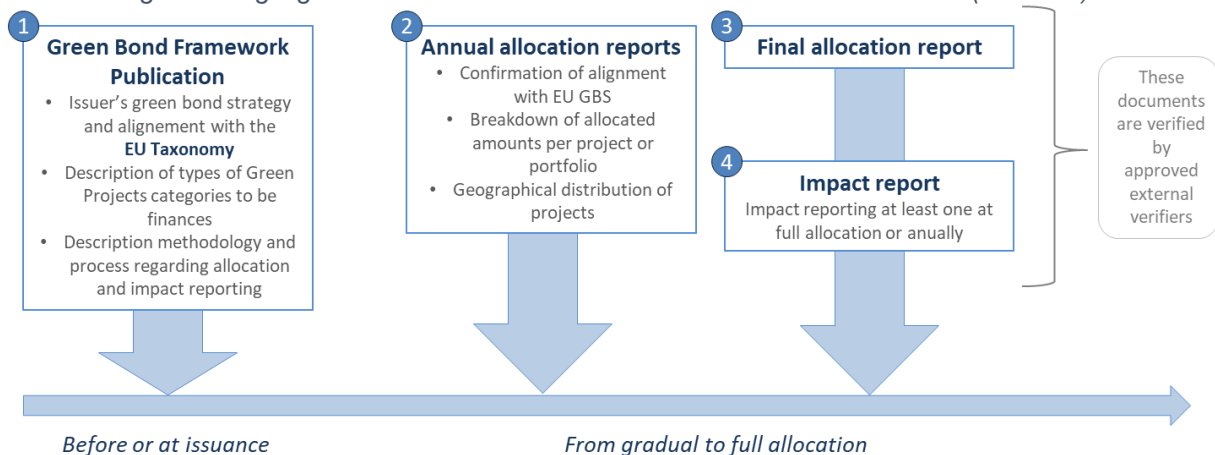
Figure 5: Overview of the potential and various uses of the Taxonomy



9. HAS THE LEGAL STATUS OF THE EU GREEN BOND STANDARD BEEN DECIDED?

The European Green Deal announced on December 2019 underlined the need for long-term signals to direct financial and capital flows to green investments. The [European Green Deal Investment Plan](#) announced on 14 January 2020 reminds that the Commission will establish an EU Green Bond Standard (GBS). As a reminder, the infographic below details the proposal on EU GBS mechanism.

Figure 2: Highlights of the mechanisms of the EU Green Bond Standard (EU GBS)



Source: [Usability Guide, EU Green Bond Standard](#) (March 2020)

The public consultation on Renewed Sustainable Finance Strategy launched by the European Commission includes questions dedicated to a **possible legislative initiative on an EU Green Bond Standard**. After evaluation of the public consultation and an internal impact assessment, the Commission will publish its decision on the scope of the EU GBS and on its legislative implementation, but timing remains unknown. Nonetheless, the Commission's intention is to keep the EU GBS a **voluntary standard**, enhancing the effectiveness, transparency, comparability and credibility of the green bond market.

The TEG recommends that in practice, three elements need to be in place before the EU GBS is formally in use:

- i. Validation of the EU Taxonomy Regulation by the Commission ([Adopted and entered into force on June 18th 2020](#))
- ii. Decision from the European Commission on how to establish the EU GBS
- iii. Supervision of the verifiers needs to be in place, or in the meantime a voluntary interim registration process for verifiers of EU Green Bonds has to be established. The TEG has recommended that oversight and regulatory supervision of external review providers eventually be conducted *via* a centralised system organised by ESMA. However, until the legislative process for a ESMA-led supervision, a market-based, voluntary interim registration process for verifiers called "the Scheme" may be set up for a transition period of up to three years. External verifier firms wishing to provide conformity verification of EU Green Bond issuance programmes could apply to the Scheme.

10. WHAT LESSONS ON THE TAXONOMY TO DRAW FROM THE EU RENEWED STRATEGY CONSULTATION?

On April 2020, the **European Commission launched a public consultation on its sustainable finance strategy** (called "Renewed sustainable finance strategy").¹⁷ All citizens, public authorities and private organizations within the EU and beyond were invited to respond. The consultation was closed on July 2020 and gathered more than **650 answers** according to Martin Spolc (Head of the Sustainable Finance and Fintech unit in the European Commission's Directorate General for Financial Services).

Respondents include pension and insurance providers, asset managers, banks, financial advisors, service providers (index providers, research providers), non-financial companies, law firms, NGOs, academics, public authorities and other stakeholders. Building on [the 2018 Action Plan](#) on financing sustainable growth, the renewed sustainable finance strategy will provide a roadmap with new actions. It is expected to be published in the fourth quarter of 2020 and to provide additional enabling frameworks for the European Green Deal Investment Plan.

We have analyzed below answers related to the European Taxonomy. **As few general takeaways:**

- **Many respondents want "to take a breath" and fully test and implement the existing proposals in the short-term before any new development**
- **There is one exception with a strong push in favor of developing criteria for brown activities.** General opinion encourages further versions of the taxonomy to be adapted to the needs that will be revealed after entry into force of the scheme.
- There is an overall expectation to strike a balance **between the encouragement of pure "green" activities, that might create a niche, and the exclusion of environmentally harmful activities, that might lead to adverse social impacts.**

The comments made herein represent the views of Natixis Green & Sustainable Hub (Natixis GSH) exclusively for the purpose of this publication. They may not reflect the position of Natixis nor its parent BPCE as per the response provided to the consultation, which is a consensus position of the group's various business lines including retail and commercial banking, asset management and insurance.

¹⁷ See in our monthly Newsletter (April 2020), "European Commission's Renewed Sustainable Finance Strategy: broader and deeper". Available [here](#).

Following the publication of some participants' answers, we have selected a few questions on topics that are directly related to the EU Taxonomy, analyzed the trends in answers and provided our opinion. Thus, we have analyzed questions regarding the development of standards by the EU for the emerging development of sustainability-linked bond and loan markets (questions n°30 & n°31 of the consultation). In the context of post-covid European relief plans, questions n°70 & n°72 related to the scope of the Taxonomy in public sectors and in EU public spending frameworks are also worth analyzing. Lastly, as the range of economic activities assessed by the TEG are often debated, we found it particularly interesting to analyze answers related to the "brown taxonomy" and a taxonomy with a broader spectrum of economic activities proposals (questions n°82 & n°83).

Renewed strategy consultation - Questions 30 & 31: The market has recently seen the **development of sustainability-linked bonds and loans**, whose interest rates or returns are dependent on the company meeting pre-determined sustainability targets. [...] **Should the EU develop standards for these types of sustainability-linked bonds or loans?** Should such a potential standard for target-setting sustainability-linked bonds make use of the EU Taxonomy as one of the key performance indicators?

OUR OPINION

We believe that regulators should be cautious about any regulatory intervention on sustainability-linked bonds. This type of products is to make issuers pay more yield if they do not meet their sustainability targets and vice versa, which introduces a welcome performance/result-based logic in issuers' sustainable funding strategy. Indeed, it incentivizes issuers to commit further vis-à-vis their sustainability targets. However, there are some downsides with the coupon step-up mechanism (which is so far the only mechanism we have seen on the market): it may lead to potential conflict of interest on sustainability performance between investors and issuers. For investors, the financial performance is better when no sustainable results are achieved. Other mechanisms are possible and should be explored, with for instance "penalty" in case of failure to achieve targets that are allocated to compensation schemes (offsetting), funding to third-parties, or increased internal CAPEX plans in taxonomy compliant activities (to ratchet efforts).

Furthermore, the sustainability-linked market is still in its infancy. LMA published the Sustainability Linked Loan Principles (SLLP) in March 2019 and ICMA published the Sustainability linked Bond Principles (SLBP) in June 2020 (see our dedicated article [here](#)). Natixis GSH was co-chairing the SLBP related working group with ICMA and co-holding the pen on this product with a dual conviction: the value and potential of the instrument as well as the need to protect its integrity and ambition.

Given the relative infancy of this market, it is our view that developing regulatory standards too soon may stifle innovation and restrict the development of the market (EU GBS was first published 5 years after the publication of the Green Bond Principles).

However, the EU can first contribute to the creation and development of this new market through guidance notes, and/or tool kits that illustrate how the EU Taxonomy can be used in such instruments (cf. screening criteria as "sustainability performance targets" guidance).

One could consider, for example, that Taxonomy-related KPIs such as the proportion of turnover compliant with the technical screening criteria can meet most of the Sustainability-Linked Bond Principles requirements (SLBP) They can be material and strategic, holistic (can capture all the economic activities performed by an entity), based on climate-science, and are calibrated for ambitious climate policy goals (climate neutrality). In addition, they will be largely used because it is a legal requirement (with no additional costs related to their calculation) with harmonized calculation methodologies (allowing comparability). (See details in question n°33 of the present document)

MAIN TRENDS IN ANSWERS

Opinions are divided but many respondents agree that the market is nascent, meaning that it is too early to make such a decision. A too constraining framework for an immature market could limit its development. Ultimately, as mentioned in the SLBP, the EU Taxonomy can be used as an optional reference, for instance, it can be used as a standard for selecting relevant KPI, with benchmark across sectors for target calibration. Furthermore, some participants remind that those instruments must not have a "climate only" focus and should integrate other SDGs.

EXCERPTS OF PUBLICLY AVAILABLE ANSWERS

“The definition of KPIs for target-setting sustainability-linked loans or bonds would probably require further analysis and refinements to assess whether the EU Taxonomy would be an accurate reference”. (*Central bank*)

“Sustainability-linked instruments aim at incentivizing behavioral change of the borrower with no constraints as to the way such change is achieved. Linking the KPI directly to a specific activity of the Taxonomy would therefore be contradictory with the structure of such instrument” (*Corporate*)

“Should there be an EU standard, it could rely on EU Taxonomy regarding the environmental KPIs of such financial instruments. However, to ensure these products could also target social issues or other sustainability topic relevant for the corporate, the use of Taxonomy should be optional. Possibility would be to add a "comply or explain" statement in the documentation.” (*Corporate*)

“We agree that such a potential standard for target-setting sustainability-linked bonds or loans should make use of the EU Taxonomy as one of the key performance indicators. However. Some activities not covered by the taxonomy should also be allowed to underpin sustainability KPIs for specific sectors. Therefore, this potential standard could use the taxonomy as reference for environmental target setting (e.g. aiming to align the company’s business activities to a certain degree by a certain year). However, sustainability-linked loans may cover also social and governance targets, hence a broader sustainability framework would be required.” (*Asset Manager*)

Renewed strategy consultation - Question 70: Is the **EU Taxonomy**, as currently set out in the report of the TEG, **suitable for use by the public sector**, for example in order to classify and report on green expenditures?

Explain which public authority could use it, how and for what purposes, as well as the changes that would be required to make it fit for purpose.

OUR OPINION

As a tool primarily designed for investors, companies, issuers and project developers, the EU Taxonomy is only partially suitable for the public sector as issuer. **Indeed, interventions of public authorities are by nature different from businesses.** For example, direct intervention in the economy is rare: yet, support to economic activities that contribute to climate change mitigation often takes the form of subsidies or tax rebates, but these contributions are hard to assess under the current Taxonomy (although eligible as Use-of-Proceeds in Green Bond frameworks from Sovereign Issuers). Note that public procurement is instrumental and often sets standards because of the financial amounts at stake. Member States can use the Taxonomy for instance in their industrial, social housing, transportation, agricultural policies. Corporate taxation can be used as a tool by member states to encourage and reward taxonomy compliance.

MAIN TRENDS IN ANSWERS

There is no clear consensus on this suitability question. Most stakeholders agree that the Taxonomy can be used as a Swiss Army Knife for the public sector at different levels: regional, national or European. It can provide filters for selecting and defining green investments and can also serve to set targets and monitor decarbonization progress.

Nevertheless, **the heterogeneity of the public sector activities could be challenging.** The lack of data and of accessibility to information related to publicly funded projects can be a barrier. Some respondents complained that criteria do not take into account regional differences so it could reportedly be difficult to apply it in a local context for public administrations. We partially agree with that remarks as one of the main goals of the Taxonomy is to avoid fragmentation of green definitions. Lastly, there are calls in favor of a “fully realized Taxonomy” **with social classification.**

EXCERPTS OF PUBLICLY AVAILABLE ANSWERS

“While the taxonomy can definitely inform public budgeting and can eventually be used to classify and report on green expenditures, given the complexities, we recommend first to conduct a thorough analysis on how best to do so and an impact assessment. It is not evident exactly how to report on and narrow down the application of the taxonomy [...] given the complexity of deployment of national budgets (and other internal budgets e.g. regional, municipal, provinces).” (*Institutional Investor*)

“The public sector can use the Taxonomy to classify significant categories of expenditure. These include, e.g., payments from the concessions related to upgraded infrastructure of public buildings/ street lighting, forfeiting payments, leasing payments for sustainable public-transport infrastructure (e.g. leasing of non-diesel buses), servicing the loans extended to energy efficient upgrades of the infrastructure to be reported under economic activities that make a substantial contributions on their own performance.” (*Bank*)

“There are limits to the extent that the Taxonomy in its current limited form can be used by the public sector in terms of other expenditures. This is because the transition will require activities which do not fall within the Taxonomy to be supported by the public sector. There will also be public needs which have to be met by the public sector which are societally very important but may be unable to meet the Taxonomy criteria.” (*Institutional Investor*)

Renewed strategy consultation - Question 72: Should the EU Taxonomy play a role in the context of public spending frameworks at EU level?

OUR OPINION

The Taxonomy could play an important role in the context of EU spending programmes and budget analysis (so-called green budgeting). However, since the Taxonomy does not cover a broader enough range of social and environmental objectives yet, social aspects must definitely be taken into account. For example, they can be assessed under the “do no harm”, or even under a taxonomy for social activities, that could focus first on health, housing or education activities (using the SDGs). For the climate and environmental objectives, we believe, the EU post-COVID recovery plan is an opportunity for the Taxonomy to be fully used and leveraged, guaranteeing spending complies with EU climate objectives, especially with the Green and Digital Transformation and the “Just Transition” plans (see our newsletter article [“Historic deal reached on the EU recovery package and budget”](#).)

MAIN TRENDS IN ANSWERS

Most of the market participants agree the Taxonomy can play a role in all EU programs only if social objectives are incorporated. A majority of stakeholders recognize the **benefits** as it can guarantee spending programmes, at EU and national levels, to be in line with EU’s objectives. Nonetheless, **social assessments** need to be developed. It is hard to know whether calls for attention to social issues are used as a brake to slow green efforts.

EXCERPTS OF PUBLICLY AVAILABLE ANSWERS

“Yes, but only if social objectives are incorporated in the EU Taxonomy [...]. All spending programs could be briefly assessed to ensure alignment with EU sustainability targets, and to ensure that programs which are not directly targeted at sustainability do not have adverse impacts on the achievement of these targets.” (*Public Institution*)

“In the short-term, the application of the existing taxonomy might be helpful to steer recovery programmes. In the mid-term, a fully developed and legally processed taxonomy is required, including social and societal aspects.” (*Institutional Investor*)

“While initially designed for private investors, the EU Taxonomy – once sufficiently developed – could also be used by public sector entities. Convergence of standards between the private and the public sector is desirable, as this would result in the availability of comparable expenditures data across private and public activities. [...] In view of the increased relevance of “green” public investment under the European Green Deal, there is merit in also exploring how the EU Taxonomy could be used to assess public expenditures within the EU budget and how it could be applied or adapted at national level for green budgeting purposes or for guiding the investment priorities.” (Multilateral Development Bank)

“The taxonomy is a sort of “procurement list” or “shopping list” to build a sustainable economy. Therefore, it is particularly fit to inform public procurement.” (*Institutional Investor*)

Renewed strategy consultation - Question 82: Do you think that existing actions need to be complemented by the development of a taxonomy for economic activities that are most exposed to the transition due to their current negative environmental impacts (“brown taxonomy”) at EU level? Why?

OUR OPINION

A well-designed brown Taxonomy would be very useful but how to define it is much more complicated than defining green criteria both from a political and scientific standpoint. Indeed, it would extensively arise challenging questions. For instance, should performance levels be calculated versus peers or versus companies’ own historical performance (improvement against a baseline)? Should it be calculated versus science-based ranges and performance levels? In that case, on what climate temperature scenario should it be based on (e.g. +3°C, +4°C)? Should it use the EU-ETS values as a reference (e.g. Best Available Technologies 10% worst installations to mirror the 10% best installations in the EU used for manufacturing activities).

The current Regulation focusing on pure or “dark green” activities is binary, and therefore relatively simple to grasp but it has unintended consequences since the Taxonomy thresholds exclude *de facto* a broad range emitting sectors’ companies and facilities. Indeed, the thresholds are calibrated on aspirational and ambitious performance levels.

Therefore, in our view, “shades of brown” would be welcome. To be fully useful, it should help defining what is “medium brown” because the most climate harmful activities are relatively well known and often subject to exclusion policies (coal, tar sands, fracking, oil-fired heating in buildings). The scope of a brown taxonomy should be economy wide, as it is for the green taxonomy. We believe parallelism with the green taxonomy in terms of metric and threshold should be pursued whenever possible.

Meanwhile, we are concerned about complexity for practitioners. Thus we do not support a formal or explicit neutral taxonomy in order to avoid overload of shades.

MAIN TRENDS IN ANSWERS

There is no consensus. On one hand, a brown taxonomy could be a complementary tool to the green one, helping supervisors to identify climate-related risks by offering additional levels of granularity and offering a comprehensive spectrum of climate risk assessment. Therefore, it could be an incentive for companies to implement greening measures and plans. It will also ensure a greater level of disclosures by companies.

On the other hand, the current short-term goal is above all to implement a completely efficient green taxonomy, meaning that regulations and actions should be taken gradually.

Noteworthy, some respondents are completely opposed to a brown taxonomy as the identification of brown activities could be penalizing them in terms of financing, especially for the companies wishing to transition towards greener activities.

EXCERPTS OF PUBLICLY AVAILABLE ANSWERS

“The comparability and reliability of ESG data will only improve if clear and sufficiently granular taxonomies for “green”, “brown” and “social” activities are developed and consistently implemented by the financial sector, together with common and uniformly enforced ESG-related disclosure standards for companies” (*Supervisor*)

“Help supervisors to identify and manage climate and environmental risks; Create new prudential tools, such as for exposures to carbon-intensive industries; Make it easier for investors and financial institutions to voluntarily lower their exposure to these activities; Identify and stop environmentally harmful subsidies” (*Institutional Investors*)

“Harmonization of disclosures and better comparison among peers. The scope of the Non-Financial Reporting Directive is likely to be expanded, and the disclosure requirements for ESG risks, including transition and physical risks, under the Pillar 3 framework will enter into force in 2022. The EU COM Non-binding guidelines for climate reporting ask banks to disclose indicators against the EU “green” taxonomy, nevertheless same metrics for the “brown” side are missing. Those upcoming regulations, aiming at more granular data for banks as regards the activities of their counterparties, call for a common definition of economic activities that are most exposed to the transitional risk due to their current negative environmental impacts.” (*Central bank*)

“We believe the EU should focus on making the transition activities category a proper category by introducing additional, intermediate thresholds in the current taxonomy so that different shades of green can appear and companies can be incentivized to transition rather than deterred by too ambitious thresholds from the onset.” (*Bank*)

“No. It is vital that the sustainable financial system (SFS) provides the opportunity for a supportive approach that enables finance to improve the performance of not only ‘good’ sustainability performers but also, those sites that are far behind what is expected. Instead of a brown taxonomy, SFS should focus on incentivizing investments that drive sustainable development for currently poor performing activities. For example, access to finance premised on the company’s improvement on specified sustainability KPIs for that activity.” (*Corporate*)

“We are concerned that the use of such a taxonomy would prove punitive and might restrict in the availability of financing for companies engaged in needed energy transition which are the ones that need to develop technological solutions to reduce their carbon footprint. The risk is that the brown taxonomy fails to reflect the transitioning of companies towards a green economy (given the focus on economic activities, and not on companies’ practices), and might then deter funding from companies that invest heavily in their transition and that are essential to climate change mitigation”(*Bank*)

Renewed strategy consultation - Question 83: Beyond a sustainable and a brown taxonomy, do you see the need for a taxonomy which would cover all other economic activities that lie in between the two ends of the spectrum, and which may have a more limited negative or positive impact, in line with the review clause of the political agreement on the Taxonomy Regulation?

OUR OPINION

To avoid an overload of shades, we do not support a neutral taxonomy. As mentioned, a green taxonomy completed by a “brown taxonomy” well-designed will be comprehensive enough and already hard to apply in the short term.

MAIN TRENDS IN ANSWERS

There is no consensus on this question. A broader spectrum with detailed and comprehensive criteria would certainly support the acceleration of the transition. Those favorable to a brown taxonomy also defend this proposal: if neutral activities are not identified, a purely brown taxonomy could have a significant impact in the market whereby they are also considered harmful activities and hence struggle to find the adequate financing.

The respondents who answered negatively did not provide further details. Nonetheless, the main argument of those who answered negatively is the complexity of the classification. For them, it is still too early to develop such a classification system. One needs to wait and measure the effective impact EU Taxonomy version.

EXCERPTS OF PUBLICLY AVAILABLE ANSWERS

“Although the adopted Taxonomy Regulation, next to green economic activities, already covers “enabling” and “transition” activities, i.e. those necessary for a gradual, secure and affordable transition in line with the various dimensions of the Energy Union as set out in the Governance Regulation, such category is not well identified. Hence, to the extent that such transition category is not well-calibrated in the final TEG report, the Commission should consider identifying a dedicated category for transition economic activities more explicitly, with own technical screening criteria (including GHG emission thresholds) which are progressively decreasing in line with a well-defined decarbonization trajectory.” (*Corporate*)

“The completion of the EU taxonomy to all economic activities and the gradual development of more granular criteria for other sustainability objectives beyond climate change will be key for the practical implementation of the EU taxonomy and, hence, for the publication of wider, more comparable disclosures and for application in risk management tools. Such complete taxonomies would enable also more granular prudential monitoring and calibration of monitoring metrics. A better understanding of the links between environmental and social objectives (also in light of COVID-19 impact on financial sector), supported by relevant datasets, seems warranted too” (*Supervisor*).

11. ARE THERE LINKS BETWEEN THE EU RECOVERY PLAN AND THE EU TAXONOMY?

As a reminder, on July 21st 2020, following a marathon EU-summit in Brussels, the European Council, composed of the leaders of the EU's 27 Member States, agreed on ambitious [post-Covid Recovery Plan](#). **The deal spending package is worth €1.8 trillion and is composed of two elements:**

- **A €750bn package aimed at funding post-pandemic relief efforts** across the EU called "Next Generation EU" (NGEU), equivalent to 4.7% of the EU GDP
- **The EU's regular 2021-2027 budget** reaching nearly **€1.1 trillion** (so-called Multi-Financial Framework (MFF) of 2021-2027)

The NGEU budget will be principally disbursed as **loans or grants** and will be used for investments and reforms including in the green and digital transitions but the deal does not explicitly declare what mechanism will be used to ensure funding goes to climate-friendly schemes. Although **no reference to the EU taxonomy** has been mentioned, we believe **this classification is the simplest way to guarantee spending complies with climate neutrality objective** as the technical screening criteria have been calibrated to achieve this goal. Furthermore, the TEG has already **outlined five principles that should be applied to the recovery plan:**

- Plan a recovery focusing of building back better with a **focus on climate change issues**
- Build resilience through an economically and environmentally **sustainable model**
- Ensure that recovery funds meet the **minimum safeguards and "do no significant harm" requirements**
- Apply these measures to both private and public sector
- **Collaborate internationally**, to create "a common global language around sustainability"

The EU recovery plan could be an ultimate incentive for EU Taxonomy use and it already raises even more ESG-related questions illustrated by the European Commission's proposals regarding **non-recycled plastic tax or the Emission Trading System (ETS) extended to the aviation and maritime sectors.**

THE KEY FEATURES OF THE EU TAXONOMY

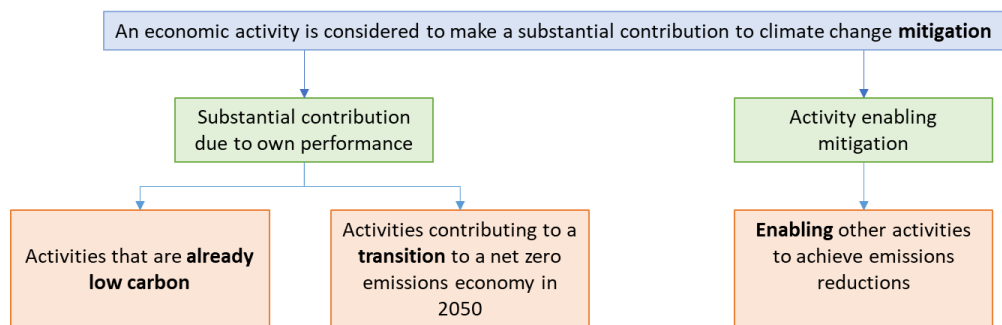
12. WHAT ARE THE TWO MAIN TYPES OF ACTIVITIES CONSIDERED TO BE TAXONOMY-ALIGNED?

The Taxonomy distinguishes two main categories of activities: those contributing to **climate change mitigation**, and the others contributing to **climate change adaptation**.

For climate change mitigation, the Taxonomy Regulation recognizes two distinct types of substantial contribution that can be considered Taxonomy-aligned:

- **Economic activities that make a substantial contribution based on their own performance:** For example, an economic activity being performed in a way that is environmentally sustainable. In the TEG's June 2019 report, these were referred to as "greening of" activities but there is no change in the meaning. It includes **activities that are already low-carbon** and **activities contributing to a transition to a net zero emissions economy by 2050**.
- **Activities enabling mitigation:** Economic activities that, by provision of their products or services, enable a substantial contribution to be made in other activities. For example, an economic activity that manufactures a component that improves the environmental performance of another activities. There were called "greening by" activities in the previous version.

Figure 3: Economic activities contributing to climate change mitigation



Source: Taxonomy Final Report, March 2020

Enabling activities are precisely defined in the Article 11a of the EU Taxonomy Regulation:

“An economic activity shall be considered to contribute substantially to one or more of the environmental objectives [...] by directly enabling other activities to make a substantial contribution to one or more of those objectives, and where that activity:

- does not lead to a lock-in in assets that undermine long-term environmental goals, considering the economic lifetime of those assets;*
- has a substantial positive environmental impact on the basis of life-cycle considerations.”*

The following table extracted from the Excel tool provides a list of mitigation economic activities that are considered as “enabling activities”.

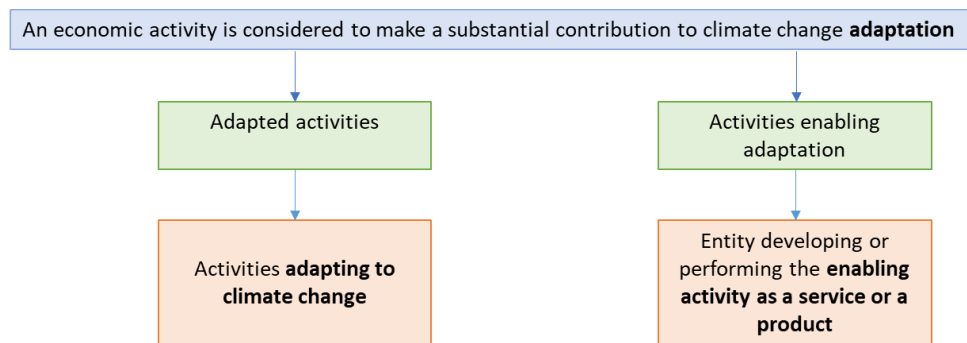


ENABLING ACTIVITIES

- Manufacture of low carbon technologies
- Transmission and Distribution of Electricity
 - Storage of Electricity
 - Storage of Thermal Energy
 - Storage of Hydrogen
- Direct Air Capture of CO2
- Capture of anthropogenic emissions
 - Transport of CO2
- Infrastructure for low carbon transport (land transport)
- Infrastructure for low carbon transport (water transport)
- Individual renovation measures, installation of renewables on-site and professional, scientific and technical activities
- Data-driven climate change monitoring solutions

For climate change adaptation, the Taxonomy Regulation also recognizes two distinct types of substantial contribution that can be considered Taxonomy-aligned: adapted activities and activities enabling adaptation.

Figure 4: Economic activities contributing to climate change adaptation



Source: Taxonomy Final Report, March 2020



13. HOW IS “ADAPTATION TO CLIMATE CHANGE” DEFINED?

The goal of adaptation is to manage the impacts of climate change, by reducing the adverse effects and maximizing the positive ones, whereas mitigation tends to reduce the cause of climate change with GHG emissions reduction and removal / sink activities. Activity-level adaptation aims at strengthening an asset or economic activity to withstand identified physical climate risks over its lifetime, such as considering sea-level rise in the design of a bridge. Systemic adaptation aims to actively reduce vulnerability and build resilience of a wider system, or systems, such as a community, ecosystem, or city. The Adaptation Taxonomy covers 68 economic activities. With that in mind, the adaptation Taxonomy comprises two types of substantial contribution to adaptation objectives:

- **Adapted activities:** an economic activity is adapted to all material physical climate risks identified for the economic activity to the extent possible and on a best effort basis.
- **Activities enabling adaptation of an economic activity:** the activity reduces material physical climate risk in other economic activities and/or addresses systemic barriers to adaptation and is itself also adapted to physical climate risks.

Table 2: Comparison between "adapted activities" and "activities enabling adaptation"

	ADAPTED ACTIVITY <i>Adopting adaptation solutions</i>	ACTIVITY ENABLING ADAPTATION <i>Developing adaptation solutions</i>
Qualitative screening criteria	Reducing all material physical risks Supporting system adaptation Monitoring adaptation DNSH criteria	Removing barriers to adaptation Reducing all material physical risks if relevant Supporting system adaptation if relevant Monitoring adaptation if relevant DNSH criteria
Example	<i>Entity adapting to climate change</i> Water utility company purchasing and installing early warning systems to reduce the risk of flood	<i>Entity developing the enabling activity as a product/service</i> Company developing/providing installation of early warning systems for flood risk

The table below offers more details about the “adaptation” screening criteria:

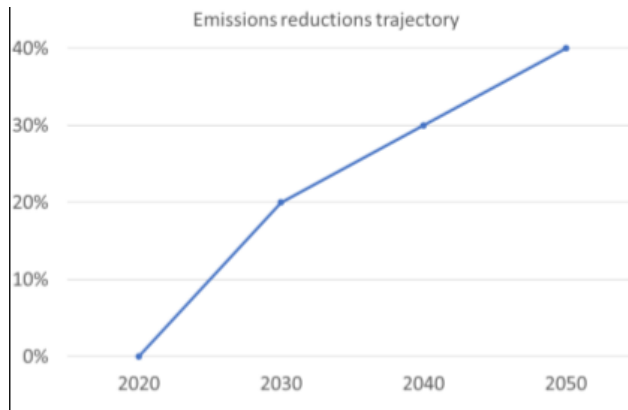
SCREENING CRITERIA FOR ‘ADAPTED ACTIVITIES’	
Reducing material physical climate risks <i>The activity must reduce all material physical climate risks to that activity</i>	The activity integrates physical/non-physical measures and the assessment considers both current weather variability and future climate change, including uncertainty is based on robust analysis of available climate data and projections.
Supporting system adaptation <i>The activity and the measures do not adversely affect the adaptation efforts of other people, nature and assets</i>	The economic activity and its adaptation measures do not increase the risks of an adverse climate impact and consideration should be given to the viability of 'green' or 'nature-based-solutions' over 'grey' measures to address adaptation.
Monitoring adaptation results <i>The reduction of physical climate risks can be measured</i>	Adaptation results can be monitored/measured against defined indicators.
SCREENING CRITERIA FOR AN ACTIVITY ENABLING ADAPTATION	
Supporting adaptation of other economic activities <i>The activity reduces material physical climate risk in other economic activities and/or addresses systemic barriers to adaptation</i>	<i>Activities enabling adaptation include: a) Promote a technology, product, practice, process or innovative uses of existing technologies; or, b) Remove barriers to adaptation by others</i> The activity reduces/facilitates adaptation to physical climate risks beyond the boundaries of the activity itself.



14. WHAT ARE THE DIFFERENT CATEGORIES OF METRICS & THRESHOLDS?

We identify four main types of eligibility based on different metrics in the TEG’s report. This categorization is our own and not official. The table below gives a list of examples:

Abidance by Standards, labels and regulations	Technological eligibility
<ul style="list-style-type: none"> • Compliance with the European Code of Conduct for Data Centre Energy Efficiency for data processing, hosting and related activities • Compliance with the Sustainable Forest Management (SFM) for forestry activities • EU Energy Label or European Water Label Scheme for some activities in the manufacturing of low carbon technologies 	<ul style="list-style-type: none"> • Eligibility of zero tailpipe emission vehicles (incl. hydrogen, fuel cell, electric) • Eligibility of zero direct emissions trains • Eligibility of solar PV, wind power and aluminum recycling (Best Available Techniques Reference Documents)
Intensity-level performance	Relative improvement performance
<ul style="list-style-type: none"> • Manufacture of primary aluminum. Criteria 1: direct emission for production should be at or below 1.514 tCO₂e/t • Transportation sector: Eligibility of vehicles with tailpipe emission intensity of maximum 50g CO₂/km (WLTP) until 2025. From 2026 onwards, only vehicles with emission intensity of 0g CO₂/km (WLTP) are eligible • Cement manufacturing. The EU-ETS benchmark value for cement clinker manufacturing is 0.766 tCO₂e/t of clinker and emissions associated to the clinker/production processes lower than: 0.498 tCO₂e/t of cement. 	<ul style="list-style-type: none"> • Construction sector (building renovation). Criteria 2: the renovation lead to reduction of Primary Energy Demand of at least 30% compared to the energy performance of the building before the renovation. • Agriculture activities (growing of perennial crops). Reduction of GHG emission in line with a given trajectory: for example, a 20% reduction in GHG emissions required by 2030 compared to emissions in 2020, and a 30% emissions reduction required by 2040 compared to 2020 (see below).



15. HOW MANY ECONOMIC ACTIVITIES HAVE BEEN ASSESSED AND PROVIDED WITH CRITERIA?

The Technical Annex contains updated criteria – **70 for climate change mitigation and 68 for climate change adaptation economic activities**. For climate change mitigation, three new activities were added since the previous TEG report: storage of thermal energy, storage of hydrogen and forest. Sectors responsible for 93.5% of direct greenhouse gas emissions in the EU were prioritized when identifying economic activities for which technical screening criteria were developed.

Noteworthy, the Taxonomy Regulation requires the European Commission to review the technical screening criteria for transitional activities at least every 3 years and for other activities at least every 5 years.

16. WHAT ARE THE ACTIVITIES NOT YET ASSESSED THAT SHOULD BE CONSIDERED IN PRIORITY?

Some issuers willing to abide by the EU Taxonomy Regulation or to use related standards such as the EU GBS might face only partially applicable or absent technical criteria. The TEG proposes two forms of flexibility for the EU Taxonomy alignment when:

1. The technical screening criteria may not be directly applicable because of the innovative nature, the complexity, the location and/or other legitimate factors
2. The technical screening criteria have not yet been developed, such as for example for specific sectors or the four outstanding environmental objectives

In case the activity is not covered yet, **the Second Party Opinion (SPO) provider would propose its analysis based on former TEG reports and guidance from the Taxonomy Regulation (applying the spirit of the law)** Indeed, **the Taxonomy Regulation includes a few useful and prescriptive elements for assessments, beyond frameworks and definitions:** for instance, Article 12 of the Regulation provides some useful information for companies and SPOs on what could “substantial contribution to the sustainable use and protection of water and marine resources” mean and involve. The end-goal to pursue is defined as contributing to the good status of bodies of water and sources of harm are mentioned (urban and industrial wastewater discharges, especially, contaminants of emerging concern such as pharmaceuticals and micro plastics). Ultimately, potential process, measures or Use-of-Proceeds are implicit: adequate collection, treatment and discharge of urban and industrial waste waters (to free it from any micro-organisms or parasites) or reuse of water.

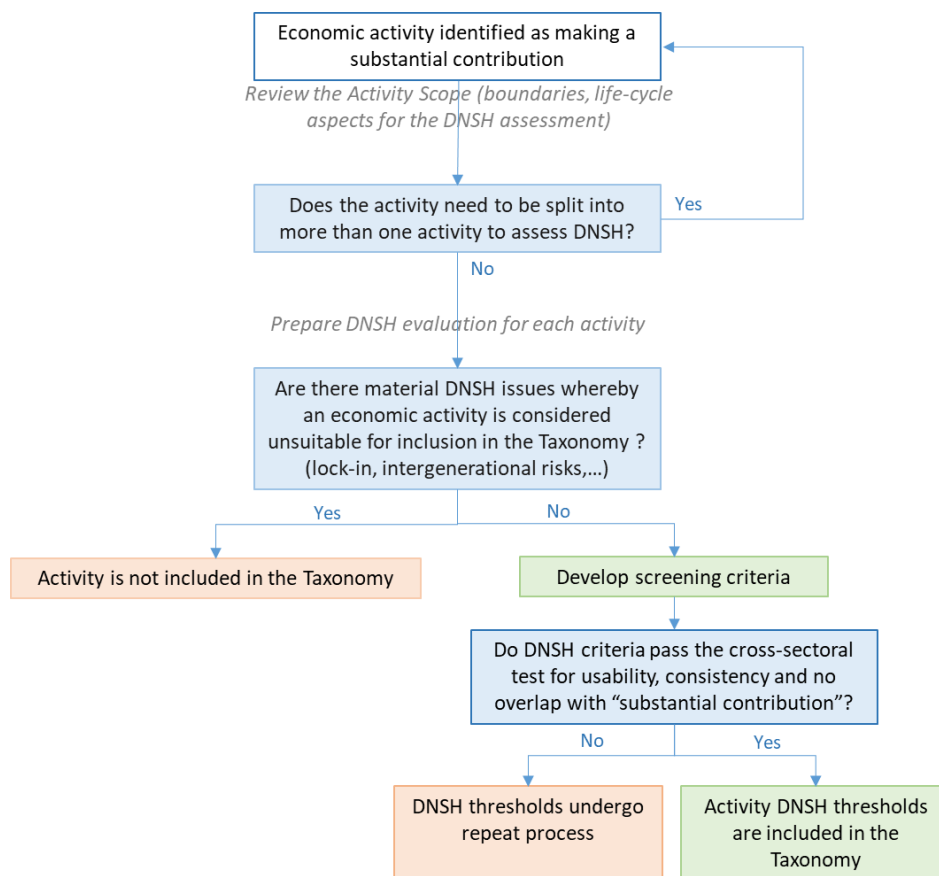
Meanwhile, the **TEG highlights that some important activities are not captured by NACE codes** such as urban and regional planning for low carbon development including avoided journeys, support for lower carbon personal choices such as vegetarian diets, and investments to maintain public natural capital such as natural forests and wetlands. It says further work is needed to include these in the Taxonomy in future.

17. WHAT ARE THE MAIN REGULATIONS AND DIRECTIVES USED FOR THE “DO NO SIGNIFICANT HARM” ASSESSMENT?

The “Do No Significant Harm” (DNSH) criteria aims at ensuring that progress against some objectives are not made at the expense of others and recognizes the reinforcing relationship between different environmental objectives. For DNSH criteria that reflect legal requirements under EU regulations, the TEG says it would be reasonable for Taxonomy users to assume **these criteria have been met in the normal, lawful conduct of business**, unless evidence to the contrary is demonstrated.

Material issues whereby an activity is considered unsuitable for inclusion in the Taxonomy include (*inter alia*) the lack of empirical data for reasonable evaluation of DNSH or lock-in and intergenerational risks.

Figure 4: Do no significant harm decision tree



Source: Taxonomy Final Report, March 2020

Assessment of significant harm to other environmental objectives has been completed and/or enriched in TEG’s 2020 March Report and is therefore more detailed. The table below is an extract of the most used Regulations and Guidelines in the DNSH assessment.



Regulations and directives		Guidelines, decisions, practices	
Biocidal products regulation	Non-road mobile machinery regulation	Sustainable Use of Pesticides Directive	
Ambient Air Quality Directive	Type-approval requirements for the general safety of motor vehicles	Rolling Stock regulation	Council decision on limit exposure to electromagnetic fields
Eco-design Directive	Clean and energy efficient road transport vehicles	Water Framework Directive	Best Available Techniques (BAT) / EU Best Available Techniques reference documents (BREFs)
Urban Wastewater treatment Directive	EU F-Gas regulation	Birds Directive	
Regulation on fertilizers/soil improvers for agricultural use	Environmental Impact Assessment (EIA) Directive	Habitats Directive	EU Waste List
Landfill Waste Directive	Strategic Environmental Assessment (SEA) Directive	REACH regulation	Construction and demolition waste management protocol
Directive on Geological Storage of Carbon Dioxide	EU Water Legislation		

18. HAS THE BINARY NATURE OF THE TAXONOMY BEEN AMENDED?

Two options are proposed by the TEG to reduce stringency and binary side effects: **implementation plan** and developing **technical screening criteria levels of harm to environmental objectives** (brown Taxonomy). The Taxonomy also already includes criteria for activities considered to be “**transitional**”, defined as “*activities having emissions performance levels that are below the substantial contribution threshold, but are not near to zero*” but this criteria category does not cover all the activities yet. The Taxonomy Regulation stipulates that further work will be conducted to define those criteria.

The ambition to go beyond the green niche is confirmed: “*We need emission reductions wherever we can find them*” said Nathan Fabian (TEG Rapporteur for the Taxonomy Group and PRI chief Investment Officer) during a [Stakeholders event](#) held in March 2020.

The TEG considers that a fully realized Taxonomy should incorporate other dimensions such as **social objectives** (to identify substantial contributions in addition to minimum safeguards, for instance, in the context of pandemics, health-related activities) and **technical screening criteria for significant levels of harm to environmental objectives**. However, the TEG considers that using an alternative word to ‘brown’ is necessary to describe activities that are significantly harmful because if taxonomies are to be harmonized internationally, the terms used will need to be appropriate for different cultural contexts. The TEG thereby suggests **three performance levels** within the Taxonomy structure:

**SUBSTANTIAL CONTRIBUTION
(GREEN)**

**A MIDDLE CATEGORY OF
NEITHER SUBSTANTIAL
CONTRIBUTION NOR SIGNIFICANT
HARM**

**SIGNIFICANT HARM
(TO BE CALLED BROWN, OR
PERHAPS RED)**



PRACTICAL USE OF THE TAXONOMY AND REQUIREMENTS PER ACTOR CATEGORIES

19. WHAT ARE COMPANIES AND INVESTORS LEGALLY REQUIRED TO DO AND BY WHEN?

Disclosure obligations are required under the Taxonomy for **two main categories of actors: large companies and financial market participants.**

LARGE COMPANIES

Financial and non-financial companies that fall under the scope of the Non-Financial Reporting Directive (NFRD) will have to disclose information on how and to what extent their activity is Taxonomy compliant.

It concerns large public-interest companies with more than 500 employees, covering approximately 6,000 companies and groups across the EU.

Companies must report on Taxonomy financial compliance metrics, meaning their activities' green shares – in percentage of revenues, OPEX or CAPEX. (publication in the course of **2022** covering the financial year 2021 for activities related to climate change mitigation and adaptation, in the course of **2023** for the financial year 2022 for activities related to the other Taxonomy environmental objectives).

Remarks: One acknowledges that implementation specifics (what, how, who) are not clear-cut as the NFRD directive is planned to be revised in 2021 and will be subject to further revision. Despite possible modifications, no revision will be made on the obligation for companies to report their green shares by the end of 2021. Furthermore, the European Commission will adopt Delegated Acts by the 1st of June 2021 specifying how the corporate disclosure obligations should be applied in practice. The Delegated Act will differentiate non-financial and financial companies. In the meantime, a European or international reporting standard is being discussed (EFRAG).

FINANCIAL MARKET PARTICIPANTS

Financial market participants offering financial products in the EU, including occupational pension providers, will be required to complete their first set of disclosures against the Taxonomy, covering activities that substantially contribute to climate change mitigation and/or adaptation, by the **31st of December 2021**. Depending on the type of product or offering, **investors will have to provide different types of mandatory disclosures.** If an investment firm claims its products have environmentally sustainable objectives, it will need to disclose the nature and extent to which the product aligns with the Taxonomy. If not, it will state that the product does not align.

For each relevant product, financial market participants will be required to state in existing pre-contractual and periodic reporting requirements:

- how and to what extent they have used the Taxonomy in determining the sustainability of the underlying investments;
- to what environmental objective(s) the investments contribute;
- the proportion of underlying investments that are Taxonomy-aligned, expressed as a percentage of the investment, fund or portfolio (details on the respective proportions of enabling and transition activities)

20. HOW CAN THE EU TAXONOMY BE APPLIED AT PROJECT LEVEL?

The identification of eligible activities under the Taxonomy is expected to be relatively straightforward. Projects often entail specific activities but in practice, projects could also involve components that can comply with the Taxonomy and components that cannot (for example, the refurbishment of current infrastructure or real estate). For this reason, a granular approach to analyze each project's compliance with the Taxonomy is needed. Taxonomy-eligible activities can be identified through their NACE code and considered as 'green'.

The DNSH and Minimum social safeguards respect verification might challenge taxonomy assessment at project level since they are likely to be reviewed at companies level, following the same process as bond issuance frameworks. This could penalize the eligibility of economic projects initiated within large companies that do not meet these criteria.

Furthermore, when structuring **a bond or a loan for a multi-sector project (mixing land rehabilitation, buildings, transport, waste management, etc.) defining eligibility might be challenging.** Each of the sub-project/asset shall meet the specific eligibility criteria. If the capital allocation to the projects was split equally across three activities and only one of the projects satisfied the technical screening criteria, then only 33% of the investment would qualify.

21. HOW CAN COMPLIANCE WITH THE TAXONOMY BE DEMONSTRATED?

When the EU Taxonomy refers to qualitative criteria (e.g. local, EU regulations, or international standards), the assessment and verification of “**do no significant harm**” criteria and **minimum safeguards** could conclude positively on compliance when the following three conditions are met:

- i. Existence of the **legally required environmental and/or social frameworks** and permits at **project level**.
- ii. Existence of a risk analysis at project level to assess the **likelihood of the project causing significant harm or breaching minimum safeguards**. However, when the issuer has a wider corporate due diligence system, the risk analysis can be considered solved by the existence of environmental and/or social impact reports that are typically related to the permitting process.
- iii. Existence of **mitigation action plans whenever material controversies emerge**. The TEG proposes the use of primarily internal, but, when relevant, also external databases to detect potential controversies. Issuers should explain, for instance in their Green Bond Framework, the mitigation plan adopted if applicable.

Nonetheless, the TEG reminds that due diligence systems are dynamic and on-going processes and they are primarily preventive.

It is recommended that financial actors carrying out due diligence should rely on existing credible information sources, such as reports from international organizations, credible civil society and media, as well as established market data providers. The TEG recommends the consultation of the **National Contact Points** (NCPs) reports that are under the OECD supervision. NCPs are existing agencies established by governments with a two-fold mandate following to an Action Plan (see “Action Plan to strengthen National Contact Points for Responsible Business Control: 2019-2021” report):

- Promoting the OECD Guidelines for Multinational Enterprises (which are henceforth one of the pillars of the Taxonomy minimum safeguards and cover a large range of topics, incl. on bribery, competition or taxation)
- Handling cases (referred to as “specific instances”) as a non-judicial grievance mechanism

This greater role devoted to the OECD is also probably a way for European institutions to be more inclusive through the EU Taxonomy ecosystem because the Paris-based organization has a membership that goes far beyond the European Union (49 governments have an operating NCP).

22. HOW TO DEAL WITH FORWARD-LOOKING COMPLIANCE?

The TEG proposes to consider as eligible, i.e. Taxonomy aligned, “*the financing of improvement measures that are part of an implementation plan to meet activity threshold over a defined time period*” (forward-looking eligibility). The [EU Green Bond Standard User Guide](#) also released in March corroborates this proposal. It states that “*Investments that will align the activity with the EU Taxonomy criteria according to a predefined investment plan and timeline as specified in the relevant activity criteria are eligible use-of-proceeds for Green Projects*”.

Officially, in its Technical Report, the TEG specifies that for activity that does not meet the screening criteria yet, the financing of improvement measures (CAPEX and, if relevant, OPEX) can be counted as Taxonomy-aligned if **they are part of an implementation plan** to meet the activity threshold over a **period of five years**. The technical annex mentions longer periods: for example, the report states “*Aluminum mitigation measures are eligible provided they are incorporated into a single investment plan within a determined time frame (5 or 10 years)*”.

However, it is not clear whether the Taxonomy Regulation as it stands would allow it because this notion of implementation plan is totally absent from the Text. Indeed, the Article 3 of the Taxonomy Regulation (“Criteria for environmentally sustainable economic activities”) and the Article 19 (“Requirements for technical screening criteria”) reveal no explicit reference to forward-looking conformity with the threshold or interim period.

We agree there is strong rationale to include retrofit CAPEX to achieve future compliance by meeting threshold or obtaining standard for instance, otherwise, only “greenfield” CAPEX would be eligible under the EU Taxonomy (and some OPEX leftovers). In economies where the stock of capital is slowly renewed, the inclusion of brownfield investment is essential, but such approach requires monitoring:

- Whether the thresholds are actually met in the end within the predefined period
- The initial investments are properly delineated and set in good faith (and do not include investments that do not contribute to meeting the thresholds as per the technical screening criteria, but in practice, is very challenging to separate the non-contributing part)

Noteworthy, disentangling the share of investment that will help to meet the technical screening criteria from operating and maintenance expenditures might be challenging.

23. IS THERE A MANDATORY CERTIFICATION OR AUDIT VERIFICATION MECHANISM?

The EU institutions only supervise the application of the legislative texts (juridical conformity, often verified by national authorities) or the administrative processes, but the Taxonomy Regulation does not explicitly require **any formal certification or audit verification of Taxonomy-related disclosure**, even though it is **encouraged**. Disclosures must be made as part of the non-financial reporting under NFRD, which does not, as a baseline, require verification (although transposition into some Member States may influence this, in France for instance, limited assurance is required on non-financial reporting). The NFRD does not detail the certification system and requirements, meaning that it would be the role of each State Member should it consider it necessary.

Currently the voluntary external review market is divided between four types of organizations:

- Non-financial rating agencies and sustainability consultancies specialized in second-party opinions;
- Big-four audit firms providing mostly post-issuance verification or “assurance” services;
- Credit Rating Agencies;
- Global technical inspection and certification bodies

For the moment, there is no public sector-supported scheme compensating for the verification expenses. Meanwhile, some companies are providing audits and advisory services for Taxonomy-aligned assessments.

24. HOW TO DEAL WITH ECONOMIC ACTIVITIES AND ENVIRONMENTAL OBJECTIVES NOT ASSESSED YET?

The TEG encourages companies to disclose when they perform activities not yet covered with criteria as opposed to activities covered but not meeting the criteria. They are invited to publish an explicit statement with an **explanation** and explicit **statement** regarding their inability to meet the technical screening criteria. A registered or supervised verifier shall confirm that the Projects contribute substantially to at least one of six environmental objectives of the EU Taxonomy, while not significantly harming any of the other objectives, and comply with minimum safeguards.

25. IS ANY GUIDANCE PROVIDED FOR EXTRA-TERRITORIAL CHALLENGES?

Extra-territoriality usability challenges are better covered although there is no silver bullet solution. The TEG acknowledges that the international influence of the Taxonomy will exist despite there being no intention to bind third countries on their own sustainability or sustainable finance activities. It is a very diplomatic language considering reluctances from non-European countries to see European standard prevail.

The TEG highlights that the EU Taxonomy is no different to other corporate or financial product reporting obligations already in place in the EU in terms of international influence. The TEG claims that it has identified technical screening criteria that have global relevance. However, in practice, global applicability or relevance is only mentioned a few times. The TEG also recognized that sometimes locally relevant standards may reasonably be applied in countries outside the EU (for both substantial contribution or DNSH performance) due to the local economic development context, lack of available data or reporting systems, lack of access to technology solutions. Yet, European companies are supporting the use of the Taxonomy by non-European actors as the reporting requirements could penalize European actors, compared to non-European ones. Another challenging stake is for financial market participants (especially for investors) to report on their non-European economic activities, including the green share that is likely not to be disclosed by companies outside the EU.



FOCUS ON MARCH 2020 REPORTS' KEY UPDATES AND PROPOSALS

26. IS THE NACE CLASSIFICATION SYSTEM USABLE?

A recurrent feedback in the consultation was the lack of comparability between the NACE classification used for the Taxonomy and the classifications used by corporates and the financial services industry. To answer this concern, the TEG provided an **Excel spreadsheet mapping the NACE classification system** (Nomenclature des Activités Economiques dans la Communauté Européenne) **against the Bloomberg Industry Classification System (BICS) and the Thompson Reuters Business Classification system (TRBC)**. It also states that the full development of the Taxonomy will necessitate the addition of NACE codes in a timely manner. Similar to buildings, it may be necessary to identify activities that are unlikely to have NACE codes. The TEG recommends that tables matching proprietary classifications with the NACE codes should be published on relevant Platform for Sustainable Finance website(s) and should be updated regularly. The table below offers, as an example, a comparison between the different codes for the activity "Manufacture of aluminum".

Figure 6: Excel sheet classification codes comparison for the "Manufacture of Aluminum" activity

NACE description	NACE class
Aluminium production	24.42
BICS description	BICS code
Manufacture of aluminium	1810151110
TRBC description	TRBC code
Aluminium (NEC)	5120103010
Primary Aluminium Production	5120103011
Secondary Smelting & Alloying of Aluminium	5120103012
Aluminium Rolling	5120103013
Aluminium Refining	5120103014
Non-Paper Containers & Packaging (NEC)	5130201010
Metal Containers & Packaging	5130201013

27. WERE NEW ECONOMIC ACTIVITIES REVIEWED?

In its previous reports, the TEG set out recommended technical screening criteria for 67 economic activities, identifying when those activities can be considered as making a substantial contribution to mitigation and doing no significant harm to the other environmental objectives¹⁸. Even though the criteria identifying when those activities make a substantial contribution to adaptation were set out, the TEG had not set out the DNSH criteria for the other five objectives.

Furthermore, some activities' technical screening criteria have been revised with additional guidance, such as for "Forestry"; "Growing of non-perennial crops", "Production of Electricity from Hydropower"; "Transmission and Distribution of Electricity"; Centralized wastewater treatment"; "Engineering activities and related technical consultancy dedicated to adaptation to climate change".

On climate change mitigation, three new activities (Afforestation, storage of thermal energy, storage of hydrogen) have been added to the Taxonomy and can be assessed, counting as eligible.

¹⁸ Climate change adaptation, pollution prevention and control, use and protection of water and marine resources, circular economy, and protection and restoration of biodiversity and ecosystems.

Because of the very nature of specific activities, some are only assessed in either “adaptation activities” category or “mitigation activities” category. Further work is expected on some activities. In particular two are mentioned as a priority: **Research and development** (natural sciences and engineering) and **Provision of specialized telecommunications applications for weather monitoring and forecast**. The DNSH assessments for these two activities have not been fully completed yet.

Nuclear energy’s DNSH criteria are to be reviewed too. Given the assessments’ limitations linked to the long-term management of High-Level Waste (HLW), the TEG explained that it could not conclude that the nuclear energy value chain does not cause significant harm to other environmental objectives on the time scales in question. The TEG has thus not included any assessment sheet for nuclear activities, which fueled lively debates. The TEG recommends that more extensive technical work is undertaken on the DNSH aspects of nuclear energy in the future and by a group with in-depth technical expertise

28. ARE THERE SUBSTANTIAL CHANGES TO THE METHODOLOGY?

Not really, but further explanations are provided about how to carry assessments (“Taxonomy in practice” section) and how to face complex situations.

As a reminder, the Taxonomy key features are listed below:

- **Binary nature:** the new concept of “implementation plan” and call for a three-performance structure within the Taxonomy (see question n°18)
- **New economic activities and activities not yet covered:** how to deal with them (see question n°24)
- **Classification systems comparability:** translations from NACE code to other classification systems (BICS, TRBC) provided by an Excel spreadsheet (see question n°26).
- **Do no significant harm assessment:** An activity contributing to climate change mitigation must avoid significant harm to climate change adaptation and the other four environmental objectives: 1. Sustainable use and protection of water and marine resources; 2. Transition to a circular economy, waste prevention and recycling; 3. Pollution prevention and control; 4. Protection of healthy ecosystems. (for more details refer to the part “do not significant harm & minimum safeguards” of this document)
- **Social minimum safeguards:** activity should be carried out “in alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the International Labour Organisation’s (‘ILO’) declaration on Fundamental Rights and Principles at Work, the eight ILO core conventions and the International Bill of Human Rights”.(for more details refer to the part “do not significant harm & minimum safeguards” of this document)
- **Extra-territorial challenges:** non-European activities are mentioned as globally integrated markets and economic supply chains raise the question of the utilization’s scope of the European Taxonomy. By virtue of globally integrated markets and economic supply chains, the disclosure obligations on financial product issuers and corporations in the EU will create implications for international actors. Yet, the compliance to the Taxonomy by non-European actors is unpredictable. (see question n°25)

29. ARE THERE SUBSTANTIAL CHANGES TO THE THRESHOLDS?

The below table, shows the main changes made to the applicable thresholds:

	Metric/Threshold of Updated version (March 2020)	Previous version (June 2019)
Forestry (Afforestation, rehabilitation/restoration, reforestation, existing forest management and conservation forest)	Continued compliance with the Sustainable Forest Management (SFM) requirements, disclosed at 10-year intervals through a forest management plan (or equivalent) that shall be reviewed by an independent third-party certifier	A 5-year interval disclosure, through a forest management plan without reference to third-party certification
	Changes in carbon stocks should be disclosed based on growth yield curves in 10-year intervals through a forest management plan (or equivalent instrument) that shall be reviewed by an independent third-party certifier	A 5-year interval disclosure based on growth yield curve
Construction of new buildings	The threshold is based on nearly zero-energy building (NZEB) requirements. The net primary energy demand of the new construction must be at least 20% lower than the primary energy demand resulting from the relevant Nearly Zero Energy Building requirements	A level of energy performance equivalent to the EPC rating of B (or above) was required in addition to national requirements for NZEB
Building renovation	a) Major renovation: compliant with energy performance standards set in the ad hoc regulations transposing Energy Performance of Buildings Directive (EPBD) OR b) Relative improvement: the renovation leads to reduction of Primary Energy Demand of at least 30% in comparison to the energy performance of the building before the renovation (with external validation by an accredited independent expert)	Criteria a): No change OR Criteria b): Relative improvement: the renovation achieves energy savings of at least 30% in comparison to the baseline performance of the building before the renovation (with external validation by an accredited independent expert)
Acquisition and ownership	<p><i>Buildings built after 2021:</i> The net primary energy demand of the new construction must be at least 20% lower than the primary demand from NZEB requirements</p> <p><i>Buildings built before 2021:</i> The building performance is comparable to the performance of the top 15% of the national stock, in terms of calculated Primary Energy Demand during the use phase.</p> <p><i>Large non-residential buildings:</i> Efficient operations must be ensured through dedicated energy management</p>	Need to meet all of these criteria: <ul style="list-style-type: none"> • Acquisition of a building issued with EPC rating B (or above) • Acquisition of any other building, provided that it is subsequently improved (within 3 years of purchase, either through one single improvement achieving the thresholds or through a series of improvements), achieving one of the following: <ul style="list-style-type: none"> -Savings in energy performance of least 30% against the baseline; performance and predicted improvement shall be based on a specialised building survey and be validated by an accredited energy auditor -EPC rating B (or above) -Energy performance standards set for major renovation in applicable building regulations transposing the EPBD
Manufacturing of low carbon technologies	Manufacture of low carbon transport vehicles and their key components, fleets and vessels are eligible for category L vehicles, with a threshold of zero tailpipe emission vehicles	L vehicles excluded (2- and 3-wheel vehicles and quadricycles)
Manufacturing of iron/steel	No changes in threshold but production from coke is added: Coke (excluding lignite coke) = 0.286 tCO ₂ e/t product.	Production from was coke excluded



Manufacturing of chlorine	Electricity use for chlorine manufacturing is at or lower than 2.45 MWh/t Chlorine.	Former threshold: 2.75MWh/t
Production of electricity from bioenergy	Facilities operating above 80% of GHG emissions-reduction in relation to the relative fossil fuel comparator set out in RED II increasing to 100% by 2050.	85 % of GHG emissions
Manufacture of aluminum	Criteria 1 (GHG emissions <1.514tCO ₂ e/t aluminum) needs to be met in combination with <i>EITHER</i> criteria 2 (15.29 MWh/t average electricity consumption for electrolysis) <i>OR</i> 3 (100g CO ₂ /kwh carbon intensity for electrolysis consumption)	Need to meet the 3 conditions

New thresholds were added regarding the storage of hydrogen and of thermal energy, the material recovery from non-hazardous waste and the transportation of CO₂:

Storage of hydrogen	Eligibility, if the Infrastructure is used to store Taxonomy-eligible hydrogen (see Manufacture of hydrogen).
Storage of thermal energy	Eligibility of all thermal energy storage (including Thermal Energy Storage (UTES) or Aquifer Thermal Energy Storage (ATES), subject to regular review.
Material recovery from non-hazardous waste	Eligibility, if at least 50%, in terms of weight, of the processed separately collected non-hazardous waste is converted into secondary raw materials
Transport of CO₂	Eligibility of assets that increase the flexibility and management of an existing network, without expanding the network to include carbon capture and use activities
Transportation	<i>Passenger/Freight Rail Transport, Public Transport, Passenger cars and Commercial Vehicles</i> Eligibility of zero-direct emissions vehicles (e.g. electric/hydrogen)

30. WHAT HAS BEEN ADDED IN THE MINIMUM SOCIAL SAFEGUARDS?

The TEG reminds that new minimum safeguards were introduced in the Taxonomy Regulation (Political agreement reached last December by the co-legislators on the overarching regulation) to reference the **UN Guiding Principles on Business and Human Rights and the “OECD Guidelines for Multinational Enterprises”**, including the principles and rights set out in the eight fundamental conventions identified in the **International Labour Organization’s declaration on Fundamental Rights and Principles at Work and the “International Bill of Human Rights”**. Where applicable, more stringent requirements in EU law still apply.

Moreover, the [Article 7 of the Taxonomy Regulation](#) introduces additional safeguards applicable to solutions implemented to adapt economic activities, requiring that they lead to no increase in the risk of an adverse impact on other people, nature and assets. This safeguard is in addition to the previously established safeguards against harm caused by the economic activity itself, either to adaptation itself or to the other five environmental goals addressed by the Taxonomy (captured via the DNSH criteria).

31. WHY IS THE TEG IN FAVOR OF A BROWN TAXONOMY RATHER THAN SHADES OF GREEN?

The TEG argues that incorporating “brown” criteria would help brown industries explaining **incremental improvements** in their activities and receiving some positive recognition in the market. “Brown” Taxonomy thresholds could be used to **identify very simply the move of a significantly harmful activity to an acceptable level of harm**. Reflecting improvements would also encourage companies or other issuers to disclose their strategy and financing plans and gradually move to green activities. **The TEG considers that those three levels would eliminate the need for additional shades of green in the Taxonomy.** Identifying an environmentally harmful economic activity as partially green carries risks, such as leading the market to believe that any performance improvement is good enough even if the underlying activity and its performance is ultimately inconsistent with climate goals over the medium to long term. In other words, better does not mean green.

32. HOW COULD A BROWN TAXONOMY BE DEFINED?

A well-designed brown Taxonomy would be very useful but how to define it is much more complicated and raises several challenging questions such as:

- Should metrics and thresholds to define brownness be calculated *versus* peers and sector average performances? Rather against company’ historical performances?
- Should brown criteria calculated *versus* science-based ranges and performance levels? If yes, on what climate temperature scenario should it be based? On a 3°C or 4°C increase temperature?
- Should it use the EU-ETS values as a reference (e.g. “worst Available Technologies or 10% worst installations to mirror the 10% best installations in the EU used for manufacturing activities).

Note that Natixis has developed a **seven-level classification from dark brown to dark green** as part of its **Green Weighting Factor** initiative, from which we can confirm the existence of numerous challenges in the design of such a Taxonomy, but also the great value of this shaded approach for the sake of monitoring change / transition. However, the current Regulation focusing on green is binary and therefore relatively simple to grasp. Adding a brown taxonomy, possibly with “shades of brown” would be very useful but would unavoidably add some complexity. By contrast, to avoid overload of shades, we do not support a neutral taxonomy. To be fully useful, a brown Taxonomy should help defining what is medium brown because the most climate harmful activities are relatively well known and often subject to exclusion policies (e.g. coal, tar sands, fracking, oil-fired heating in buildings). The scope of a brown Taxonomy should be economy wide, as it is for the green Taxonomy.

We believe parallelism with the green Taxonomy in terms of metric and threshold should be pursued whenever possible. Such parallelism is possible when the technical screening criteria (TSC) are expressed in terms of intensity per unit of output. The subsequent question is the calibration threshold or methodology for brown criteria.

Parallelism appears more challenging when:

- TSC are expressed in improvement against baseline / own performances. For example, in building renovations, is there a level of improvement that is considered brown?
- TSC are good practices (essential management practices are defined in growing perennial crops, it would be hard to define) or technologies (there is no list of worst available technologies)

It seems unrealistic to use TSC when TSC are a standard for defining green (e.g. Sustainable Forest Management (SFM) requirements). Not having a standard can prove to be challenging as a definition for brown even for standards with different levels (Standard levels are likely to only be useful for shades of green).

33. NEW PRODUCTS: TOWARDS A TAXONOMY FOR KPI-LINKED BONDS?

KPI-linked bonds, also called “Sustainability-linked bonds” (SLBs) have been recently defined by the International Capital Market Association (ICMA) as “any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ ESG objectives”. The typical example would be a change in coupon depending on whether a target sustainability key performance indicator (KPI) is met. As a reminder, on June 9th 2020, ICMA published [the Sustainability-Linked Bond Principles](#).

The European Commission in its public consultation about **its Renewed Strategy asked whether the EU should develop standards for sustainability-linked bonds or loans**. It also questioned whether such a standard should make use of the EU Taxonomy as one of the key performance indicators.

OUR ASSESSMENT OF PRACTICALITY AND RELEVANCE

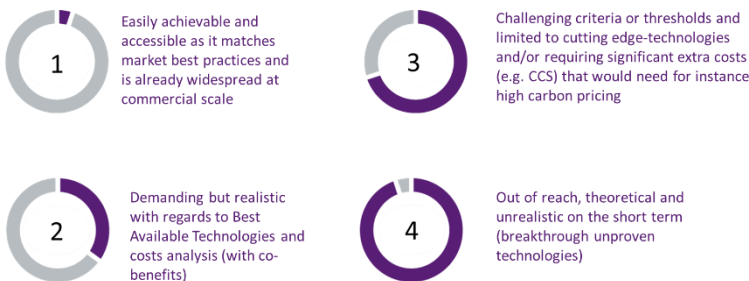
Example of the Aluminum case study

It depends on the assessed economic activities. Indeed, the feasibility and the practicality of the assessment is closely related to the chosen technical screening criteria. The relevance of these criteria can be examined through two aspects: the **stringency** (depending on the level of threshold to meet, the availability of the market best practices or technologies) and the **usability** (difficulty and time to collect the necessary data or indicators and to demonstrate compliance) of this criterion.

See below for an example of a post March 2020 updated assessment of the TEG's proposed criteria for the manufacture of aluminum.

Our stringency assessment scale

We have developed a four-level scale to assess the stringency of the technical criteria proposed by the TEG, 1 being the less stringent to 4 being extremely stringent



Our usability assessment scale

We have developed a four-level scale to assess the usability of the technical criteria proposed by the TEG, 1 being very limited to 4 being extremely usable

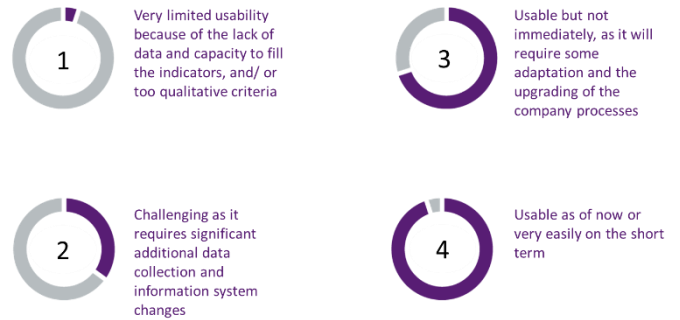


Figure 7: EU Taxonomy: Focus on the Manufacture of aluminum

<p>Classification</p> <p>Macro sector : Manufacturing</p> <p>Code: C24.4.2 (Page 172-175)</p> <p><input type="checkbox"/> Already low carbon</p> <p><input checked="" type="checkbox"/> Transition activities</p> <p><input checked="" type="checkbox"/> "Enabling activities"</p> <p><input type="checkbox"/> Adaptation activities</p>	<p>Main features</p> <p><input checked="" type="checkbox"/> Absolute (e.g. gCO2/KWh, gCO2/pkm)</p> <p><input type="checkbox"/> In relative (gains in %, e.g. 30% in energy savings for renovation of buildings)</p> <p>Emissions covered :</p> <p>scope 1 <input checked="" type="checkbox"/> scope 2 <input checked="" type="checkbox"/> scope 3 <input type="checkbox"/></p> <p><input checked="" type="checkbox"/> Technology or practices criteria (automatic, e.g. solar PV, crop rotation)</p> <p><input type="checkbox"/> Label / standard / regulation</p>	<p>Metric & threshold</p> <p>1 - Primary aluminum production needs to meet :</p> <ul style="list-style-type: none"> Criteria 1: Direct emission intensity is at or below the value of the related EU ETS benchmark : 1.514tCO2e/t alu (to be reduced starting on 2021 on a yearly basis by a factor between 0.2% and 1.6%, still to be determined.) <p>AND</p> <ul style="list-style-type: none"> Criteria 2: Electricity consumption for electrolysis at or below the European average emission factor according to IAI: 15.29MWh/t alu (to be updated annually) Criteria 3: Electricity carbon intensity for electrolysis : 100g CO2e/kWh (Taxonomy threshold subject to periodical update) <p>2 - Secondary aluminum production - All aluminum recycling is eligible due to significantly lower emissions than primary aluminum</p>
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Stringency Assessment



Do no significant harm & Minimum Social safeguards

- Water management
- Waste management (BREF for the non ferrous materials)
- Ability to process alu scrap
- Air pollution in line with the BAT –AEL levels (i.e. PFC, PAHs, PMs, HF...)
- Damage to ecosystem (compliance with EU Directives 2014/525/EU and 2001/42/EC & IFC Performance Standards
- Groundwater contamination and pollution of local water courses due to spent pot lining (SPL) treatment
- Appropriate mitigation in Protected areas



Comments: The technical criteria for primary aluminum is clear cut and in line with sectors' usually tracked KPIs. Data should be available. Even if the criteria 1 is quite stringent as the [EU ETS](#) are set against a benchmark of the 10% most efficient installations, the opportunity given in the final report to choose between the criteria 2 and 3 is more flexible and opens the door to more eligible operations (such as recent technology equipped gas powered smelters). According to [the IAI](#), the World average electricity consumption for Alu electrolysis is already below the threshold set, due to recent technologies developments outside the EU. We suppose that the rationale behind the flexibility given, is that on the short term the availability of low carbon electricity may be a limiting factor, depending on the region within the EU. Based on our calculations, the combination of criteria 1 and 2 could lead to a carbon intensity ratio above 6 tCO2e/t aluminium (for instance for a recent technology equipped gas powered smelters) that would not be aligned with a 2°scenario based on [TPI's methodology](#).

Natixis' GSH view



Figure 8: EU Taxonomy: changes in the technical screening criteria for primary aluminum

	June 2019 report ¹	March 2020 final report ²																																								
Technical Screening criteria	<p>Manufacture of primary aluminium is eligible if the three following criteria are met:</p> <p>Scope 1</p> <ul style="list-style-type: none"> Criteria 1: Direct emission for primary aluminium production is at or below the value of the related EU-ETS benchmark. As of February 2020, the EU-ETS benchmarks values for aluminium manufacturing is 1.514 tCO₂e/t. (Direct emissions are to be calculated according to the methodology used for EU-ETS benchmarks) Criteria 2: Electricity consumption for electrolysis is at or below: 15.29 MWh/t (European average emission factor according to International Aluminium Institute, 2017, to be updated annually) Criteria 3: Average carbon intensity of the electricity that is used for primary aluminium production (electrolysis) is at or below: 100 g CO₂e/kWh (Taxonomy threshold for electricity production, subject to periodical update). <p>AND</p> <ul style="list-style-type: none"> Scope 2 Criteria 2: Electricity consumption for electrolysis is at or below: 15.29 MWh/t (European average emission factor according to International Aluminium Institute, 2017, to be updated annually) Criteria 3: Average carbon intensity of the electricity that is used for primary aluminium production (electrolysis) is at or below: 100 g CO₂e/kWh (Taxonomy threshold for electricity production, subject to periodical update). <p>➤ Scope 1&2 < 3.043gCO₂/t aluminium (based on our calculations)</p>	<p>Manufacture of primary aluminium is eligible if Criteria 1 (see below) is met in combination with either criteria 2 or 3 (see below):</p> <p>Scope 1</p> <ul style="list-style-type: none"> Criteria 1: Direct emission for primary aluminium production is at or below the value of the related EU-ETS benchmark. As of February 2020, the EU-ETS benchmarks values for aluminium manufacturing is 1.514 tCO₂e/t. (Direct emissions are to be calculated according to the methodology used for EU-ETS benchmarks) Criteria 2: Electricity consumption for electrolysis is at or below: 15.29 MWh/t (European average emission factor according to International Aluminium Institute, 2017, to be updated annually) Criteria 3: Average carbon intensity of the electricity that is used for primary aluminium production (electrolysis) is at or below: 100 g CO₂e/kWh (Taxonomy threshold for electricity production, subject to periodical update). <p>OR</p> <ul style="list-style-type: none"> Scope 2 Criteria 2: Electricity consumption for electrolysis is at or below: 15.29 MWh/t (European average emission factor according to International Aluminium Institute, 2017, to be updated annually) Criteria 3: Average carbon intensity of the electricity that is used for primary aluminium production (electrolysis) is at or below: 100 g CO₂e/kWh (Taxonomy threshold for electricity production, subject to periodical update). <p>➤ Scope 1 < 1.514 tCO₂e/t aluminium ➤ Scope 2: could go from ~0.3tCO₂e/t alu to > 6.2tCO₂e/t alu (based on our calculations*)</p>																																								
Rusal's carbon intensity targets	Scope 1&2: Aligned	Scope 1 : Not aligned																																								
	<table border="1"> <thead> <tr> <th></th> <th>Base year</th> <th>Initial Score</th> <th colspan="5">Target Score</th> </tr> <tr> <th>Year</th> <th>2017</th> <th>2018</th> <th>2019</th> <th>2020</th> <th>2021</th> <th>2022</th> <th>2023</th> </tr> </thead> <tbody> <tr> <td>Scope1 t CO₂eq / t Al</td> <td>2,20</td> <td>2,11</td> <td>2,1</td> <td>2,09</td> <td>2,07</td> <td>2,05</td> <td>2,03</td> </tr> <tr> <td>Scope2 t CO₂eq / t Al</td> <td>0,46</td> <td>0,35</td> <td>0,35</td> <td>0,35</td> <td>0,35</td> <td>0,35</td> <td>0,35</td> </tr> <tr> <td>Scope1+2 t CO₂eq / t Al</td> <td>2,66</td> <td>2,46</td> <td>2,45</td> <td>2,44</td> <td>2,42</td> <td>2,40</td> <td>2,38</td> </tr> </tbody> </table>			Base year	Initial Score	Target Score					Year	2017	2018	2019	2020	2021	2022	2023	Scope1 t CO ₂ eq / t Al	2,20	2,11	2,1	2,09	2,07	2,05	2,03	Scope2 t CO ₂ eq / t Al	0,46	0,35	0,35	0,35	0,35	0,35	0,35	Scope1+2 t CO ₂ eq / t Al	2,66	2,46	2,45	2,44	2,42	2,40	2,38
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Scope 1: all direct emissions related to the production (the process's direct emissions and the emissions due to fuel use for on-site energy production).
Scope 2: Electricity consumption for electrolysis process and related emissions from the generation of the electricity used

*~0.3tCO₂e/t alu: assuming 20gCO₂e/kWh of average carbon intensity of the electricity used from a hydroelectric powerplant (criteria 3 met) with an energy efficiency for electrolysis of 13.5MWh/t)

*>6.2tCO₂e/t alu : assuming 15.29MWh/t of energy efficiency for electrolysis (criteria 2 met) with 400gCO₂e/kWh average carbon intensity of the electricity used from a gas-fired power plant.

Figure 9: EU Taxonomy: changes in the DNSH criteria for primary aluminum

Sustainability impacts	June 2019 report ¹	March 2020 final report ²
Do no significant harm criteria	Water	N/a
	Pollution & Emissions to Air	<ul style="list-style-type: none"> Emissions to air (e.g. sulphur dioxide - SO₂, nitrogen oxide - NO_x, particulate matter, Total Organic Carbon (TOC), dioxins, mercury (Hg), hydrogen chloride (HCL), hydrogen fluoride (HF), Total Fluoride, and (PFCs) polyfluorinated hydrocarbons (PFCs)) are within the BAT-AEL ranges set in the BREF for the Non-Ferrous Metals Industries. A minimum requirement is the implementation and adherence to a recognised environmental management system (ISO 14001, EMAS, or equivalent).
		N/a
	Waste	Measures are in place to minimise and manage waste (including hazardous waste) and material use in accordance with the BREF for the Non-Ferrous Metals Industries.
In order to avoid risks to circular economy, aluminium manufacturing plants need to be able to process aluminium scrap.		In order to avoid risks to circular economy, aluminium manufacturing plants need to be able to process aluminium scrap. In order to avoid unnecessary resource and energy consumption, the aluminium scrap collection and sorting activities should be optimised for separation on an alloy specific basis. If scrap alloys are mixed, the functionality of the recycled material is restricted, and valuable alloying elements may be lost.
Ecosystems	<ul style="list-style-type: none"> Environmental Impact Assessment (EIA) must be completed in accordance with the EU Directives on Environmental Impact Assessment (2014/52/EU) and Strategic Environmental Assessment (2001/42/EC), or other equivalent national provisions or international standards For sites/operations located in or near to biodiversity-sensitive areas, ensure that an appropriate assessment has been conducted in compliance with the provisions of the EU Biodiversity Strategy (COM (2011) 244), the Birds (2009/147/EC) and Habitats (92/43/EEC) Directives (or other equivalent national provisions or international standards based on the conservation objectives of the protected area. 	

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