EU SUSTAINABLE FINANCE TAXONOMY

WHAT IS THE TAXONOMY?

The EU taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable. It has been developed with input from experts across investment, industry, civil society and the public sector.

The Taxonomy sets performance thresholds (referred to as “technical screening criteria”) for economic activities which:

- make a substantive contribution to environmental objectives – starting with climate change mitigation or climate change adaptation; and
- avoid significant harm to other EU environmental objectives (pollution, waste & circular economy, water, biodiversity).

They must also meet minimum social safeguards, currently defined as ILO Core Labour Conventions.

In the EU, a first set of technical screening criteria were developed by a Technical Expert Group (TEG) and launched in June 2019. They will be used to develop an EU regulation establishing the Taxonomy.

EXAMPLE TAXONOMY ACTIVITY: PASSENGER CARS

- Passenger cars with tailpipe emissions intensity of less than 50g CO₂/km are considered to make a substantive contribution to climate change mitigation. This includes zero tailpipe emissions cars (hydrogen, fuel cell, electric vehicles).
- To avoid significant harm to other environmental objectives, the production facility should manage material physical risks on a best efforts basis, avoid undermining others’ adaptation efforts, and ensure compliance with existing EU regulation on hazardous waste and end of life treatment of vehicles (circular economy) and pollution.

This is an illustrative summary. The full criteria are set out in the Taxonomy Technical Report.
WHO WILL USE THE TAXONOMY?

Under the current proposal, investors who market environmentally sustainable funds will disclose:

1. how they use the Taxonomy when determining if an investment is environmentally sustainable. The Taxonomy could be used in portfolio construction or as the basis of engagement. Alternatively, investors can explain their own preferred methodology; and
2. the proportion of the fund that invests in Taxonomy-eligible activities.

The Taxonomy can help investors to comply with the recently-agreed EU disclosure requirements on sustainable investments, which include requirements for funds targeting sustainability objectives to disclose the methodologies used to assess, measure and monitor the objectives, how those objectives are met and the overall sustainability impact of the product. Further rules on how to present these disclosures are under development.

Companies are encouraged to disclose their Taxonomy-related revenues and expenditures under the updated Non-Financial Reporting Directive guidelines.

WHY HAVE A TAXONOMY?

The Taxonomy is a common language between investors, issuers and policymakers. It can build confidence that investments are meeting robust environmental standards and are consistent with high-level policy commitments like the Paris Agreement.

The Taxonomy was the top recommendation of the High-Level Expert Group on Sustainable Finance, to which the PRI was an observer. It is the first action in the EU Sustainable Finance Action Plan.

PRI POSITION

The PRI supports the EU’s efforts to establish a Taxonomy in regulation. The Taxonomy is an important step forward to ensure that capital markets can contribute to the transition to a low-carbon, resilient and resource efficient economy.

The Taxonomy offers benefits to investors. It can help to:

■ identify investment opportunities which meet a high standard of sustainability;
■ construct portfolios and monitor their impact;
■ strengthen and enable more specific dialogue between investors and companies; and
■ support communication between fund managers and asset owners, particularly resource-constrained asset owners who may struggle to develop deep environmental expertise.

The Taxonomy should help, rather than restrict, investors. Investors should be able to use the Taxonomy criteria to screen investments or engage portfolio companies around improvements in line with Taxonomy criteria. They should also be free to state and explain their own alternative methodology, if preferred.

The Taxonomy cannot be used to replace an investor’s own judgement. The PRI will not support any regulation which would:

■ require investors to invest in Taxonomy-eligible activities; or
■ limit investors’ ability to develop and market their own proprietary environmental strategies.
WHAT SHOULD INVESTORS DO?

The PRI recommends that investors:

■ read the User’s Summary – a short report designed to introduce the key concepts and give an overview of the economic activities that have been assessed by the TEG;
■ investigate how the Taxonomy could apply to existing green funds or new strategies. The PRI is hosting a webinar to explore the implications for Signatories; and
■ respond to the TEG’s forthcoming call for feedback on the Taxonomy report, which will be released by early July 2019.

The full methodology, detailed user guidance and the technical screening criteria are listed in the Technical Report.

CONTACT

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For regular updates on global responsible investment policy, sign up to the PRI’s Policy Briefing.

The PRI engages in public policy to remove barriers to a more sustainable financial system, consistent with the PRI’s mission and strategy.

The Taxonomy regulation is under negotiation. The PRI will continue to evolve its position on the Taxonomy as it engages with policy makers around its development. All policy positions will be published on the PRI’s website.

ADDITIONAL BACKGROUND

The Taxonomy is the first action in the European Commission’s Action Plan on Financing Sustainable Growth. A proposed regulation was issued in May 2018 and is still under negotiation. This sets out the legal framework for the Taxonomy, including its use by investors, its ongoing governance (via a permanent Platform on Sustainable Finance) and minimum social safeguards.

The Technical Expert Group on Sustainable Finance – an independent advisory body made up of members from finance, industry, the public sector and civil society – was established in June 2018 to help develop the technical details of the Taxonomy, as well as make recommendations on corporate climate disclosure, low carbon benchmarks and an EU Green Bond Standard. The PRI is acting as Rapporteur for the Taxonomy working group.

On 18 June 2019, the TEG released a technical report on the Taxonomy which sets out a working model for a future Taxonomy. The TEG will issue a call for feedback by early July and continue working until December, when a final report will be submitted to the European Commission.