

HOW POLICY MAKERS CAN IMPLEMENT REFORMS FOR A SUSTAINABLE FINANCIAL SYSTEM

PART II

IMPLEMENTATION GUIDE FOR SUSTAINABLE INVESTMENT POLICY
AND REGULATION TOOLS – TAXONOMIES OF SUSTAINABLE
ECONOMIC ACTIVITIES

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CONTENTS

INTRODUCTION	4
INITIAL POLICY ANALYSIS AND SCOPING	8
POLICY DESIGN PHASE	9
IMPLEMENTATION	16
MONITORING AND REVIEW	17
APPENDIX 1: CASE STUDIES	19
APPENDIX 2: REFERENCES AND ADDITIONAL RESOURCES	28

INTRODUCTION

WHAT ARE TAXONOMIES?

A sustainable finance taxonomy can be defined as a classification system to help investors and other stakeholders understand whether an economic activity is environmentally and socially sustainable (or, more precisely, meets the social and environmental criteria defined by the taxonomy). In practice, sustainable finance taxonomies generally comprise a list of activities that are considered to align with specified social or environmental goals, alongside technical criteria (e.g. performance metrics or thresholds) to assess when those activities are aligned with sustainability goals.

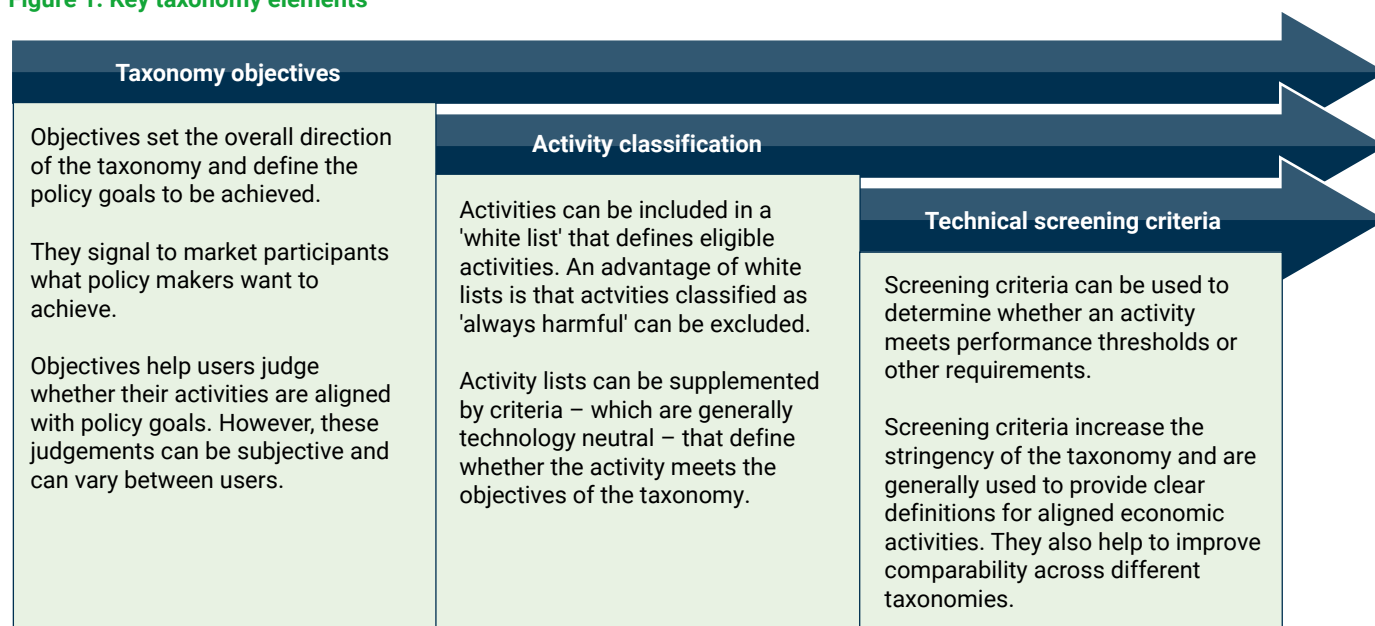
Sustainable finance taxonomies provide a common language for investors, issuers, project promoters and policy makers. They help investors assess whether investments meet robust sustainability standards and align with policy commitments such as the Paris Agreement on Climate Change, the Sustainable Development Goals (SDGs) and national sustainability and climate change goals.

Sustainable finance taxonomies generally comprise three elements:

1. **Objectives** which define the aims of the taxonomy.
2. **Activity lists** which detail eligible economic activities (i.e. those activities that can make a positive contribution to the objectives of the taxonomy). Taxonomies may also go beyond sustainable economic activities and include, for instance, economic activities that are needed to enable a transition towards achieving social or environmental goals or economic activities that are inherently harmful: such 'extended' taxonomies should always make clear that they are not only identifying sustainable economic activities, and maintain a clear distinction between the different types of economic activities (i.e. sustainable, transition, harmful) so that investors can clearly distinguish the degree to which their investments are (not) contributing to the objectives defined by the taxonomy.
3. **Performance criteria** which determine whether the eligible activities are aligned with the objectives of the taxonomy. Criteria should be defined for how economic activities can **significantly contribute** to the objectives of the sustainable finance taxonomy, as well as for ensuring that economic activities **do no significant harm** to any of the objectives. To be aligned with a sustainable finance taxonomy, an economic activity must significantly contribute to one its objectives, while doing no significant harm to any of the other objectives.

Implementing a taxonomy in stages – starting with objectives and then moving to activity lists and performance criteria (see Figure 1 below) – can help ensure the tool is suited to the context in which the taxonomy is being developed. The specificity and detail of these objectives, activity lists and technical screening criteria can be made more detailed and demanding over time, as capacity and familiarity with the taxonomy is built.

Figure 1: Key taxonomy elements



WHY ARE TAXONOMIES IMPORTANT?

Ensuring the credibility of sustainable investment products and strategies is critical to build trust. While there has been a rapid growth in investment in areas such as green bonds, broader progress has been delayed by a lack of clear, comparable and verifiable information about what is green and/or sustainable. Many organisations have issued standards, guidelines and frameworks that seek to define sustainable activities. However, the multiple standards, guidelines and frameworks that are currently available has led to market fragmentation, inconsistencies, challenges in accessing information, higher research and transaction costs for market participants and companies, and an elevated risk of greenwashing.

By providing consistent, widely recognised standards, taxonomies are therefore a critical policy tool to ensure the credibility of sustainable investment products and strategies. As stated in the World Bank 2020 guide, *Developing a National Green Taxonomy*, "A well-defined and structured taxonomy can support better-informed and more efficient decision making and respond to investment opportunities that contribute to achieving national environmental objectives. In the absence of formally agreed-upon definitions, market actors tend to introduce their own; the result is a lack of comparability, reliability, accountability, and higher transaction costs. A national green taxonomy is useful to provide guidance to the overall financial market."¹

A well-designed, effectively implemented sustainable finance taxonomy can:

- Provide clarity on what is a green and/or sustainable activity, and under which criteria. This clarity can also reduce the risk of greenwashing.
- Help measure the degree of sustainability of an investment and of companies' activities through, for example, identifying the proportion of revenues or expenditures which are green and which are not. This can also include identifying activities that will never meet the requirements of the taxonomy.
- Help investors and companies to plan and report on a transition towards sustainability by setting the objectives and the direction of travel for different economic activities. The developers of taxonomies should ensure that a distinction is maintained between those economic activities that are inherently sustainable and those economic activities that are needed to enable a transition towards achieving social or environmental objectives.
- Help policy makers make informed decisions and develop policies that are consistent with relevant long-term objectives such as those of the Paris Agreement.
- Provide a shared reference point and encourage collaboration between policy makers, investors and companies.

¹ World Bank (2021), *Developing a National Green Taxonomy*

“Taxonomies are just one element of the policy framework. Their role is to define what activities can be considered environmentally and socially sustainable and to provide the basis for policy measures directed at supporting or encouraging these activities. But taxonomies will only cover a subset of the activities that comprise the economy as a whole. Governments will also need to take action to manage these other activities through, for example, mitigating the negative social or environmental impacts of these activities and through encouraging investment in more socially or environmentally sustainable activities.”

Margarita Pirovska (Director of Policy, PRI)

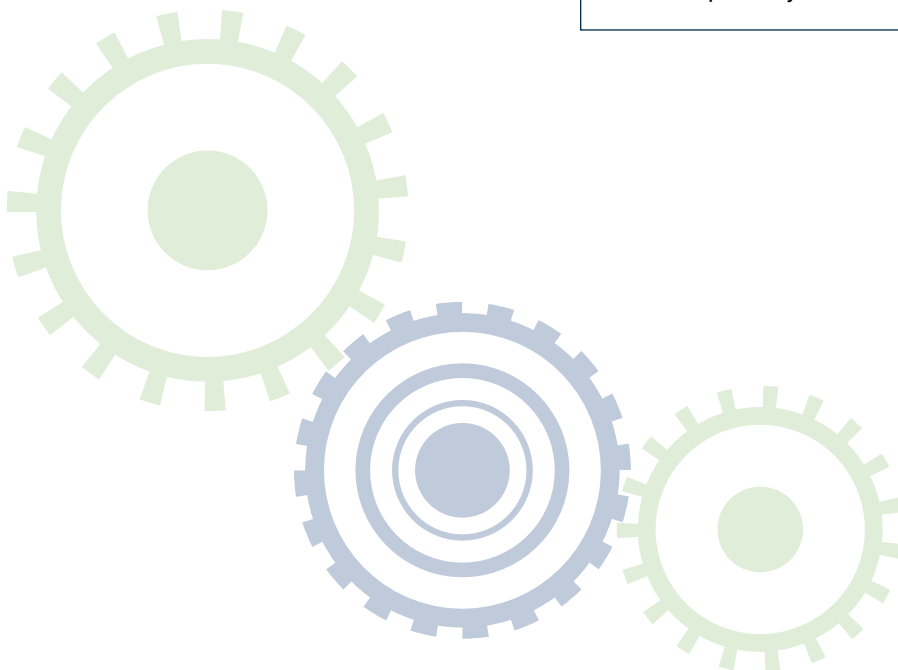
GLOBAL ALIGNMENT OF TAXONOMIES

One of the critical questions for the developers of taxonomies is the extent to which national or regional taxonomies (e.g. within the European Union) should align with other taxonomies. Clearly, alignment – or, ideally, interoperability – is important given that a key driver for taxonomy development has been the lack of consistency in defining sustainable activities, which has hindered a scaling up of sustainable investment. Without common principles and metrics, market fragmentation will continue to restrict the flow of capital into green and sustainable projects and activities.

BOX 1: UNDERSTANDING INTEROPERABILITY

In broad terms, ‘interoperability’ refers to the ability of a product or system to work with other products or systems. In information technology and systems engineering, where the term was first applied, interoperability is the ability of two or more systems to exchange information and to use the information that has been exchanged.

In relation to taxonomies, the term interoperability can be interpreted in two ways. The first, and the preferred interpretation, relates to the design of taxonomies and ensuring that national and regional taxonomies have common principles and metrics. The second relates to the processes that may be adopted to overcome potential inconsistencies between taxonomies. For example, this may be through formally recognising different taxonomies as ‘equivalent’ (even if they are not perfectly aligned on principles or metrics), or through agreeing on future convergence of national or regional taxonomies but allowing countries or regions to follow different pathways which reflect national circumstances.



From a design perspective, interoperability requires taxonomies to:

- Have similar objectives as other taxonomies, although there can be some adaptation to national contexts;
- Use the same or easily comparable industry classification systems to define economic activities;
- Have a similar approach regarding the design of technical screening criteria (i.e. including both significant contribution and do no significant harm criteria), and use technical screening criteria that are transparent and broadly similar; and
- Use consistent metrics and calculation methodologies.

These interoperability requirements suggest that governments should adopt comprehensive taxonomies with clear objectives, explicit lists of acceptable activities, and science-based, technology-neutral technical screening criteria. It is important to acknowledge that taxonomies that comprise lists of acceptable activities may have an important role to play in building market capacity² and as a first step in developing a comprehensive taxonomy that includes technical screening criteria.

From a global perspective, taxonomies will be most valuable if they are similar in structure, have aligned objectives, have easily comparable (computable) classification systems for eligible activities, and use the same metrics to define screening criteria and assess performance (although the specific metrics may be calibrated differently to reflect specific national circumstances).

"From an investor perspective, comparability is key. We need taxonomies to have common metrics and to have alignment between the different national and regional taxonomies."

Sylvia Chen (Senior Sustainable Officer, ESG Research & Engagement, Amundi)

"I would expect an Australian approach to start with the EU taxonomy as a base and then use this to assess other taxonomies and consider how to incorporate Australian-specific jurisdictional-specific issues and needs."

Sean Carmody (Executive Director, Cross-Industry Insights and Data, Australian Prudential Regulation Authority)

"Interoperability is not just about interoperability between the ASEAN region and the rest of the world but also interoperability within the region. We don't have the same formal political arrangements as the European Union, and the economic and sustainability characteristics of our member states are very diverse. We therefore needed to build support, and to ensure that all countries were, and continue to be, fully engaged. To do this, we have developed a taxonomy approach that is calibrated to national circumstances and that allows, in a staged, orderly and progressive manner, countries to move towards an ASEAN-wide taxonomy."

Eugene Wong (Chief Executive Officer, Sustainable Finance Institute Asia)

"National circumstances may mean that countries cannot achieve full interoperability straight away. This should not be a barrier to getting started and to building capacity and expertise. International cooperation and measures to support and recognise domestic efforts are essential if we are to achieve the goal of global interoperability."

Fiona Stewart (Global Lead Insurance and Pensions, World Bank Group)

² UN Department of Economic and Social Affairs and International Platform on Sustainable Finance (2021), [Improving compatibility of approaches to identify, verify and align investments to sustainability goals](#).

INITIAL POLICY ANALYSIS AND SCOPING

INITIATION AND BASELINE ASSESSMENT

Policy makers need to build a clear understanding of the landscape and the needs of different stakeholders. The questions that they need to answer are set out in Box 2.

Answering these questions will require research, analysis and exploration – including policy analysis, interviews with relevant stakeholders and assessments of current reporting practice – to develop a robust understanding of the context within which a taxonomy might be adopted.

BOX 2: PRIORITY ELEMENTS OF SUSTAINABLE INVESTMENT POLICY AND REGULATION

FEATURES	DATA COLLECTION METHOD(S)	COMMENTARY
Stakeholder expectations	<ul style="list-style-type: none"> Interviews Policy analysis 	<ul style="list-style-type: none"> Identify the environmental and/or social policy objectives that a taxonomy needs to support. Identify the actors the taxonomy is trying to mobilise or influence, and the outcomes that are being sought. Identify the potential users of a taxonomy to understand their needs and expectations, and to understand their views on the environmental or social policy priorities that could be supported by a taxonomy.
Existing policies	<ul style="list-style-type: none"> Interviews Policy analysis Review of current reporting practice 	<ul style="list-style-type: none"> Assess how existing policies (e.g. wider corporate disclosure requirements) are shaping company and investor reporting. Assess whether there are frameworks (e.g. a green bond catalogue) that are already used or referenced in the domestic market.
<ul style="list-style-type: none"> Current reporting requirements Current reporting universe 	<ul style="list-style-type: none"> Desk research Review of current reporting practice 	<ul style="list-style-type: none"> Assess whether companies are already reporting against other taxonomies (e.g. large, publicly-listed companies may report against international taxonomies). Review what information is being provided by companies (and what information gaps may remain). This includes information provided in company reporting and accounts.
Expected reporting		Identify the data points and information that might be required by or useful to the users of the taxonomy.

POLICY DESIGN PHASE

The policy design phase requires policy makers to define the objectives of the taxonomy, to consider implementation options (including taxonomy objectives, activity classifications and screening criteria), and to build support for the taxonomy through engagement. This is an iterative process.

DEFINING THE OBJECTIVES OF THE TAXONOMY

Policy makers need to define the objectives of the taxonomy (a number of examples are presented in Box 3) i.e., to clarify the purpose of the tool (and in addition to any science-based taxonomy objectives determined in the development of the tool). These objectives will be shaped by the needs and interests of target stakeholders (e.g., see Box 4) and the wider social and environmental policy goals of the country in question (e.g., a green taxonomy should be explicitly linked to environmental objectives such as national climate goals, and a social taxonomy to the social goals of the country in question).

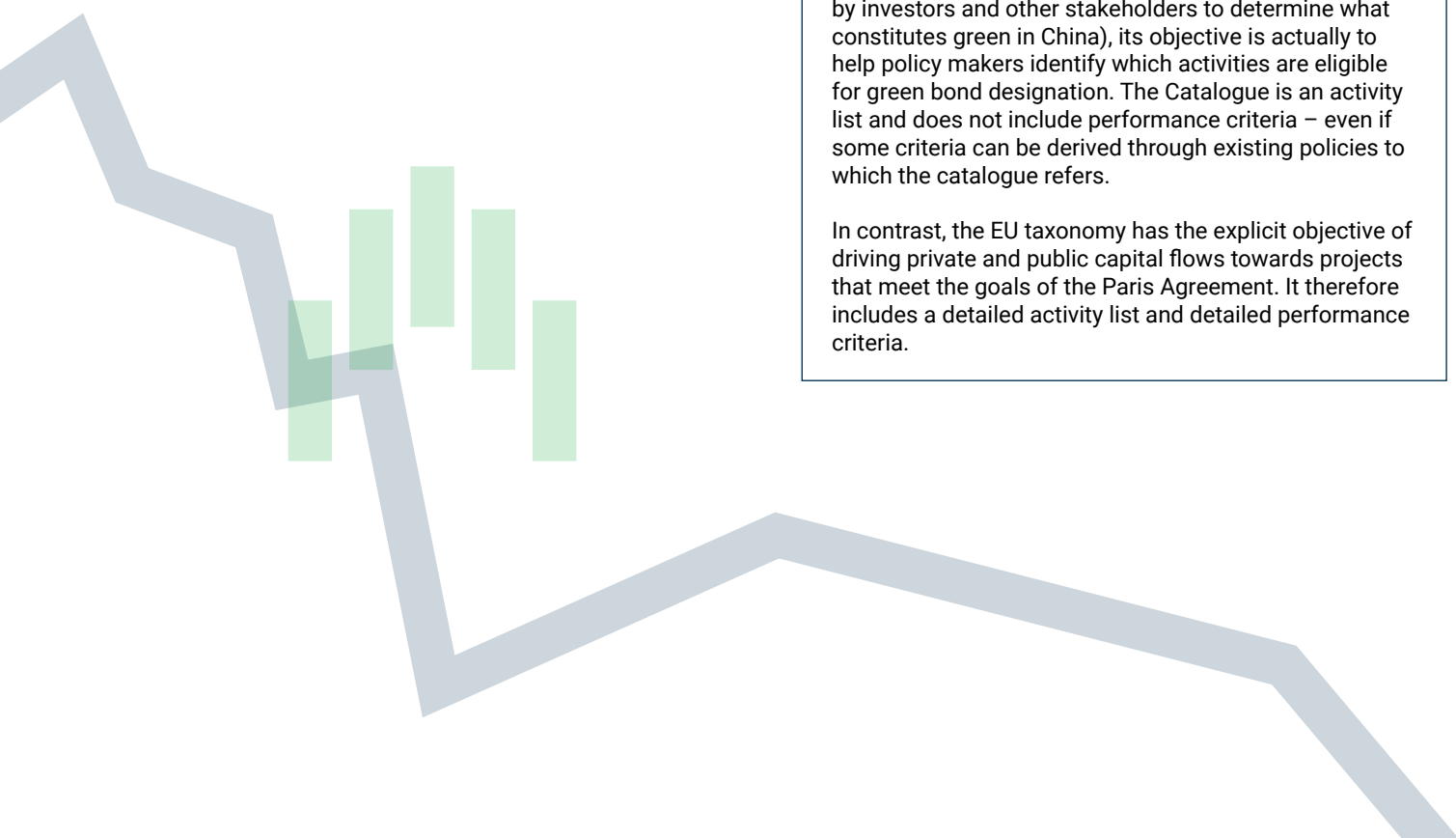
BOX 3: POTENTIAL OBJECTIVES FOR A TAXONOMY

- Provide decision-useful information to guide the transition towards national and international sustainability goals and standards, respecting environmental boundaries and societal needs.
- Connect national sustainability goals to corporate disclosures.
- Increase investment in green and sustainable assets.

BOX 4: EXAMPLES OF TAXONOMY OBJECTIVES

While China's Green Bond Endorsed Project Catalogue is often described as a taxonomy (and is widely used by investors and other stakeholders to determine what constitutes green in China), its objective is actually to help policy makers identify which activities are eligible for green bond designation. The Catalogue is an activity list and does not include performance criteria – even if some criteria can be derived through existing policies to which the catalogue refers.

In contrast, the EU taxonomy has the explicit objective of driving private and public capital flows towards projects that meet the goals of the Paris Agreement. It therefore includes a detailed activity list and detailed performance criteria.



“We engaged with the European Commission when we were developing the South African taxonomy. We needed to understand the reasons for the policy choices made in the EU taxonomy, and to get feedback on whether our approach would be considered as aligned with Europe’s.”

Sarah McPhail (Director, Financial Sector Policy, National Treasury of South Africa)

“An important question for policy makers is, where will capital go? Specifically, will capital tend to move to the highest standards? While this is a decision for individual investors, it is probably fair to say that reporting frameworks that are aligned with the EU taxonomy – currently the highest standard – will be most attractive for international investors.

“While this is logical, it may have the perverse effect of meaning that capital does not flow to those jurisdictions where it is most needed or where the most significant improvements might be achieved.”

Fiona Stewart (Global Lead Insurance and Pensions, World Bank Group)

BOX 5: CONSIDERATIONS WHEN DEFINING TAXONOMY OBJECTIVES

FEATURES	COMMENTARY
Stakeholder support for the taxonomy objectives	<p>The taxonomy’s objectives should align with relevant national and international sustainability goals and standards, ensuring that capital respects environmental boundaries and societal needs.</p> <p>The taxonomy should be clear about which stakeholder groups will use the taxonomy and how the taxonomy might be used by these stakeholders.</p>
Alignment with existing standards and regulations	<p>Existing regulations and standards may mean that current reporting and data already partially or wholly meet stakeholders’ requirements. The taxonomy should therefore avoid unnecessary duplication.</p>
Alignment with other jurisdictions	<p>Consideration should be given to the extent to which a taxonomy should be aligned with other taxonomies (e.g. regional taxonomies, green bond frameworks). The interoperability of taxonomies is a key issue for investors, and taxonomy divergence is a major concern.</p>

POLICY INSTRUMENT DEVELOPMENT

As discussed in Section 1, policy makers need decide whether a taxonomy is to be implemented in stages. This decision will be made on a country-by-country basis, informed by factors such as industry capacity and expertise, the presence or absence of other sustainability disclosure requirements, current reporting practice and the objectives for the taxonomy (e.g., the importance and urgency of attracting inward investment).

Box 7 sets out the key features of taxonomies. These features shape the functionality and usefulness of the taxonomy, although a more complex taxonomy may also be more expensive to implement. Box 8 then sets out some of the more specific design features of taxonomies.

BOX 6: LESSONS FROM THE SOUTH AFRICAN GREEN FINANCE TAXONOMY

In Appendix 1, we present some of the key lessons

learned from the development of South Africa's Green Finance Taxonomy. Among the key insights from this process are:

- Stakeholder consultation was critical, both to guide the taxonomy design and to raise awareness.
- While the EU taxonomy provided a robust starting point for the development of South Africa's taxonomy, it was essential to adapt the EU taxonomy to South Africa's local priorities.
- Capacity and resources are essential in both the taxonomy development and implementation stages.

BOX 7: KEY FEATURES OF A TAXONOMY

FEATURES	COMMENTARY
Classification system/list of economic activities	A taxonomy should be based on a market or national classification system of economic activities. For example, the EU taxonomy is based on the EU activity classification system, NACE. The use of such classification systems helps ensure that taxonomies are comprehensive in their coverage.
Technical criteria: performance metrics and thresholds for each activity	For each sector and type of activity considered by a taxonomy, specific technical criteria are necessary to define whether an activity is taxonomy-compliant or not. For example, in the EU taxonomy, power generation would be considered to substantially contribute to climate change mitigation if it emits less than 100g of CO ₂ e per kWh. Criteria should be defined for how economic activities can significantly contribute to the objectives of the sustainable finance taxonomy, as well as for ensuring that economic activities do no significant harm to any of the objectives.
Minimum safeguards	For policy consistency, a taxonomy should not promote activities that are contrary to other government policies and international agreements. In the case of the EU taxonomy, this guarantee is addressed through two specific sets of provisions: <ol style="list-style-type: none"> 1. A 'do no significant harm' clause, whereby an economic activity that contributes to one environmental objective (e.g. reduces CO₂ emissions) does not go against any other of the six environmental objectives (e.g. by threatening biodiversity). 2. Minimum safeguards including the OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, with specific reference to the International Labour Organization Core Labour Conventions.

BOX 8: TAXONOMY DESIGN CONSIDERATIONS

FEATURES	COMMENTARY
Taxonomy objectives	Objectives should be science-based, in line with environmental boundaries and societal needs, and linked to national and international policy goals and standards. Objectives are helpful when evaluating progress and can provide a framework for the future development of the taxonomy.
Eligibility of economic activities	Taxonomies have tended to use existing international industry classification systems to determine eligible economic activities. Examples of these classification systems include the Global Industrial Classification System (GICS) and the International Standard Industrial Classification System (ISIC). A benefit of using a widely used classification system is that it supports the interoperability of different taxonomies.
Alignment of economic activities	<p>Within the eligible sectors detailed by the taxonomy, the extent to which specific activities align with the objectives of the taxonomy needs to be determined. This can be done by specifying technical screening criteria, which are specific performance-based criteria to determine if an activity is aligned with the taxonomy (e.g. only energy produced below a certain carbon intensity level would be eligible). In order to be aligned with a sustainable finance taxonomy, an economic activity must significantly contribute to one its objectives, while doing no significant harm to any of the other objectives.</p> <p>An intermediate step could be to develop 'white lists', which list those activities that are aligned with the taxonomy (e.g., solar power production).</p>
Reporting universe	<p>The effectiveness and influence of a taxonomy increases as it covers more of the economy.</p> <p>Taxonomies could start by focusing on larger companies where reporting may be more advanced or with key industry sectors, and then extending to smaller companies or other industry sectors.</p>
Reporting period	Taxonomies should encourage companies to report in line with their financial reporting, i.e. taxonomy-related data should be provided for the same time periods as financial data, and should apply to the same scope of company activities.

BOX 8: TAXONOMY DESIGN CONSIDERATIONS (continued)

FEATURES	COMMENTARY
Data assurance	Independent assurance is generally recognised as a way of producing higher quality data and of reassuring stakeholders about the quality of that data. However, assurance also involves costs for companies and may delay reporting.
Costs of reporting	A more complex taxonomy increases costs of reporting, as do implementation processes such as verification.
Mandatory or voluntary disclosure requirements	<p>The usefulness of a taxonomy is improved as more companies report against the taxonomy and as investors integrate these disclosures into their investment research and decision-making.</p> <p>Ultimately, mandatory reporting is likely to be needed to ensure high levels of reporting by companies and use by investors, although voluntary measures can make an important contribution in terms of awareness-raising, capacity-building and catalysing initial capital flows.</p> <p>In practice, in many cases taxonomy-related reporting requirements will be implemented as part of corporate ESG reporting requirements (i.e. the taxonomy would provide a framework for the information to be reported under other regulations).</p>
Investor reporting on taxonomy use	<p>Investors and other financial institutions could be encouraged or required to use the taxonomy as part of their reporting to beneficiaries, clients and other stakeholders.</p> <p>Investors using the taxonomy to market or promote financial products as aligned with the taxonomy would be expected to report on a continuous basis as underlying holdings change or as information about these holdings is updated.</p>
Regulatory impact analysis	<p>A regulatory impact analysis is an approach to assessing the effects of proposed and existing regulations and non-regulatory alternatives. It can support evidence-based decision making on adoption and implementation of policy.</p> <p>Regulatory impact analysis methodologies vary between countries. The OECD 'Best practice principles for regulatory impact analysis' chapter in its <i>Regulatory Impact Assessment</i> report gives detailed guidance on regulatory impact assessment options. The OECD also publishes details of the methods used in various countries.</p>

“Inevitably, many countries will decide to start with a voluntary taxonomy in order to build capacity and familiarity with taxonomy-related reporting and with the use of these data in investment decision-making. A key element of good practice is to have clarity on the path ahead, specifically on the intention to move from voluntary to mandatory and the timeframe for this move. This provides investors and companies with the necessary time to prepare.”

Margarita Pirovska (Director of Policy, PRI)

“In Colombia, we decided to use the EU taxonomy as the starting point for our taxonomy. It gave us a starting point for the majority of sectors and allowed us to focus on ensuring that the taxonomy reflected national priorities, and that it reflected the particularities of activities related to adaptation and on land-use management.”

Mariana Escobar (Head of Sustainable Finance Hub, Superintendencia Financiera de Colombia)

“It is important to ensure that the reporting and other costs for companies are minimised. In Colombia, we already have good levels of reporting against the Global Reporting Initiative, and so we are trying to build on this reporting infrastructure to introduce new requirements to help increase the information’s comparability, availability and relevance for investors. We also recognise the many benefits to companies and to investors of introducing a taxonomy and part of our role is to demonstrate that the benefits significantly outweigh the costs.”

Mariana Escobar (Head of Sustainable Finance Hub, Superintendencia Financiera de Colombia)

STAKEHOLDER CONSULTATION

Engagement is an essential part of the policy-making process; it can shape the design and implementation of the policy instrument, build capacity and expertise, and build support for the instrument.

Policy makers should engage stakeholders when defining the overall objectives for the taxonomy, when defining its scope and when developing technical screening criteria. Different stakeholders will, inevitably, make different contributions and have different levels of technical expertise. It is, however, important that a diverse range of inputs are sought to ensure that the taxonomy is technically credible and seen as credible by key stakeholder groups.

BOX 9: THE EU TAXONOMY TECHNICAL EXPERT GROUP

The European Commission established a Technical Expert Group (TEG) to develop recommendations for technical screening criteria which responded to the framework set out in the Taxonomy Regulation (the overarching framework for the taxonomy issued by the European Commission).

The TEG consisted of 35 members from civil society, academia, business and the finance sector, as well as additional members and observers from EU and international public bodies. Prospective members were invited to apply, with applicants then reviewed and selected by the Commission. The TEG engaged with other stakeholders, including representatives of all parts of the investment chain, industry sector bodies, academia, environmental experts, civil society organisations and public bodies.

The TEG released a first draft proposal for the taxonomy in December 2018 and, in June 2019, a technical report containing proposed technical screening criteria for 67 economic activities that make a substantial contribution to climate change mitigation, as well as setting out the conceptual approach for climate change adaptation and initial guidance on how to use the taxonomy. Both reports were opened for consultation and comment from a wide range of stakeholders, with feedback for the technical report closing in September 2019.

The TEG’s final report was published in March 2020, with its recommendations taking account of the feedback received from the consultation process.

BOX 10: STAKEHOLDER ENGAGEMENT

FEATURES	COMMENTARY
Key stakeholders	Engagement should occur with all stakeholders identified at earlier stages of the process. Policy makers should track who they have engaged with and should provide feedback on how they have responded to suggestions received.
Engagement process	<p>Engagement can occur both privately and publicly. It can involve the use of methods such as interviews, roundtables and consultations. Ideally, engagement should have a public element, e.g. a formal public consultation process, where all stakeholders have an opportunity to provide feedback.</p> <p>The information presented to stakeholders should include an explanation of why action is needed, a description the objectives of the policy, and a full draft of the proposed policy measure, including information on who it is applicable to, the implementation schedule and enforcement processes.</p> <p>Stakeholders should be invited to give general feedback on the proposed policy and should also be able to provide specific feedback on all aspects of the policy instrument.</p>
Outputs from the engagement process	A review document that summarises the engagement responses and describes how these have (or have not) been incorporated into the proposed policy instrument.

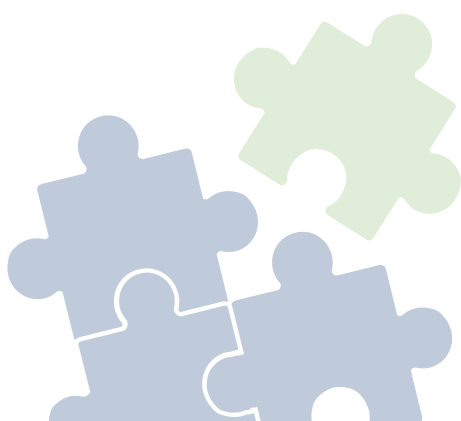
“Taxonomies take a long time to develop and to implement. When we started to develop the South African taxonomy, we thought that it would be a six- to 12-month process.

“However, the process has taken over two years and is still ongoing. We found that we could not simply adopt, or adopt with some modifications, the EU taxonomy. We needed to educate and build expertise in the South African market. We needed to understand what financial institutions were already doing, as many had already developed their own taxonomies or categorisations of green activities. We had to pilot the taxonomy to understand the practicalities of implementation to companies.”

Sarah McPhail (Director, Financial Sector Policy, National Treasury of South Africa)

“Building capacity and creating momentum have been important elements of our approach in Colombia. We have engaged with companies to explain what information the taxonomy will require and to encourage them to start gathering and reporting this information. We have also engaged with pension funds to describe the information that companies will be providing, and to explain how this information might be useful to them in assessing the risks and opportunities presented by social and environmental issues.”

Mariana Escobar (Head of Sustainable Finance Hub, Superintendencia Financiera de Colombia)



IMPLEMENTATION

Implementation is when the designed policy is accepted and put into action by the relevant regulatory agencies. As discussed above, policy makers may take a staged approach to implementation, starting with objectives, then defining economic activity lists and, over time, specifying performance criteria.

Piloting is a critical aspect of stakeholder engagement. Piloting allows stakeholders – both the providers and users

of information – to build their familiarity with the taxonomy, identify areas where the taxonomy might be improved, and build relationships between providers and users.

To be useful to investors and other stakeholders, taxonomy-specific disclosures (e.g. on economic activities or performance) need to be supplemented by other data, including economic activity classification and financial information such as turnover and profitability.

BOX 11: TAXONOMY IMPLEMENTATION CONSIDERATIONS

FEATURES	COMMENTARY
Resourcing	Once the policy is adopted, policy makers and stakeholders (including those who are required to take action, those who are interested in the outcomes of the policy, and those who might want to use the data and information generated) need to consider how they will resource implementation of the policy. For example, asset owners and asset managers will need to consider how they might encourage adoption by market participants. These asset owners and asset managers also need to consider how they will integrate the information generated into their investment processes, portfolio construction and reporting.
Sequencing of implementation	Policy makers may take a staged approach to implementation. They may, progressively, focus their efforts on: <ul style="list-style-type: none">■ Raising awareness of the taxonomy;■ Checking that companies are providing appropriate disclosures, and taking action if these disclosures are not being provided;■ Checking the extent that taxonomy-related disclosures are being used by asset owners and asset managers, and assessing how this information is influencing investments and capital flows; and■ Checking that companies are providing high quality disclosures that are accurate, consistent and comparable.
Additional tools and guidance	Policy makers can produce guidance documents and host education events on best practice to assist companies with reporting and investors with using the reported information.

MONITORING AND REVIEW

Formal and regular reviews should be built into the regulatory process. For taxonomies, the monitoring and review process can evaluate how the market is transitioning towards full alignment with the objectives of the taxonomy and can be used to identify any changes needed to ensure the economic activity classifications and performance criteria remain appropriate.

In situations where policy makers have decided to take a staged approach to implementation, monitoring and review can be used to evaluate progress and identify the point where additional requirements (e.g. technical screening criteria) might be introduced.

Depending on the findings of the review process, policy makers should commit to refining and enhancing the existing regulation, ensuring the legislation remains effective and relevant.

“One of the key challenges for policy makers is ensuring that their taxonomies remain aligned with international developments. For example, the evolving interpretation of the ‘do no significant harm’ requirements in the EU taxonomy may mean that domestic taxonomies need to change if they are to continue to be seen as interoperable with the EU taxonomy.”

Kate Levick (Associate Director, Sustainable Finance, E3G)

“While there is a clear logic underpinning the argument that taxonomies should be updated and refined to ensure their continued relevance and to ensure interoperability, it is important that the implications of such updates are properly understood. For example, how are investments that were previously considered ‘green’ or ‘sustainable’ to be treated if they are no longer assessed as being green? Is there a need for exemptions – and would this undermine the credibility of the taxonomy with international investors? – or for compensation?”

Sarah McPhail (Director, Financial Sector Policy, National Treasury of South Africa)

BOX 12: TAXONOMY REVIEW

QUESTIONS	COMMENTARY
Objectives of the review	<p>The objectives of a review are to establish:</p> <ul style="list-style-type: none"> ■ Whether the taxonomy has met (or achieved) its objectives ■ Whether the taxonomy has been effective (e.g. has it influenced investment and capital flows?) ■ Whether there have been changes in context (e.g. the emergence of new environmental issues or the development of new technologies) which may entail changes in the taxonomy's objectives or design ■ Whether and how the taxonomy is being used by investors and other stakeholders
Timing	<p>It is not uncommon for policy instruments such as taxonomies to be reviewed two or three years after they have been adopted and at two- or three-yearly intervals thereafter.</p>
Compliance with taxonomy requirements	<p>Monitoring processes should consider questions such as:</p> <ul style="list-style-type: none"> ■ Are companies aware of the taxonomy and the reporting requirements? ■ Are companies reporting in line with the requirements of the taxonomy? ■ To what extent are capital flows to taxonomy-aligned activities occurring?
Review outputs	<p>The results of reviews should address questions such as:</p> <ul style="list-style-type: none"> ■ Have companies provided the quality of disclosures that are required for the taxonomy? ■ Are investors using the taxonomy to align their investments with the taxonomy objectives? ■ What actions have been taken to address non-reporting and inadequate reporting? ■ What are the barriers to better reporting and alignment? ■ Are the objectives of the taxonomy being delivered? ■ How could the taxonomy be made more effective? ■ Does the taxonomy need to evolve (e.g., in terms of its technical screening criteria or its assurance requirements)?

APPENDIX 1: CASE STUDIES

This section provides five examples of different regional or jurisdictional approaches to taxonomy development, highlighting some of the key features and lessons learned from each.

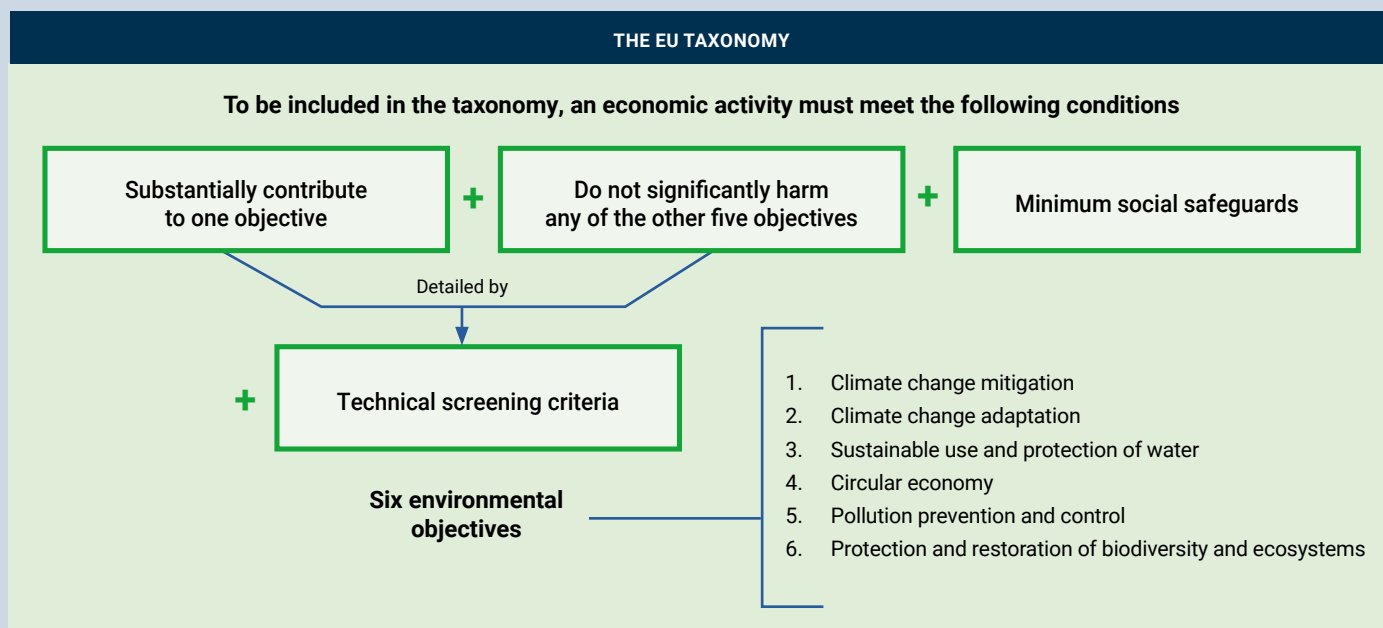
CASE STUDY 1:

EU TAXONOMY

The EU taxonomy is the most detailed, investor-focused taxonomy developed thus far.³ Having been recommended as a key action by the European Commission's High-Level Expert Group on Sustainable Finance, it was developed with the specific purpose of mobilising private capital flows into sustainable projects and activities. The European Commission wanted a tool that would help meet the goals of the Paris

Agreement whilst also assisting with, and existing within, its other sustainability aims. The EU taxonomy is, therefore, a multi-objective taxonomy that denotes eligible economic activities which are detailed by technical screening criteria and which also meet thresholds of 'do not significant harm' to other EU policy objectives and minimum social safeguards.

Figure 2: The EU taxonomy⁴



As an investor-focused tool aiming to be a definitive resource for guiding which activities are aligned with making a substantial contribution to the EU's overarching sustainability policy goals, the taxonomy needed clear and comprehensive technical screening criteria and, importantly, consensus around these criteria. The criteria were developed by the Commission-established EU Technical Expert Group, which

comprised members from various stakeholder groups, including academics, finance sector professionals and civil society.

Legislation is now being implemented using the EU taxonomy activity lists and technical screening criteria for the EU's climate change mitigation and adaptation-related objectives.

³ For further information, see the European Commission's [EU taxonomy webpage](#).

⁴ International Platform on Sustainable Finance (Taxonomy Working Group) (2021). [Common Ground Taxonomy – Climate Change Mitigation Instruction Report](#), p. 12.

CASE STUDY 2:

THE CHINA GREEN BOND PROJECT CATALOGUE

In recent years, China has issued multiple pieces of legislation governing green finance, and specifically regarding bonds. However, this legislation has been fragmented across various government departments, resulting in varied definitions of what constitutes 'green' in China.⁵

What is commonly described as the China Taxonomy was originally the People's Bank of China (PBOC) 2015 Green Bond Endorsed Project Catalogue, a document which was subsequently updated and jointly released by the PBOC, the National Development and Reform Commission (NDRC) and the China Securities Regulatory Commission (CSRC) in 2021.

Whereas the EU taxonomy was designed to achieve certain clearly defined science-based objectives, the purpose of the China taxonomy is to define those activities or projects eligible for green bond designation, but not to set specific performance goals to be achieved. It responded to a need to improve the credibility of the green bond market (in terms of projects clearly showing environmental impact) and was the culmination of efforts by Chinese regulators to harmonise definitions of green bonds that were previously governed by differing legislation.

The 2021 Catalogue classifies activities into six areas (each of which is subdivided into more specific areas, with descriptors of what an eligible activity can constitute) as follows:

1. The Energy Saving and Environmental Protection Industry
2. The Clean Production Industry
3. The Clean Energy Industry
4. The Ecology and Environment-related sector
5. The Sustainable Upgrade of Infrastructure
6. Green Services

The 'Description/Condition' section of the classification does specify some thresholds, such as meeting energy efficiency standards defined in existing policy. These are, in effect, technical screening criteria to ensure that activities align with legislation, effectively creating a white-list of activities with clear definitions which both define domestic approaches to green bond classification and signal to international stakeholders what constitutes green in China.

Another purpose of the 2021 Catalogue was to increase the alignment of China's green bond market with international markets. In that context, one of the notable changes relative to the 2015 Catalogue was the removal of clean coal and other fossil fuel-related projects.

The 2021 Catalogue has not been developed in isolation. It has also led to other international initiatives to improve comparability; a notable development is the work of the International Platform on Sustainable Finance (IPSF),⁶ supported by China and the EU, to identify commonalities and differences in their respective approaches and outcomes. This work has become known as the IPSF Common Ground Taxonomy.⁷ It focusses on the climate change mitigation objective of the EU taxonomy, and highlights the instances where activities overlap between the EU and China taxonomies, including detailing where China or the EU has more stringent criteria.

5 PBOC, NDRC and CSRC (2021). [Green Bond Endorsed Projects Catalogue \(2021 Edition\)](#).

6 See the European Commission webpage, [International Platform on Sustainable Finance](#).

7 See the International Platform on Sustainable Finance (Taxonomy Working Group) (2021). [Common Ground Taxonomy – Climate Change Mitigation Instruction Report](#) and the International Platform on Sustainable Finance (Taxonomy Working Group) (2021). [Common Ground Taxonomy Table](#).

CASE STUDY 3:

THE MALAYSIA TAXONOMY

The Malaysia Taxonomy, issued by Bank Negara Malaysia, the country's central bank, defines itself as a principles-based taxonomy focused on climate change. Its purpose is to assist in the assessment and categorisation of "economic activities according to the extent to which the activities meet climate objectives and promote the transition to a low-carbon economy".⁸ The taxonomy was specifically developed to be applicable to financial institutions supervised by Bank Negara Malaysia but was also designed to be useful to other financial sector stakeholders and to the public sector.

Bank Negara Malaysia has explained its approach as follows:

"The principle-based approach considers the state of economic development of the country and the nascent stage of climate risk management at which businesses and other economic agents are currently in. By taking a more nurturing approach, this could avoid disruptive exclusions and dislocations, thus ensuring an orderly transition of the economy.

"The principle-based approach also supports applications in a wider context and alignment with other classification systems, particularly for [financial institutions] that operate across geographies. This takes into account different surrounding conditions across economies, progress in bridging data gaps, the quality of reporting or verification systems, and the ongoing update on national commitments, sectoral targets, thresholds and metrics."

The five guiding principles (see Box 13) that underpin the taxonomy are used to illustrate the direction of travel. The taxonomy provides example activities but is not prescriptive on direct definitions of activities, and so allows actors to take an approach that is appropriate to their current state. It also acknowledges that some companies may be aligning their reporting with other international taxonomies and allows companies to take that approach.

BOX 13: MALAYSIA CLIMATE CHANGE AND PRINCIPLE-BASED TAXONOMY GUIDING PRINCIPLES

1. Climate change mitigation
2. Climate change adaptation
3. No significant harm to the environment
4. Remedial measures to transition
5. Prohibited activities

⁸ Bank Negara Malaysia (2021), [Climate Change and Principle-based Taxonomy](#), p. 5.

CASE STUDY 4:

THE SOUTH AFRICAN GREEN FINANCE TAXONOMY

South Africa's National Treasury launched a multi-stakeholder process in June 2020 to develop a national Green Finance Taxonomy.^{9,10} A draft taxonomy was published for public comment on 7 June 2021.¹¹

The key lessons learned from this process are summarised in Box 14 below. An intergovernmental governance structure is planned to guide the future evolution of and updates to the taxonomy.

BOX 14: KEY LESSONS FROM SOUTH AFRICA'S GREEN FINANCE TAXONOMY

LESSON	ADDITIONAL NOTES AND COMMENTARY
Stakeholder consultation has been essential to guide key decisions in the taxonomy process and to raise awareness among potential users.	A Technical Working Group was established to provide strategic guidance to the project, and broader stakeholder consultations were undertaken virtually in October 2020. The result was strong local awareness of the initiative, shared ownership by key constituencies, and an opportunity for financial institutions and investors – including pension funds – to provide input and prepare for implementation.
Capacity and resources are critical to enable taxonomy development and implementation.	<p>The initial phase of work was carried out with support from the International Finance Corporation, part of the World Bank Group.</p> <p>The National Business Initiative and the Carbon Trust were selected to undertake research, stakeholder engagement and taxonomy development.</p> <p>Future taxonomy expansion is planned in relation to the Just Transition and social topics.</p>

⁹ We would like to thank Sarah McPhail (Director, Financial Sector Policy, National Treasury of South Africa) for this case study.

¹⁰ For more information, see the South Africa Sustainable Finance Initiative's Taxonomy Working Group [webpage](#).

¹¹ Republic of South Africa National Treasury (2021), [Working Draft: Draft Green Finance Taxonomy](#). June 2021.

BOX 14: KEY LESSONS FROM SOUTH AFRICA'S GREEN FINANCE TAXONOMY (continued)

LESSON	ADDITIONAL NOTES AND COMMENTARY
<p>The EU taxonomy provided a robust starting point but needed to be adapted to reflect South Africa's priorities</p>	<p>Stakeholders agreed the best approach would be to adapt a recognised international framework. The EU taxonomy was selected due to its global relevance, its comprehensive technical foundations, and its influence on the expectations of international investors.</p> <p>Key elements of the EU taxonomy, such as the use of environmental objectives, the do no significant harm principle, and the adherence to social safeguards, were adopted due to their alignment with local trends and to embed ESG risk management in South Africa's finance sector. For example, South Africa's pension funds are required by regulation to consider all material factors, including ESG factors, in their investment decision making. The taxonomy supports both their risk management and positive impact objectives.</p> <p>All stakeholders emphasised the importance of adapting the EU framework to local standards, priorities and realities. For instance, South Africa seeks to achieve a Just Transition to a low-carbon economy and requires investment solutions to achieve this – such as for phasing out coal and greening the mining sector while creating jobs in new green sectors.</p> <p>The proposed Green Finance Taxonomy included amended criteria for certain sectors in alignment with local environmental standards while maintaining harmonisation with international best practice.</p> <p>Social aspects are particularly important for South Africa as a developing country. Social safeguards were therefore included in line with the EU approach.</p>

CASE STUDY 5:

THE ASEAN TAXONOMY FOR SUSTAINABLE FINANCE

In March 2021, the ASEAN Finance Ministers and Central Bank Governors' Meeting endorsed the establishment of the ASEAN Taxonomy Board (ATB) to develop, maintain and promote the ASEAN Taxonomy for Sustainable Finance.¹² The ATB was jointly established by the four bodies under the ASEAN Finance Cooperation Process, namely the ASEAN Capital Markets Forum, the ASEAN Insurance Regulators' Meeting, the ASEAN Senior Level Committee on Financial Integration, and the ASEAN Working Committee on Capital Market Development. It is hosted by the Sustainable Finance Institute Asia. In November 2021, the ATB released the ASEAN Taxonomy for Sustainable Finance. Version 1.¹³

The taxonomy has been developed to provide a common building block that enables an orderly transition and fosters sustainable finance adoption by ASEAN member states. This commonality is important given that there are a variety of systems and policies on sustainable finance across the 10 member states and given that the members of ASEAN have quite different economies, financial systems and transition paths. The taxonomy is seen as a tool for transition for high emission sectors and as a tool for providing access to funding for sustainable projects, assets and activities.

ASEAN has made clear that Version 1 is the foundation for the ongoing development of the ASEAN Taxonomy. The framework will evolve as the multitude of stakeholders in ASEAN provide their feedback and detailed technical screening criteria are developed.

“The unique feature of the ASEAN Taxonomy is its emphasis on allowing all 10 of the ASEAN member states to be involved, even if they are starting from a very low base, by having a principles-based Foundation Framework, and a Plus Standard with metrics and thresholds that itself is tiered to have more than one threshold for each economic activity to allow for the different starting points of each ASEAN member state. This enables every country to join and, over time and at a rate consistent with their national priorities and economic development, to successfully transition to a low-carbon, sustainable economy.”

Eugene Wong (Chief Executive Officer, Sustainable Finance Institute Asia)

The environmental objectives of the taxonomy include supporting action on climate change (emissions reductions) and adaptation, the protection of healthy ecosystems and biodiversity, the promotion of resource resilience and the transition to a circular economy.

¹² We would like to thank Eugene Wong (CEO, Sustainable Finance Institute Asia) for his support with this case-study.

¹³ ASEAN Taxonomy Board (2021), [ASEAN Taxonomy for Sustainable Finance. Version 1](#).

ASEAN TAXONOMY 5 HIGH LEVEL PRINCIPLES

Principle 1	Principle 2	Principle 3	Principle 4	Principle 5
The ASEAN Taxonomy will be the overarching guide for all ASEAN member states, providing a common language and complementing their respective national sustainability initiatives	The ASEAN Taxonomy will take into consideration widely used taxonomies and other relevant taxonomies, as appropriate, and shall be contextualised to facilitate an orderly transition towards a sustainable ASEAN.	The ASEAN Taxonomy shall be inclusive and beneficial to all ASEAN member states.	The ASEAN Taxonomy shall provide a credible framework, including definitions, and where appropriate, be science-based.	The ASEAN Taxonomy will be aligned with the sustainability initiatives taken by the capital market, banking and insurance sectors, or at least not conflict with them.

The taxonomy comprises two main elements: (a) the Foundation Framework, which is applicable to all ASEAN member states and allows a qualitative assessment of activities, and (b) the Plus Standard, with metrics and thresholds to further qualify and benchmark eligible green activities and investments.

Under the Foundation Framework, economic activities must fulfil at least one of four environmental objectives to potentially qualify as “sustainable”:

1. Climate change mitigation (e.g., avoiding or reducing greenhouse gas emissions)
2. Climate change adaptation (e.g., building resilience to the physical impacts of climate change)
3. Protection of healthy ecosystems and biological diversity (e.g., preventing pollution or deforestation)
4. Promotion of resource resilience and the transition to a circular economy (e.g., managing waste)

In addition, all activities must meet two “essential criteria”: activities must not significantly harm any environmental objective; and efforts must be taken to identify and mitigate the activity’s potential adverse environmental impacts (e.g., formal environmental impact assessments may be required for larger projects). All activities must also avoid contravening local regulations.

ENVIRONMENTAL OBJECTIVES

1 Climate change mitigation	2 Climate change adaptation
3 Protection of healthy ecosystems and biological diversity	4 Promotion of resource resilience and the transition to a circular economy

ESSENTIAL CRITERIA

1 Do No Significant Harm (DNSH)	2 Remedial measures to transition
------------------------------------	--------------------------------------

The Plus Standard will provide additional, detailed technical screening criteria for specific economic activities, focusing initially on the following six priority sectors:

- Agriculture, forestry and fishing
- Manufacturing
- Electricity, gas, steam and air conditioning supply
- Transportation and storage
- Construction and real estate activities
- Water supply, sewerage, waste management and remediation activities

One of the key features of the ASEAN taxonomy is that it proposes what it calls a “stacked approach” to developing activity-level thresholds, which allows standards and expectations to tighten over time. This approach recognises that, for each activity, there are multiple decarbonisation pathways and hence multiple thresholds that can be referenced at a single point in time. This approach allows the taxonomy to acknowledge that entities undertaking a particular activity in different ASEAN member states will be at different starting points. The idea is that, for certain entities or jurisdictions, higher emissions can be permitted for a limited period, while incentivising progress to lower emissions by having a mechanism whereby those less ambitious tiers have a clearly stipulated expiry year, after which they are no longer applicable. Over time, the intention is that less stringent tiers will be removed and that all entities will move to the most stringent tier that is aligned with global net-zero emissions by 2050, and/or the Paris Agreement.

APPENDIX 2: REFERENCES AND ADDITIONAL RESOURCES

- ASEAN Taxonomy Board (2021), [ASEAN Taxonomy for Sustainable Finance](#). Version 1.
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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org



The World Bank

The World Bank Group is an international organization designed to finance projects that enhance the economic development of member states. With 189 member countries, staff from more than 170 countries, and offices in over 130 locations, the World Bank Group is a unique global partnership: five institutions working for sustainable solutions that reduce poverty and build shared prosperity in developing countries. The organization provides a wide array of financial products and technical assistance, helping countries share and apply innovative knowledge and solutions to the challenges they face.

More information: www.worldbank.org



Chronos Sustainability

Chronos Sustainability was established in 2017 with the objective of delivering transformative, systemic change in the social and environmental performance of key industry sectors through expert analysis of complex systems and effective multi-stakeholder partnerships. Chronos works extensively with global investors and global investor networks to build their understanding of the investment implications of sustainability-related issues, developing tools and strategies to enable them to build sustainability into their investment research and engagement.

For more information, see: www.chronossustainability.com

