

PRI RESPONSE

EU CONSULTATION ON DRAFT DELEGATED REGULATIONS SETTING CRITERIA ON ENVIRONMENTALLY SUSTAINABLE ACTIVITIES UNDER THE EU TAXONOMY

3 May 2023

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To inform this briefing, the following investor group has been consulted: PRI Global Policy Reference Group. This consultation is not an endorsement or acknowledgement of the views expressed in this briefing

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United Nations
Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (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 range 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.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the European Commission's call for feedback on the delegated regulations that establish criteria for sustainable economic activities under the EU taxonomy.

ABOUT THIS CONSULTATION

On 5 April 2023 the European Commission [presented](#) two delegated regulations and accompanying annexes under the EU taxonomy regulation.

- The [first delegated regulation](#) includes a first set of criteria to define sustainable economic activities for *water*, *pollution*, *circular economy* and *biodiversity*. It focuses in particular on the sectors of manufacturing, water supply, sewerage, waste management and remediation, construction, civil engineering, disaster risk management, information and communication, environmental protection and restoration and accommodation activities. Other sectors such as agriculture, forestry or fishing were not included in this delegated act and still subject to 'further assessment and calibration'. It also contains annexes making amendments to the specific Disclosure Delegated Act.
- The [second delegated regulation](#) identifies additional activities for *climate mitigation* (manufacturing activities in relation to key components for low carbon transport and electrical equipment, and some transitional activities in the transport sector) and *adaptation* (emergency services, flood risk prevention and protection infrastructure, civil engineering, or desalination). Once adopted, these criteria will be included into the existing climate delegated act.

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KEY RECOMMENDATIONS

The PRI welcomes the publication of the delegated regulations (DR). This represents a crucial step forward in the implementation of the EU Taxonomy: an enriched disclosure framework will allow companies and investors to cover a more significant part of their economic activities that contribute to all the six environmental objectives covered by the EU taxonomy, and support the implementation of the EU Green Deal.

PRI has included more detailed comments in an annex to this consultation response.

ENVIRONMENTAL DELEGATED REGULATION

The proposed technical screening criteria (TSC) will improve understanding and specificity as to what is meant by 'environmentally sustainable' for water, circular economy, pollution, and biodiversity objectives.

The PRI considers it crucial that the TSC remain based on the best available scientific evidence, as required by the Taxonomy Regulation. We welcome that the DR does not deviate strongly from the TSC initially proposed by the Platform on Sustainable Finance (PSF). However, the PRI would call for biodiversity offsets to be explicitly excluded from eligible conservation activities, as was recommended by the PSF.

The PRI welcomes the pragmatism by the European Commission to prioritise sectors which will help minimise delays to the EU taxonomy framework, and acknowledges the time constraints for developing DNSH criteria for climate adaptation. However, this implies that important gaps remain compared to the proposed TSC by the PSF – most notably for biodiversity (i.e. animal production, crop production, fishing, forestry, environmental refurbishment of facilities, manufacture of food and beverages). Further work should be undertaken as soon as possible given the importance of these sectors for achieving global agreements (e.g. the Global Biodiversity Framework, the Paris Agreement, and the Sustainable Development Goals).

CLIMATE DELEGATED REGULATION

PRI welcomes the adoption of TSC for additional climate mitigation activities in sectors that are essential for the energy transition. It is crucial that the TSC remain science-based, enable and accelerate net-zero economic activities, and in the case of transitional activities do not lead to the lock-in of carbon-intensive assets – most notably for transport activities. Any review, change or addition in the DR compared to the TSC proposed by the PSF should therefore be anchored in scientific and transparent evidence.

PRI also welcomes the adoption of TSC for additional activities that provide a substantial contribution to climate change adaptation, specifically in key sectors such as water supply, civil engineering, disaster risk management, and information and communication. However, we note that in Annex II, for all new proposed activities under DNSH, considering the carbon intensity of energy sources used to

power each activity will have an impact on the 'climate change mitigation' objective. Therefore, it will prove beneficial to indicate, for example, to what extent fossil fuels or alternatively renewable sources of energy are used to power these activities.

AMENDMENTS TO THE DISCLOSURES DELEGATED ACT

PRI supports amendments to the disclosures delegated act that allow company reporting against all six environmental objectives. Company disclosures must be transparent and easy to understand so that investors can effectively calculate their own alignment, meet their own reporting requirements, and make informed decisions about their investee. The disclosure template should require non-financial companies to state which activities are eligible to which environmental objectives and the percentage alignment. It should also prevent repeated reporting (to avoid double counting) and use a standardised terminology.

PRI welcomes the clarification by the European Commission of reporting timelines, but encourages further clarification regarding the expectations from regulators if the timeline for eligibility reporting for financial institutions is maintained.

TECHNICAL AND SPECIFIC SECTOR CONSIDERATIONS

ENVIRONMENTAL DELEGATED REGULATION

Biodiversity, water and marine resources, pollution:

PRI would ask for the explicit exclusion of conservation activities needed to meet legal requirements for compensation or offsetting (e.g., in accordance with mitigation requirements under the Directive 2011/92/EU) for the *Conservation, including restoration, of habitats, ecosystems and species*, in line with the PSF recommendations. Examples of other, eligible, purposes for the conservation activity should instead be provided.

PRI would also call for the explicit reference to indigenous people as potential stakeholders for consultation under the management plan or equivalent instrument for the *Conservation, including restoration, of habitats, ecosystems and species*, in line with the PSF recommendations. It would highlight the important role of indigenous communities in the conservation of biodiversity, as was done in the Kunming-Montreal Global Biodiversity Framework.

PRI welcomes the alignment of *Nature-based solutions for flood and drought risk prevention and protection*, in the context of economic activities qualifying as contributing substantially to the sustainable use and protection of water and marine resources (Annex I), with the principles outlined by the IUCN Global Standard for nature-based solutions. This will further support efforts to standardise the definition of nature-based solutions as well as ensure they provide the appropriate environmental and social co-benefits, in line with the intent of the Taxonomy Environmental Delegated Act.

Across all Annexes, the PRI would call for the definition of “biodiversity-sensitive areas” to remain aligned over time with the definition of “areas of high biodiversity importance” from the Kunming-Montreal Global Biodiversity Framework. Although the precise meaning of “areas of high biodiversity importance” is not yet formally defined by the Convention on Biological Diversity and its Parties, it is used as an umbrella term encompassing an array of area designations such as Alliance for Zero Extinction Sites, Key Biodiversity Areas, Important Bird and Biodiversity Areas, Important Plant Areas, Ecologically and Biologically Significant Marine Areas, and biodiversity hotspots. The current examples of biodiversity-sensitive areas provided in the Annexes (Natura 2000 network of protected areas, UNESCO World Heritage Sites and Key Biodiversity Areas, as well as other protected areas) would indicate good overlap across the two definitions. However, as “areas of high biodiversity importance” gets further defined, the Taxonomy Environmental Delegated Act should maintain alignment to ensure its coherence with and positive contribution to global efforts to meet the Kunming-Montreal Global Biodiversity Framework targets.

PRI welcomes the alignment of appropriate assessments in third countries (as detailed in Appendix D and in Annex IV) with the IFC Performance Standard 6: Biodiversity Conservation and Sustainable Management of Living Natural Resources; as the latter represents a globally adopted best standard

that will support comparability of information for organisations, including investors, across jurisdictions.

Circular economy:

PRI welcomes the focus on 25 activities captured under the macro-sectors of manufacturing; construction and civil engineering; remediation and water and ICT and Services. Overall, the TSC are an important contribution to providing increased transparency, mitigating the risk of ‘greenwashing’ and avoiding market fragmentation caused by a lack of understanding on what constitutes sustainable activities for a circular economy. This is particularly important for the circular economy, as previous PRI research has shown that a lack of common understanding of what constitutes the circular economy is important to support increased investor action on this topic ([PRI discussion paper](#)).

PRI particularly welcomes criteria defined for the manufacture of plastic packaging goods and electrical/electronic equipment (including batteries), buildings, and aspects of waste management, which investors consider relevant for circular economy implementation ([PRI discussion paper](#)). It also welcomes focusing on a range of business models within service activities (such as repair, refurbishment, remanufacturing, product as service and marketplaces), which are widely applicable across a range of product manufacturing sectors.

It is regrettable that some activities have been delayed to a second set of activities (including furniture, wearing apparel, footwear and leather goods, and manufacture of food and beverage products). This applies to food and beverage products in particular, which show significant potential for improving environmental sustainability by applying circular economy activities (reducing climate emissions and nature loss).

PRI is broadly supportive of the criteria for plastic packaging, focusing on the importance of re-use models, recycled content, and ensuring products are recyclable in practice and at scale. PRI also welcomes the recognition that mechanical recycling should be prioritised over chemical recycling where possible, with chemical recycling only permissible if mechanical recycling is not feasible and emissions are less than those associated with virgin plastic production ([aligned with PRI plastics engagement guides](#)).

DNSH criteria for climate adaptation:

PRI welcomes the recognition in the DR of the wide applicability of climate adaptation. We support the need to consider climate adaptation across all sectors, to ensure that economic activities that contribute substantially to one of the environmental objectives do not cause significant harm to adaptation.

PRI acknowledges that due to time constraints, the development of TSC for activities included in the DR to align them with climate adaptation will follow at a later stage. PRI is looking forward to providing feedback when these criteria are published.

CLIMATE DELEGATED REGULATION

Climate mitigation

PRI cautions against including the manufacturing and leasing of aircrafts that rely on the future use of sustainable aviation fuels (SAF) from bio-based feedstock as a ‘transitional activity’ in the EU

taxonomy. The International Aviation Council Association (IACU) has set sustainability criteria for SAF in their CORSIA (Carbon Offsetting and Reduction Scheme for International Aviation) Sustainability Criteria for CORSIA Eligible Fuels. These include criteria related to carbon stocks, water quality and availability, soil health, air quality, biodiversity, conservation value and ecosystems, human and labour rights, land use rights, and food security, among others.

SAF currently account for less than 0.1% of aviation fuel. However, given the necessary acceleration and upscaling of production following a vast increase in demand, there is insufficient evidence and guarantee that existing sustainability criteria can be applied in practice to mitigate resulting social and environmental risks. The EU taxonomy should therefore avoid the risk of lock-in to high-carbon assets for all modes of transport and manufacturing and focus instead on incentivising the financing of genuine zero-carbon alternatives, in particular the development and manufacture of carbon-free commercial-scale aircraft.

Climate adaptation

With regards to DNSH:

- Indirect physical risks need to be considered, as well as the impact of certain business activities on vulnerability of societies and the environment, to prevent maladaptation. For example, some interventions (such as flood defences) may lead to changes in hazard dynamics that could generate increased exposure for other entities. Unless this has been sufficiently modelled using the appropriate expanded analysis, it will be an unknown.
- Consideration is needed for risk transfer within and between supply-chains: while PRI appreciates that supply-chain transparency has many data and governance challenges, cascading physical climate risks along supply chain are undermeasured and therefore neglected (while potentially representing the bulk of physical climate risk).

PRI also recommends targeted amendments to the substantial contribution criteria for climate adaptation in an appendix to this document, even if acknowledging that these have already been adopted in the initial climate delegated act.

AMENDMENTS TO THE DISCLOSURES DELEGATED ACT

As regards reporting timelines, the proposed amendments in article five of the Taxonomy Environmental Delegated Act imply that financial institution would need to report on their exposure to eligibility for the four remaining environmental objectives and new mitigation and adaptation activities in their Taxonomy reporting from January 2024, at the same time than non-financial companies: this will pose challenges for investors, because they will not yet have access to non-financial reporting. The PRI therefore encourages the EC to clarify reporting expectations if that timeline is maintained, as well as regulators' oversight on such disclosure requirements that will be difficult to comply with for financial institutions.

APPENDIX: SUBSTANTIAL CONTRIBUTION CRITERIA FOR CLIMATE ADAPTATION

With regards to Annex II, PRI suggests the amendments to the substantial contribution criteria, related to climate risk and vulnerability assessments. In summary, these should:

- Include data at the appropriate spatial resolutions
- Consider more than one IPCC physical risk scenario in the analysis
- Include social and environmental sensitivity data for vulnerability analysis

The corresponding changes to the text of Annex II are outlined below.

1. The economic activity has implemented physical and non-physical solutions ('adaptation solutions') that substantially reduce the most important physical climate risks that are material to that activity.
2. The physical climate risks that are material to the activity have been identified from those listed in Appendix A to this Annex by performing a robust climate risk and vulnerability assessment with the following steps:
 - (a) screening of the activity to identify which physical climate risks from the list in Appendix A to this Annex may affect the performance of the economic activity during its expected lifetime;
 - (b) where the activity is assessed to be at risk from one or more of the physical climate risks listed in Appendix A to this Annex, a climate risk and vulnerability assessment to assess the materiality of the physical climate risks on the economic activity;
 - (c) an assessment of adaptation solutions that can reduce the identified physical climate **risk vulnerability**.

The climate risk and vulnerability assessment is proportionate to the scale of the activity and its expected lifespan, such that:

- (a) for activities with an expected lifespan of less than 10 years, the assessment is performed, at least by using climate projections at the smallest appropriate scale **and spatial resolution, and with the most updated datasets across hazard and vulnerability variables**.
- (b) for all other activities, the assessment is performed using the highest available resolution, state-of-the-art climate projections across the existing range of future scenarios consistent with the expected lifetime of the activity, including, at least, 10 to 30 year climate projections scenarios for major investments **across more than one physical climate scenario** .
- **(c) Where possible, assessment should identify and account for supply-chain dependencies, where potential impact from climate change on one asset may further**

impact other assets and social and environmental systems. This information may be materially relevant to complying with 4 (a), (c), and (e) below.

- **(d) For both (a) and (b), the corresponding vulnerability data and metrics generated should be socially and environmentally inclusive, feeding into 5 (a) and (b) below**

3. The climate projections and assessment of impacts are based on best practice and available guidance and take into account the state-of-the-art science **(models and data)** for vulnerability and risk analysis **guided by the and** related methodologies in line with the most recent Intergovernmental Panel on Climate Change reports, scientific peer-reviewed publications and open source or paying models.

4. The adaptation solutions implemented:

- (a) do not adversely affect the adaptation efforts or the level of resilience to physical climate risks of other people, of nature, of cultural heritage, of assets and of other economic activities;
- (b) favour nature-based solutions or rely on blue or green infrastructure to the extent possible;
- (c) are consistent with local, sectoral, regional or national adaptation plans and strategies;
- (d) are monitored and measured against pre-defined indicators and remedial action is considered where those indicators are not met;
- (e) where the solution implemented is physical and consists in an activity for which technical screening criteria have been specified in this Annex, the solution complies with the do no significant harm technical screening criteria for that activity.

5. In order for an activity to be considered as an enabling activity as referred to in Article 11(1), point (b), of Regulation (EU) 2020/852, the economic operator demonstrates, through an assessment of current and future climate risks, including uncertainty and based on robust data, that the activity provides a technology, product, service, information, or practice, or promotes their uses with one of the following primary objectives:

- (a) increasing the level of resilience to physical climate risks of other people, of nature, of cultural heritage, of assets and of other economic activities;
- (b) contributing to adaptation efforts of other people, of nature, of cultural heritage, of assets and of other economic activities

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of European Commission further to implement the EU taxonomy.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org