

CONSULTATION RESPONSE

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

18 December 2020

OVERALL STATEMENT

The PRI welcomes the publication of the Taxonomy Delegated Regulation (DR). This represents a crucial step forward in the implementation of the EU Taxonomy.

1. The Taxonomy must remain based on best available scientific evidence.

It is central that throughout final consultations and negotiations, the purpose of the Taxonomy is not undermined; that is to help investors to identify, report on and ultimately finance activities with sustainable levels of environmental performance. As legally binding instruments, it is necessary that the Taxonomy DR receive appropriate scrutiny before its final adoption. In this context, the PRI considers it crucial that the **technical screening criteria remain based on the best available scientific evidence**, as required by the Taxonomy Regulation.

PRI recommends that the European Commission and co-legislators remain faithful to the purpose of the Taxonomy as a tool to finance the sustainability transition. Any fundamental changes to the Technical Expert Group (TEG) recommendations and any further adjustments that could arise in the final stages of the adoption process **should be justified based on scientific and transparent evidence**. The Taxonomy will strongly shape financial markets and influence the way investors direct capital towards sustainable activities in the years ahead. Misleading markets through weakening criteria would undermine the credibility and usefulness of the Taxonomy and risk creating stranded assets and accelerating climate risks, to the ultimate detriment of European savers and citizens.

2. Changes made to the Taxonomy should mainly improve upon TEG recommendations.

The PRI recommends the Commission to ensure that the final technical screening criteria follow the TEG recommendations or improve upon them. While investors recognise practical challenges in implementing the Taxonomy, the TEG recommendations for technical **screening criteria have been widely recognised as credible and based on a transparent, evidenced and apolitical process**. We strongly support the Commission upholding the decision regarding the <100gCO₂e/kWh threshold for power generation, their creation of a new activity section for restoration of wetlands as well as research, development and innovation related to the reduction, avoidance or removal of GHG emissions and their proposals for manufacture of hydrogen which strengthen TEG requirements.

However, the PRI is concerned **some changes made to the Taxonomy DR could negatively impact its ambition** to channel investment to the transition to a low carbon, resilient and resource-efficient economy. Within the draft DR, criteria for activities such as the production of electricity from bioenergy and specific feedstock have been weakened. Furthermore, despite the Commission sticking with the TEG's <100gCO₂e/kWh threshold for power generation, the accompanying 5-yearly declining threshold to 0CO₂e/kWh by 2050 has been removed. The PRI recommends the Commission to reassess the approach where the technical screening criteria have been weakened, compared to the TEG recommendations, and to **ensure that the final adopted text lives up to the high ambition** as set out in the Taxonomy Regulation.

3. The European Commission and co-legislators have a responsibility to maintain the integrity of the Taxonomy and avoid delays in its implementation.

Through ongoing negotiations, **there is a risk of further weakening of the criteria if short-term political priorities are made at the expense of environmental integrity**. The EU has sought to lead the global dialogue on sustainability and Taxonomies. Central to this is ensuring **the credibility of its own Taxonomy** which is inspiring other jurisdictions. Politically ambitious and uncompromised criteria consistent with the

TEG's recommendations and the EU climate neutrality targets are needed to foster market trust and avoid greenwashing from all stakeholders. The PRI therefore recommends that **the Delegated Regulation should be adopted as soon as possible, so it can enter into force on time.**

TECHNICAL AND SPECIFIC SECTOR CONSIDERATIONS

1. There is a need for additional non-EU equivalents to define some activities' thresholds.

The EU Taxonomy does use global frameworks to define some of its thresholds – e.g. to substantially contribute to climate mitigation through underground permanent geological storage of CO₂, the exploration and operation of storage sites in third countries must comply with ISO 27914:2017. Furthermore, IFC Performance Standards are often used for DNSH criteria. However, many activities do not have an outside EU equivalent. This is especially problematic since non-EU companies are not required to report alignment with the EU Taxonomy. Therefore, asset managers may be forced to rely on estimations of data and end up over weighting investments in EU companies because there is more disclosure. For consistency, and wherever relevant, **we recommend having an outside EU threshold for all criteria where possible, and otherwise further guidance to fill in the gaps.**

2. Adaptation criteria require more granularity at the activity level in general.

There needs to be more guidance on which activities enable climate adaptation, especially process-driven activities. These must be carefully assessed against forward-looking scenario analysis and climate risk analysis to **determine to what extent they can generate adaptation benefit.** Activities such as flood defence and nature-based solutions are also not well reflected.

3. The criteria for acquisition and ownership of buildings should not deviate from TEG recommendations.

Green bonds and green asset backed securities are often used to finance investments in this sector and using the Commission's suggestion of Energy Performance Certificate (EPC) class A technical screening criteria alone (for acquisition of buildings built before 31 December 2020) would significantly increase the burden for investors. The TEG's recommendation of using a different eligibility threshold (the calculated performance of the building must be within the top 15% of the local existing stock in terms of operational Primary Energy Demand, expressed as kWh/m²y) is **considered as better criteria by the industry.**

4. The criteria for forest activities have been tighten and should not deviate from TEG recommendations.

The criteria for forestry activities have been significantly heightened, yet investors are concerned that this is not an improvement to TEG recommendations. Under the categories of 'land-based climate solutions' and 'the circular economy at large' the EU Green Deal, the Paris Agreement, and the UN SDGs state that sustainable forestry and sustainable timber production takes place as both direct (carbon sequestration and storage) and indirect (sustainably sourced renewable materials substituting fossil-intensive resources) mitigants of climate change. However, the revised criteria for sustainable existing forest management (now named Improved forest management) contradict this, arguing that for forestry investments to be considered sustainable, they must be of conservation or impact investing kind. **The new criteria have been tightened to such a degree that they are unattainable at large** and thus discouraging for institutional investors.

ANNEX

Background on the EU Taxonomy

- The European Green Deal (EGD) recognises that *climate change and environmental degradation are an existential threat to Europe and the world*.¹ It also recognises the critical role that investment, especially private players, can play in realising the goals of the EGD so that Europe becomes the world's first climate-neutral continent by 2050.
- To achieve this goal, it is critical that investors, issuers, supervisors and policymakers have a shared understanding of which and to what extent investments are “environmentally sustainable”. The EU Taxonomy provides that shared understanding by offering a precise list of sustainable economic activities.
- Markets accept and understand the value of Taxonomies as a classification system to define environmental (and social) performance measures based on scientifically agreed thresholds and criteria. Taxonomies have been in use in the financial sector for many years.
- The EU Taxonomy is the first classification system to be established on a legislative basis.
- Following a relatively fast development, the Taxonomy Regulation entered into force on 12 July 2020. The Delegated Regulation under consultation set out proposed technical screening criteria for substantial contribution for the first two environmental objectives: climate change mitigation and adaptation.
- By setting a clear, legally binding framework, the Taxonomy enables further alignment with the six key European environmental objectives², also reflected in the European Green Deal overarching climate neutrality goal.
- The Taxonomy Regulation also addresses a critical issue in the debate about climate change mitigation: it provides a regulatory definition of activities that contribute to the low carbon transition. Such activities must: (1) be consistent with a pathway limiting temperature rise well below 2 degrees by 2050, (2) have GHG emission levels that correspond to the best performance in the industry, (3) not hamper the deployment of low-carbon alternatives and (4) not lead to lock-in of carbon intensive assets.
- The EU Taxonomy has received investors’ support as it relied on a process seen as transparent, advised by non-political experts and evidence based.

PRI and the Taxonomy

- The PRI contributed extensively to the TEG process. Nathan Fabian, Chief Responsible Investment Officer of the PRI, acted as Rapporteur for the Taxonomy working group of the Technical Expert Group on Sustainable Finance.³
- The PRI has also taken steps to educate and inform members about Taxonomy developments, and to encourage their participation in consultations.
- Finally, the PRI engaged a wide network of institutional investors to test the Technical Expert Group recommendations for the Taxonomy.⁴

¹ https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

² The six environmental objectives identified in the EU Taxonomy are (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems

³ https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en

⁴ <https://www.unpri.org/eu-taxonomy-alignment-case-studies/testing-the-taxonomy-insights-from-the-pri-taxonomy-practitioners-group/6409.article>

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