## Introduction

The purpose of this paper is to update the Member States expert group (MSEG) on sustainable finance on the progress achieved on the development of the taxonomy in the context of the work carried out by the Technical expert group (TEG) on sustainable finance.

As per the State of Play[[1]](#footnote-2) published in July 2018, and in line with its mandate[[2]](#footnote-3), the TEG has worked during the summer on:

1. Developing a classification framework to serve the main users of the taxonomy while facilitating tracking financial flows to sustainable investments.
2. Gathering and synthesising available information on environmentally sustainable economic activities, starting with mitigation and adaptation-related economic activities and identifying a first set of priority sectors for climate mitigation.
3. Developing its thinking around technical screening criteria for ‘substantial contribution’ and ‘not significant harm’ principles.
4. Devising a strategy on obtaining expert input and stakeholder feedback.
5. Carrying out preparatory work on the impact analysis report

For each of these themes, a summary of the deliberations, key decisions and next steps is provided in this paper.

Finally the paper invites MSEG to provide written comments in view of feeding them to TEG.

## Defining a classification framework

As already presented in the last MSEG meeting, the output from the TEG will be a list of environmentally sustainable economic activities and their technical screening criteria. This final list will need to build on robust existing classifications and be based on a comprehensive overview of economic activities. A sector classification framework to underpin the Taxonomy is therefore required.

The TEG was tasked with proposing a sector framework which meets the needs of the potential users (financial institutions both private and public, and "real economy" firms) while facilitating future tracking of financial flows to eligible economic activities.

The NACE[[3]](#footnote-4) industrial classification system was proposed as it is compatible with international and Member State frameworks, it is comprehensive in its coverage of the EU economy, is used by EU institutions such as Eurostat, and is used by some financial institutions.

The group has also noted that the GICS[[4]](#footnote-5) system is widely used in the financial sector, although it is more limited in its coverage of the economy. To ensure the Taxonomy meets also the needs of financial institutions, the group intends to develop a translation tool for users of the Taxonomy to align as much as possible the content with GICS.

**Key decisions taken**

* The NACE industrial classification will be used as the starting point for the Taxonomy. The classification will be supplemented, where useful, by definitions from other EU classification systems such as CPA[[5]](#footnote-6), PRODCOM[[6]](#footnote-7), CReMA and CEPA.
* The group will develop a translational tool to help users more familiar with GICS[[7]](#footnote-8) to interpret and consult the Taxonomy.

**Next steps**

* The mapping exercises will be continued to conclusion to enable the translational tool to be developed.

## Progress achieved on climate mitigation and adaptation economic activities

The group is tasked with proposing technical screening criteria, including thresholds where possible, for economic activities that have the potential to substantially contribute to climate change mitigation and adaptation objectives, with the view of classifying them as environmentally sustainable in line with the Taxonomy proposal (in particular Article 6 and 7). The group has focussed on gathering and synthesising information on mitigation and adaptation-related economic activities to date in particular leveraging on existing taxonomies including the work performed by the High Level Expert Group (HLEG) on sustainable finance[[8]](#footnote-9).

### First priority sectors list identified for climate mitigation objective

On economic activities delivering on climate mitigation objective, the group has carried out an initial mapping exercise to identify a first set of priority sectors.

The applied methodology by the TEG has resulted in the selection of six "NACE level 1" macro-sectors (see left column of table below). As explained with further details in Annex 1, these macro-sectors were selected based on a combination of high emitting as well as high confidence mitigation potential considerations.

Moreover, within each macro-sector the TEG has identified priority sectors/sub-sectors where thresholds and technical screening criteria have already been developed or are widely used by the market. These are provided in the right column of the table and are TEG's current priority focus in the weeks to come.

|  |  |
| --- | --- |
| NACE Macro-sector  | Short term focus / areas with established market guidance |
| A – Agriculture, forestry and fishing | Forestry  |
| C – Manufacturing | Energy efficiency improvements in selected sub-sectors |
| D – Electricity, gas, steam and air conditioning supply | Renewable power and heat generation |
| H – Transportation and storage | Low carbon land transport |
| F – Construction | Low emission buildings and substantive energy efficiency improvements  |
| L - Real estate activities |

**Next steps**

1. Technical screening criteria will be proposed for sectors and sub-sectors in the priority list, building on other existing taxonomies currently used in the market.
2. TEG will also extend the first priority list by identifying other sectors/sub-sector within the six NACE macro-sectors. This will be part of a second phase and could benefit from MSEG view and consensus on how the list should be expanded within the mandate of the TEG (see section 6 below).

### Climate adaptation economic activities

The group has clarified key concepts and developed initial proposals for an assessment approach by undertaking a stock take of economic activities contributing to adaptation, building from the HLEG Taxonomy and other sources including (but not limited to) analysis by the Intergovernmental Panel on Climate Change (IPCC), the World Bank, the UN Environment Programme and the Private Infrastructure Development Group (PIDG). The group has also conducted an initial stock take of approaches taken by financial institutions.

Discussions to date have emphasised the importance of contextual and location specific information for assessing adaptation activities as well as climate resilience building for the purpose of adapting to climate change as an intent for activities undertaken.

**Next steps**

* Further work is needed to agree a methodology for identifying economic activities delivering on the climate adaptation objective.

## Technical screening criteria

The group has been tasked with developing its thinking around technical screening criteria that would operationalize "substantial contribution" as well as the "no significant harm" principles as foreseen in the Taxonomy Regulation and in line with Article 14 therein.

### Technical screening criteria to define "substantial contribution"

The group is examining different types of technical screening criteria (including thresholds) that exist taxonomies used in the market and how these could be applied to support the EU Taxonomy’s objective.

Two categories of technical screening criteria are envisaged:

* Quantitative indicators i.e. "thresholds[[9]](#footnote-10)". Where feasible, quantitative indicators will be defined.
* Qualitative indicators / principles. These may be useful where data is limited or where adaptive policies are required, for example because activities and their impacts are location or scale sensitive.

Depending on the sector, technical screening criteria selected may be quantitative, qualitative or both in combination: these issues will be considered in greater detail during the next phase of Taxonomy work.

The group is also considering how to incorporate top down thresholds (e.g. thresholds for mitigation activities that drive decarbonisation pathways to meet the Paris Agreement) vs. bottom up thresholds (e.g. a threshold based on best in class or best available technologies).

**Next steps**

* These considerations will inform the establishment of technical screening criteria including the setting of thresholds for those economic activities analysed as part of the first priority sectors list.

### Technical screening criteria to define "no significant harm"

Where a substantial contribution is made to one environmental objective (say climate change mitigation), the Taxonomy requires also to include technical screening criteria to avoid significant harm to any of the other environmental objectives[[10]](#footnote-11).

The underlying assumption is that the EU environmental legislation would apply and as such these criteria will be established when there is a need to go beyond minimum EU regulatory standards. In particular, they should identify impact ‘hotspots’ (relevant to the economic activity and environmental objective considered), be relatively easy to describe and will have, when possible, appropriate thresholds in order that they are understood not only by the subject matter (i.e. environmental and sectorial) experts , but also by the financial and investment community.

Next steps

* These considerations will inform the formulation of technical screening criteria that ensure ‘no significant harm’ for those economic activities analysed as part of the first priority sectors list.

## Consultation, outreach and communication

For the purpose of this note, we mean the following when we use the terms consultation, outreach, and communication:

* Consultation refers to the process by which specific technical input is gathered to help develop deliverables of the TEG;
* Outreach refers to the process by which we ask stakeholders to provide feedback on progress made;
* Communication relates to the way in which the TEG communicates on its progress to the outside world, through public statements, press releases, or participating in key global sustainable finance events.

The TEG is currently developing a consultation and outreach plan that follows European Commission guidelines. A summary of this plan will be put online in the coming weeks so that interested parties are also aware of the process.[[11]](#footnote-12)

In terms of the taxonomy, the TWG has so far identified two key needs:

1. Technical input to assist in establishing technical screening criteria for the different sectors;
2. Outreach to stakeholders to receive feedback on interim progress made.

The TWG intends to use a partially overlapping phased approach in conducting consultation and outreach. As is explained above, the group will initially develop technical screening for select priority sectors, and will develop technical screening criteria for other sectors in a second round. In Phase 1, the group will consult industry experts and environmental experts to receive input for the development of the technical screening criteria for the priority sectors.

In Phase 2, once a first list of economic activities has been developed for the priority sectors, the group will reach out to relevant stakeholders to ask for their feedback on progress made. Stakeholders will be able to comment on:

* The added value of the taxonomy (in its proposed form),
* The criteria for choosing the sectors and the technical screening criteria for choosing the economic activities to be included in the taxonomy;
* The expected environmental, economic and financial impacts of those choices.

In Phase 3, and partially overlapping with Phase 2, the group will consult industry experts and environmental experts to receive input for the development of the technical screening criteria for the second round of sectors.

Please note that while in this indicative timeline no specific outreach is envisaged regarding the second round of sectors, there will be an open consultation on the final report, which will allow all relevant stakeholders to provide their feedback on those sectors as well.

An indicative timeline could look something like this:

|  |  |  |
| --- | --- | --- |
| **Phase 1** | **November- January** | Consult industry experts and environmental experts to gather input for technical screening criteria for priority sectors  |
| **Phase 2** | **February-March**  | Broader stakeholder outreach, including targeting on a sectoral basis and civil society, to consult on interim taxonomy on priority sectors  |
| **Phase 3** | **March – April** | Consult industry experts and environmental experts to gather input for technical screening criteria for second round priority sectors  |

Please note that this indicative timetable does not necessarily mean that no work on other sectors will be done before March. This will depend on the process and progress made regarding the priority sectors.

Please note finally that the consultation and outreach strategy is still under development, and that more information will be put online soon.

## Impact analysis report

The legislative proposal on the Taxonomy has already been subject to an impact assessment. However, this covered the framework provided in the L1 text and not the technical screening criteria of the EU Taxonomy. For this reason, the mandate of the Taxonomy working group foresees that the group will carefully assess the potential environmental, economic and financial impacts of the taxonomy using as a starting point for their work the proposed regulation or the final text if agreed by the co-legislators. The work will also align with the Commission’s guidelines on impact assessment to ensure consistency between the TEG impact analysis report and any future impact assessments relating to the preparation and adoption of delegated acts.

This work is at an early stage and the experts have just started discussing on how to approach this task and the main building blocks.

## Interaction MSEG - TEG

The work currently undertaken by the TEG on the Taxonomy would benefit from MSEG view on the overall approach currently adopted and in particular on the following:

* Would MSEG have comments on the resulting first list of priority sectors? Are there sectors/sub-sectors within the priority macro-sectors that are generally considered to be of high interest to MSEG for the first phase of the TEG work?
* Which sectors/sub-sectors should be added to the first list of priority sectors for the second phase and for what reasons?

MSEG is invited to provide their feedback in written form by Wednesday October 10 on the above and on any other technical issues where it wishes to provide further guidance to the TEG. MSEG is also invited to indicate subject technical areas presented in the paper where it would need more explanation from the TEG. The Commission staff would collect and synthesise them in order to feed them to the next TEG meeting which is foreseen on October 16 and 17. The needed clarification as well as progress achieved by then by the TEG can be presented at the next MSEG meeting in January 2019 or at an ad-hoc meeting by end of November if MSEG so wishes.

## Appendix – Sector prioritisation methodology for climate mitigation

To prioritise activities for assessment for inclusion in the Taxonomy, the group has so far considered mitigation characteristics of macro sectors. For the next MS expert group meeting, the group will also propose priority sectors based on their adaptation relevance and will add more mitigation sectors as the analysis continues.

The initial prioritisation for climate mitigation sectors has considered two factors:

1. The highest emitting macro level sectors.
2. High confidence mitigation potential macro level sectors.

#### Macro sector GHG analysis

GHG emissions for NACE macro sectors are listed below. Based on this assessment, four macro sectors were identified to provide initial focus (in bold in the below table). The four macro sectors identified in their entirety represented in 2016 around 84% of GHG CO2 equivalent in the EU.

|  |  |
| --- | --- |
| NACE Macro sector  | GHG tonne CO2 eq (2016, provisional)Source: ESTAT |
| **A - Agriculture, forestry and fishing** | **534,586,391.92** |
| B - Mining and quarrying | 77,860,862.01 |
| **C – Manufacturing** | **840,971,066.30** |
| **D - Electricity, gas, steam and air conditioning supply** | **1,098,083,546.14** |
| E - Water supply; sewerage, waste management and remediation activities | 161,564,425.09 |
| F – Construction | 57,811,284.18 |
| G - Wholesale and retail trade; repair of motor vehicles and motorcycles | 77,391,486.34 |
| **H - Transportation and storage** | **503,630,311.73** |
| I - Accommodation and food service activities | 18,598,937.77 |
| J - Information and communication | 10,346,281.06 |
| K - Financial and insurance activities | 7,035,014.10 |
| L - Real estate activities | 5,830,066.52 |
| M - Professional, scientific and technical activities | 19,439,533.18 |
| N - Administrative and support service activities | 23,549,820.72 |
| O - Public administration and defence; compulsory social security | 29,552,649.98 |
| P – Education | 17,999,543.73 |
| Q - Human health and social work activities | 30,093,334.93 |
| R - Arts, entertainment and recreation | 7,145,887.39 |
| S - Other service activities | 9,893,256.85 |
| T - Activities of households as employers; undifferentiated goods- and services-producing activities of households for own use | 356,091.23 |
| U - Activities of extraterritorial organisations and bodies | 79,082.70 |

#### Mitigation potential

The group has also made a judgement of activities with high mitigation potential based on experience developed in the HLEG process. Where data is available, this has been considered (see table 1 below). When updated official scenarios become available, the group will take these into account in further deliberations. Where detailed data is not available (the case for many of the subsectors) a qualitative judgement has also been applied, based on the experiences of the group. This analysis will be reviewed as more data becomes available.

Broadly, this approach has validated the high emitting macro-sectors selected above. However, based on an assessment of mitigation potential, **built environment** has been identified as an additional focus considering that buildings are responsible for approximately 40% of energy consumption and 36% of CO2 emissions in the EU [[12]](#footnote-13).

The NACE classification does not have a single category relating to built environment therefore the group identified two relevant macro-sectors - construction and real estate activities.

Table 1 - EU Greenhouse gas emission reductions overall and in different economic sectors in different decarbonisation scenarios[[13]](#footnote-14)

|  |  |  |  |
| --- | --- | --- | --- |
| **GHG reductions compared to 1990 in %** | **2005** | **2030** | **2050** |
| **Total sectors** | -7% | -40 to -44% | -79 to -82% |
| Power (CO2) | -7% | -54 to -68% | -93 to -99% |
| Industry (CO2) | -20% | -34 to -40% | -83 to -87% |
| Transport (incl. aviation, excl. maritime)[[1]](%22%20%5Cl%20%22m_5639379716884209249__ftn1) (CO2) | +30% | +20 to -9% | -54 to -67% |
| *Transport (excl. aviation, excl. maritime)*  | *+25%* | *+8 to -17%* | *-61 to -74%* |
| Residential and services (CO2) | -12% | -37 to -53% | -88 to-91% |
| Agriculture (Non CO2) | -20% | -36 to -37% | -42 to -49% |
| Other Non CO2 emissions  | -30% | -71.5 to -72.5% | -70 to -78% |

Source: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52011SC0288>

1. <https://ec.europa.eu/info/sites/info/files/180730-teg-statement_en.pdf> [↑](#footnote-ref-2)
2. Within the framework of the Taxonomy proposal, and as contained in the scoping paper, the TEG is tasked to:

	1. Determine a list of environmentally sustainable economic activities:
	2. contributing substantially to a given environmental objective as defined in Articles 6 to 11, starting with climate change mitigation and adaption;
	3. not significantly harming any environmental objective.
	4. Assess the implications of the taxonomy considering the potential environmental, economic and financial (market) impacts.
	5. Ensure coherence with the work of other sub-groups of the TEG, notably the sub-groups on EU Green Bond Standards, on low-carbon benchmarks methodologies and on metrics for climate related disclosure. [↑](#footnote-ref-3)
3. (*Nomenclature generale des Activites economiques dans les Communautes europeennes*) [↑](#footnote-ref-4)
4. (*Global Industry Classification Standard*) [↑](#footnote-ref-5)
5. (*Classification of Products by Activity)* [↑](#footnote-ref-6)
6. (*PRODuction COMmunautaire)* [↑](#footnote-ref-7)
7. And possibly any other widely used market-based classifications [↑](#footnote-ref-8)
8. <https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report-annex-3_en.pdf> [↑](#footnote-ref-9)
9. In order to be clear on what is meant by “threshold”, TEG proposes the following: *a limit value, expressed in terms of an indicator, which may not be exceeded by the economic activity during one or more periods of time.*  [↑](#footnote-ref-10)
10. Separately, minimum social safeguards are also proposed in the Level 1 text, where however no delegated acts are envisaged. [↑](#footnote-ref-11)
11. The group - together with the Commission - will also put online a more extensive Q&A regarding the work of the TEG that will answer most of the questions that currently arise in the industry. [↑](#footnote-ref-12)
12. <https://ec.europa.eu/energy/en/topics/energy-efficiency/buildings> [↑](#footnote-ref-13)
13. Extract from COMMISSION STAFF WORKING DOCUMENT IMPACT ASSESSMENT Accompanying document to the COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS A Roadmap for moving to a competitive low carbon economy in 2050 {COM(2011) 112 final} {SEC(2011) 289 final}. [↑](#footnote-ref-14)