

# TESTING THE TAXONOMY

INSIGHTS FROM THE PRI  
TAXONOMY PRACTITIONERS  
GROUP

## ABOUT THIS REPORT

By the end of 2021, investors that offer funds in Europe described as “environmentally sustainable” will need to explain how, and to what extent, they have used the Taxonomy in determining the sustainability of the underlying investments. They must also disclose the proportion of underlying investments that are Taxonomy-aligned as a percentage of the investment, fund or portfolio.

PRI has worked at a political and technical level to support the development of the Taxonomy. PRI was a member of the Technical Expert Group on Sustainable Finance (TEG) – an independent advisory body made up of representatives from finance, industry, the public sector and civil society – and coordinated the working group responsible for Taxonomy development.

The PRI Taxonomy Practitioners Group, established in September 2019, brought together more than 40 investor signatories. Investors, TEG members and service providers shared tools and experiences to help understand and support implementation of the Taxonomy.

In the final stage of this project, group members produced case studies to illustrate the methods, challenges and solutions drawn on to implement the Taxonomy in their investment processes. The PRI received almost 40 case studies from asset owners and investment managers covering a range of asset classes. Participants, including EU-based and non-EU firms, made recommendations on how to approach Taxonomy implementation and on how policymakers may develop and improve the Taxonomy.

This report is the first comprehensive set of case studies around how to use the Taxonomy. PRI hopes that by sharing the key findings with financial market participants and policymakers, the report will foster confidence and facilitate implementation of the Taxonomy.

At the time of writing, some of the more detailed aspects of the Taxonomy are still under development. The Taxonomy Practitioners Group mainly focused on implementing the recommendations of the TEG, which remain advisory. Despite the practical challenges of trialling a new type of disclosure framework, many signatories demonstrated that the Taxonomy is operational and that Taxonomy-alignment results are both useful and necessary as we continue our efforts towards a more sustainable financial system.

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# EXECUTIVE SUMMARY

This report shares insights from the first comprehensive set of case studies around how to use the EU Taxonomy. Starting in late 2019, over 40 investment managers and asset owners worked to implement the Taxonomy on a voluntary basis in anticipation of upcoming European regulation.

The investors assessed Taxonomy alignment before many details of the final regulation are in place, and before widespread corporate reporting against the Taxonomy is available. Many challenges remain, not least the availability of data and potential changes to the detailed Taxonomy criteria. Nonetheless, the progress made by the group is encouraging. The case studies detailed here demonstrate that the Taxonomy framework can be operationalised, and offer important insights for investors beginning their Taxonomy preparation.

This report also summarises recommendations from the group to policymakers and supervisors who will oversee the implementation and development of the Taxonomy. The PRI hopes that by circulating these findings, this report will foster confidence and facilitate implementation of the Taxonomy.

## SUMMARY: RECOMMENDATIONS TO INVESTORS

Based on their experience of implementing the Taxonomy, we asked investors to offer advice to other financial market participants who will be required to disclose against the Taxonomy in the future. This advice is detailed throughout the report, but broadly can be grouped into four steps:

### ESTABLISH A FRAMEWORK

- Ensure adequate resources are set aside and management is aware of this regulatory requirement
- Integrate the Taxonomy into the investment strategy
- Manage expectations

### DEVELOP A PROCESS

- Start early. Allocate time and expertise for detailed analysis
- Quantify findings as far as possible
- Start small. Test one sector/product/region
- Apply a step-by-step approach
- Take a bottom-up approach

### IDENTIFY THE CHALLENGES

- Strictly adhere to thresholds wherever possible
- Carefully consider reliability levels for different sources of data
- Verify with companies when in doubt
- Provide context for results

## **FIND SOLUTIONS**

- Engage on data
- Share with partners
- Work with data providers
- Support innovation and improvement from data providers
- Investigate validation and external assurance

## **SUMMARY: RECOMMENDATIONS TO POLICYMAKERS AND SUPERVISORS**

The investors made a series of detailed policy recommendations, which, supplemented by PRI's own analysis, follow these themes:

### **DATA**

The Taxonomy Regulation will require corporate disclosure against the Taxonomy. While this is recognised by participants as very significant, policymakers should go further to ensure that the right data, at the right level of granularity, and for the right issuers, is available.

### **GUIDANCE AND SUPERVISORY EXPECTATIONS**

Investors anticipate a need for significant practical and interpretive guidance for all Taxonomy users (investors, corporates and service providers), as well as clear expectations from supervisors.

### **TAXONOMY DEVELOPMENT**

Investors desire greater clarity on the selection, and exclusion, of some indicators and activities. Consistent with other studies, investors recognise the need to avoid competing international taxonomy frameworks.

# 1. WHAT IS THE EU TAXONOMY?

The following definition comes from the Final Report on Taxonomy, Technical Expert Group on Sustainable Finance (2020):

The EU Taxonomy is a tool to help investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy. The Taxonomy sets performance thresholds (referred to as ‘technical screening criteria’) for economic activities which:

- make a substantive contribution to one of six environmental objectives
- do no significant harm (DNSH) to the other five, where relevant
- meet minimum safeguards (e.g., OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights).

## FURTHER READING

This report assumes a baseline level of understanding of the Taxonomy. For those new to the topic, the table below of sources provides suggestions for further reading.

Useful sources for further information	
<b>TEG Final Report on EU Taxonomy</b>	<a href="https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf">https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf</a>
<b>Technical Annex to the TEG Final Report on the EU Taxonomy</b>	<a href="https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy-annexes_en.pdf">https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy-annexes_en.pdf</a>
<b>PRI Article on the EU Sustainable Finance Taxonomy</b>	<a href="https://www.unpri.org/sustainable-markets/eu-sustainable-finance-taxonomy/4567.article">https://www.unpri.org/sustainable-markets/eu-sustainable-finance-taxonomy/4567.article</a>
<b>PRI EU Taxonomy Investor Briefing</b>	<a href="https://d8g8t13e9vf2o.cloudfront.net/Uploads/d/s/r/taxonomyinvestorbriefingpostdeal_612580.pdf">https://d8g8t13e9vf2o.cloudfront.net/Uploads/d/s/r/taxonomyinvestorbriefingpostdeal_612580.pdf</a>
<b>Technical Expert Group on Sustainable Finance (TEG) – Frequently Asked Questions</b>	<a href="https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-teg-frequently-asked-questions_en.pdf">https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-teg-frequently-asked-questions_en.pdf</a>

## 2. THE CASE STUDIES

This section provides a list and links to the case studies, which can be viewed online.

The conclusions and recommendations of this report, set out in the following sections, are based on the case studies below<sup>1</sup>. To look at individual approaches to Taxonomy implementation, for different asset classes and geographies, please follow the links under each organisation name. To browse all of the case studies please click [here](#).

Organisation	HQ Region	Asset Class covered in case study	Geography covered in case study
<a href="#">Aberdeen Standard Investments</a>	Europe	Listed Equity	Global
<a href="#">Aberdeen Standard Investments</a>	Europe	Listed Equity	Europe
<a href="#">Amundi</a>	Europe	Fixed Income (corporate, general)	Global
<a href="#">AP Pension</a>	Europe	Listed Equity	Global
<a href="#">AXA Investment Managers</a>	Europe	Listed Equity/ Fixed Income (corporate, general)	Global
<a href="#">BlackRock</a>	North America	Fixed Income (corporate, general)	Global
<a href="#">BlueBay AM LLP</a>	Europe	Fixed Income (corporate, general)	Global (predominantly developed markets)
<a href="#">Carmignac</a>	Europe	Listed Equity	Global
<a href="#">CORESTATE Capital Group</a>	Europe	Real Assets (real estate)	Germany
<a href="#">Credit Suisse Group AG</a>	Europe	Listed Equity	Global
<a href="#">ESG Portfolio Management</a>	Europe	Fixed Income (green bonds)	Norway, Scotland, Chile, Canada, Iceland, Faroe Islands, Ireland
<b>Foresight Group LLP</b>	Europe	Real Assets (infrastructure)	Europe
<b>Franklin Templeton Investments</b>	North America	Fixed Income (corporate, general)	European currency denominated debt - can be global issuers
<b>Franklin Templeton Investments</b>	North America	Fixed Income (corporate, general)	European issued debt
<a href="#">Impax</a>	Europe	Listed Equity	EU, China
<a href="#">The International Woodland Company A/S</a>	Europe	Real Assets (forestry)	Brazil, Chile, USA
<a href="#">Invesco Ltd</a>	North America	Listed Equity	Europe

<sup>1</sup> The case studies are being published periodically on the PRI website, so at any given moment fewer than 37 case studies may be publicly available. All analysis in this document, including any stated statistics, is based on the full suite of 37 case studies.

<b>KBI Global Investors</b>	Europe	Listed Equity	Global including emerging markets
<b>KLP</b>	Europe	Listed Equity	Developed countries
<a href="#"><u>La Financiere de l'Echiquier</u></a>	Europe	Listed Equity	Europe
<a href="#"><u>La Française Group</u></a>	Europe	Listed Equity	Eurozone
<a href="#"><u>MN</u></a>	Europe	Fixed Income (corporate, general)	Europe, US
<a href="#"><u>Morgan Stanley Investment Management</u></a>	North America	Listed Equity/ Fixed Income (green bonds)	Global
<a href="#"><u>Neuberger Berman Group LLC</u></a>	North America	Listed Equity	US
<b>Nordea</b>	Europe	Fixed Income (corporate, general)	N/A
<a href="#"><u>Osmosis Investment Management</u></a>	Europe	Listed Equity	Global
<a href="#"><u>Ostrum AM</u></a>	Europe	Fixed Income (green bonds)	Europe
<b>PKA</b>	Europe	Fixed Income (green bonds)	Global
<b>ResponsAbility Investments AG</b>	Europe	Fixed Income (private debt)	Global (only non-EU countries)
<a href="#"><u>Robeco</u></a>	Europe	Fixed Income (green bonds)	Global
<a href="#"><u>Royal London Asset Management</u></a>	Europe	Listed Equity	UK, Europe, US
<b>SEB Investment Management</b>	Europe	Listed Equity	Global
<b>StepStone Group LP</b>	North America	Real Assets	US, EU, UK
<a href="#"><u>Swedbank Robur</u></a>	Europe	Listed Equity	Nordic region
<b>VidaCaixa Group Pension Scheme</b>	Europe	Fixed Income (corporate, general)/ Fixed Income (green bonds)	OECD
<b>Wellington Management Company LLP</b>	North America	Listed Equity	Global
<a href="#"><u>Wells Fargo AM</u></a>	North America	Fixed Income (corporate, general)	Global

## 3. HOW DID INVESTORS ASSESS TAXONOMY ALIGNMENT?

This section provides a brief overview of the predominant approaches described in the case studies, covering the scope, and assessing alignment and financial metrics.

### SCOPE OF CASE STUDIES

The investors in the group considered a range of asset classes, regions and investment styles in their case studies.

Some 89% of investors were investment managers and the remainder were asset owners. Almost one quarter of the investors came from the US, with the others based in Europe. The regions represented in their case studies were Europe or countries within Europe (32%), North America (16%), South America (5%) and Asia (3%). Some 57% of case studies considered activities globally.

Most case studies considered listed equity and fixed income, with a smaller number analysing real assets (infrastructure, real estate, forestry). None of the case studies assessed sovereign bonds, reflecting the absence of a clear methodology to do so.

### ASSESSING ALIGNMENT

To assess whether an issuer was performing Taxonomy-aligned activities, the majority of participants used third party data providers, although many supplemented this with in-house research, direct assessment of corporate reports and data available through not-for-profit organisations, such as the CDP or Climate Bonds Initiative (CBI). External validation consultants were used to a greater extent when assessing real assets, in sectors such as real estate, infrastructure and forestry.

Many participants started by assessing the extent to which their existing data services might be repurposed for Taxonomy assessment, initial screening or as a point of reference for their analysis. Participants referenced a range of services including Bloomberg's WATC EUTAX tool, MSCI, ISS, FactSet, Trucost S&P, Carbon Delta, GS Sustain Taxonomy mapping tool and RepRisk. Several participants developed proprietary frameworks for mapping Taxonomy activities to existing classifications systems.

Participants typically found it easier to access climate change mitigation data. Some participants were able to draw on firm-level assessments of elements of the minimum safeguards, such as the OECD Guidelines for Multinational Enterprises and ILO Core Labour Conventions. However, for a fuller assessment of Do No Significant Harm (DNSH) criteria and minimum safeguards, investors used a range of proxies, such as UN Global Compact compliance, IFC performance standards or NGO assessments, while noting that this did not always perfectly match the DNSH requirements of the Taxonomy.

## FINANCIAL METRICS

The most common method of calculating alignment for listed equity was quantifying the proportion of turnover aligned with the Taxonomy. Capex (and to a lesser extent Opex) were considered in sectors such as utilities, where these metrics were recognised as more relevant to the asset base. The analyses were limited by the fact that expenditure data was typically not available at the required level of granularity, and some investors sought to engage corporates on this point. In the case of Green Bonds (GBs), investors relied on use-of-proceeds to calculate the assessment. Calculating Taxonomy alignment for property, infrastructure and other single assets that do not have a revenue base was more challenging, with some participants relying on assessments of the financing of projects or assets, while others sought to have all assets within a fund validated externally to show compliance with the Taxonomy. In forestry, only Taxonomy-aligned revenues derived from certified assets that could be linked to sustainable activities were considered. These Taxonomy-aligned revenues for each underlying investment were weighted relative to the investment's share of the total capital deployed. In real estate, once a suitable building or buildings had been identified, the financial metrics considered for evaluation of the renovation process included fees generated, total investment costs and energy cost savings resulting from renovation measures.

## 4. GUIDANCE FOR MARKET PARTICIPANTS

This section assesses the recommendations of group members to other financial market participants implementing the Taxonomy.

It summarises them into a four-step process:

1. Establish a framework
2. Develop a process
3. Identify challenges
4. Find solutions

There is no single correct way to approach the Taxonomy, but following these steps may help investors initiating their Taxonomy assessment.

### ESTABLISH A FRAMEWORK

- Ensure adequate resources are set aside and that management is aware of this regulatory requirement. Decide whether there are sufficient internal resources to collect data from companies to implement the Taxonomy independently, or whether external liaison with data providers is required.
- Integrate the Taxonomy into the investment strategy.
- Manage expectations. The current Taxonomy criteria are advisory and may change. Participants typically found relatively low percentages of Taxonomy-alignment, reflecting differences between the Taxonomy framework and some existing methods of assessing sustainability. Learn from the process but recognise current limitations.

### DEVELOP A PROCESS

- Start early. Allocate time and expertise for detailed analysis – especially for identifying DNSH criteria and screening against them at company level. Consult with specialists.
- Quantify findings as far as possible. Initially, it is better to integrate ESG criteria deeper into investment activities, to avoid higher implementation costs in future.
- Start small. Test one sector/product/region - even if initially case-by-case, using a small sample group on a share of a portfolio or one sector/product/region.
- Apply a step-by-step approach. Work through DNSH and minimum safeguards screening before the more complex substantial contribution (SC) screening.
- Take a bottom-up approach to fairly assess company alignment with the Taxonomy. There is insufficient reported company data to make a top-down assessment.

## IDENTIFY THE CHALLENGES

- Strictly adhere to thresholds wherever possible. Do not pick and choose areas to assess or liberally interpret guidelines. Participants highlighted enabling activities as a particular risk. These should only be considered where the activity is explicitly defined as enabling in the Taxonomy, rather than including any company providing a service to another Taxonomy-aligned company.
- Carefully consider reliability levels for different sources of data, noting that in the absence of high quality corporate disclosure, all in-house or third party assessments will involve estimation, modelled data or use of proxies.
- Verify with companies directly when in doubt or if there is a lack of data.
- Provide context for results, which may help explain a lack of alignment.

## FIND SOLUTIONS

- Engage on data. Engage early with investee companies, particularly smaller companies or non-EU companies, being clear as soon as possible about requirements to publish relevant technical data for more aligned reporting. Doing so will allow investors to make allocations and fund managers to include companies in a portfolio or opportunity set.
- Share with partners. Cross-check findings with other investors investing in the same companies and collaborate on publicly available information. Be clear: agree on best practice, clarify the data set and when it is likely to be available, be transparent about methods (data, models and sourcing of data).
- Work with data providers. Use data provider tools to ease the burden of manual input. Some participants mentioned using several data providers to compare results, build confidence and fill gaps in data provision.
- Support innovation and improvement from data providers to deliver the data required to carry out the assessments (more granular Opex/Capex data disclosure as opposed to mainly revenue disclosure), assess data gaps and encourage holistic, off-the-shelf solutions and further product development. Data providers should be encouraged to cover all steps of the Taxonomy assessment.
- Investigate validation and external assurance of both underlying Taxonomy data and processes followed by external managers and data providers.

“While detailed in-house analysis and application of the EU Taxonomy is very time-consuming, we believe there is value in understanding all the pitfalls. This should help to assess the robustness of the approaches taken by different data providers, even if applied on a limited sample of issuers or GBs.”

“There is value in nurturing an understanding of a company’s culture, regulatory environment and the industry in which it operates. This will avoid overburdening companies to report information that may not add value to the investment process.”

“Industry groups and trade associations have a role to play in translating the taxonomy into an industry reporting standard, supported by best practice processes and assurance requirements.”

## 5. CHALLENGES AND SOLUTIONS

This section summarises challenges and proposes solutions to Taxonomy implementation.

Group members identified the key challenges they faced in implementing the Taxonomy, and the solutions they found. The challenges can be broadly defined as problems around sourcing data, matching data to the Taxonomy, adapting to the granular Taxonomy approach and creating new processes to address the Taxonomy. Various solutions were proposed – but not all will be suitable for every investor. There were also specific challenges for those dealing with Green Bonds.

### TABLE SUMMARISING MAIN CHALLENGES AND SOLUTIONS

Challenges	Solutions
<b>1. Sourcing and matching data</b>	
<ul style="list-style-type: none"> <li>■ The data required may not be clearly defined, quantitative, publicly available, sufficiently granular or reliable.</li> <li>■ There was a particular lack of expenditure data, which limited assessments of climate change adaptation.</li> <li>■ Most investors did not use NACE codes, so they translated into other industry classification systems.</li> <li>■ Assessing DNSH was particularly challenging due to the absence of data and the qualitative nature of many DNSH criteria.</li> <li>■ Application of EU standards outside of the EU remains challenging.</li> <li>■ Some activities were not covered by the TEG recommendations for the Taxonomy, or still require further research.</li> </ul>	<p><b>Compare, match and validate data</b></p> <ul style="list-style-type: none"> <li>■ Analyse corporate disclosure to validate existing data sources and engage with companies to verify accuracy.</li> <li>■ Conduct peer analysis to inform proxy assumptions where unable to document specific activities and engage with companies to verify or disclose further information.</li> <li>■ Encourage collaboration between investment teams and sustainability specialists.</li> <li>■ Set up an ESG due diligence assessment process with investment teams. This could be employed to investigate practical ways to use the Taxonomy (e.g. how to assess a building before its acquisition).</li> <li>■ Where data is not available or unreliable, adopt a precautionary approach and be clear on data limitations.</li> <li>■ Map disclosed segment revenue to economic activity. As revenue looks at current performance while Capex looks at potential performance, consider reporting both.</li> <li>■ Where criteria are unclear, make a judgement to interpret technical screening criteria and respective</li> </ul>

	<p>thresholds. Be clear on what judgements you have made, and on what basis.</p> <ul style="list-style-type: none"> <li>■ Build ‘correspondence tables’ between Taxonomy criteria, existing certification schemes and other non-EU standards.</li> <li>■ To understand the exact scope of each activity to identify the most suitable match, test on a smaller portion of the investment portfolio or for activities for which KPIs are available/comparable with Taxonomy criteria.</li> </ul> <p><b>Work with partners and engage</b></p> <ul style="list-style-type: none"> <li>■ Engage companies and request information on activities aligned with revenue, Capex or Opex; raise awareness of the benefits of compliance. This is especially important for smaller companies or for those operating outside the EU.</li> <li>■ Liaise with data providers to clarify and corroborate data.</li> <li>■ Working with other investors, engage service providers to agree a baseline expectation on terminology used, mapping of data and DNSH and minimum safeguards implementation, particularly for non-EU issuers.</li> </ul>
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## 2. Adapting to the taxonomy approach

<p><b>Resources</b></p> <ul style="list-style-type: none"> <li>■ The Taxonomy demands a significant time investment to understand, interpret and apply the criteria. More guidance is required.</li> <li>■ Expertise is very valuable in assessing technical screening and criteria, especially DNSH.</li> </ul> <p><b>Interpretation</b></p> <ul style="list-style-type: none"> <li>■ Some screening criteria involve interpretation.</li> <li>■ In the absence of perfect data, assessment of similar data sets might lead to disparate outcomes.</li> </ul>	<p><b>Piloting</b></p> <ul style="list-style-type: none"> <li>■ Start small-scale. Use existing processes and resources, and then build and adjust a framework to support a full-scale roll-out.</li> <li>■ Agree on a subjective assessment or standard of alignment when unable to document specific activities.</li> <li>■ Use third party validation to legitimize declarations.</li> </ul> <p><b>Developing clarity</b></p> <ul style="list-style-type: none"> <li>■ In calculating potentially-aligned figures, seek evidence to support any assumptions, make robust calculations of estimates, build an audit trail and be transparent about your process.</li> </ul> <p><b>Working with partners - Building consensus</b></p>
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<ul style="list-style-type: none"> <li>■ There are various approaches to calculating potential alignment<sup>2</sup> and the way these calculations are applied may vary significantly.</li> </ul>	<ul style="list-style-type: none"> <li>■ Ensure participation and involvement of all invested parties/stakeholders, review as many resources as possible and collaborate with external partners to clarify more complex implementation questions.</li> <li>■ Engage with companies to help interpret criteria until they are ready to report in the technical and activity-based way that the Taxonomy requires, based on an assessment of substantial contribution thresholds.</li> <li>■ Develop a clear understanding of potential solutions and proactive stakeholder engagement plans to deliver Taxonomy compliance.</li> </ul>
<h3>3. Starting a taxonomy process</h3>	
<ul style="list-style-type: none"> <li>■ There is no off-the-shelf solution or tool to conduct Taxonomy analysis.</li> <li>■ Investors have limited capacity, time and resources to conduct manual screening.</li> </ul>	<ul style="list-style-type: none"> <li>■ Consider using a data provider to build on existing capabilities and adopt a pragmatic approach based on available data.</li> <li>■ Consider using manual screening on small company samples to get an idea of the challenges and inform discussions with providers. Start with a limited universe.</li> </ul>

<sup>2</sup> In addition to the mandatory disclosures required by the Regulation, the TEG recommended that investors could report on potential alignment in cases where an activity is very likely to be Taxonomy-aligned but a full assessment could not be completed.

## FOCUS ON GREEN BONDS

Challenges	Solutions
<ul style="list-style-type: none"> <li>■ GBs issuance requires a different approach to corporate issuance, where an activity could be measured and classified by turnover, Opex or Capex.</li> <li>■ Use-of-proceeds breakdown often not available.</li> <li>■ Some activities are not yet covered by the Taxonomy and some GBs proceeds may match the other five environmental objectives of the Taxonomy.</li> <li>■ Resource limitations and questions of interpretation mean it can be challenging to assess DNSH per project.</li> </ul>	<ul style="list-style-type: none"> <li>■ To help address the complexity of GBs, consider the likelihood of a given activity to be Taxonomy compliant and use the share of proceeds allocated to link a GB to each activity.</li> <li>■ Estimate GBs use-of-proceeds using available reported data and issuer engagement.</li> <li>■ Based on the EU's Green Bond Framework (GBF), create an internal GBF to guide the ESG due diligence process of GBs. Involve ESG and Credit teams in the application of the internal GBF to help identify investments/use-of-proceeds for climate adaption and mitigation purposes.</li> <li>■ For DNSH, use the GBF, external ESG data provider monitoring and in-house engagement.</li> <li>■ Focus on third party providers specialised in assessing compliance with global norms and screening of the portfolio at the issuer level.</li> <li>■ Check that the requirements for non-EU companies set out in the GBF match or surpass high industry standards. If that is the case then assume that GBs which meet those requirements are also Taxonomy aligned.</li> </ul>

## 6. POLICY RECOMMENDATIONS

This section sets out policy recommendations made by investors and supplemented by the PRI's own policy analysis.

The Taxonomy is an innovative disclosure regulation. While the high-level framework is clear, successful deployment of the Taxonomy will benefit from greater support from policymakers and regulators. This section summarises the recommendations made by the group to policymakers. It is divided into three key themes:

1. Data
2. Guidance and Supervisory Expectations
3. Taxonomy Development.

### DATA

The Taxonomy Regulation will require corporate disclosure against the Taxonomy. While this is recognised by participants as very significant, policymakers should go further to ensure that the right data, at the right granularity, and for the right issuers, is available.

- Future corporate disclosure obligations should go beyond the scope of the existing corporate reporting requirement (and implicitly, the scope of the current Non-Financial Reporting Directive) and consider private companies, as well as potentially strengthening expectations on issuers of green bonds.
- Much of the available data is not yet at sufficient granularity. More activity-level reporting, and particularly reporting of revenues per business or product, would help investors who are undertaking detailed company analysis to avoid the use of estimates, or company-wide measures as proxies. However, this may not be necessary if corporates provide reliable firm-level disclosure of Taxonomy-alignment.
- Standardised reporting expectations for some of the more subjective or qualitative elements of the Taxonomy (e.g. minimum safeguards, DNSH criteria) would help to improve provision of data.
- Companies should be encouraged to standardise their reporting methodologies, potentially using tools, templates and the possible future development of an EU database of Taxonomy reports.
- The EU should encourage audit or assurance of corporate Taxonomy-alignment corporate data.
- Some investors suggested a role for policymakers to engage data providers to limit discrepancies, agree on common definitions on key terms and standardise the approach to subjective elements, while others suggested that investors should collaborate to achieve the same goals.

## GUIDANCE AND SUPERVISORY EXPECTATIONS

Investors anticipate a need for significant additional practical and interpretive guidance for all Taxonomy users (investors, corporates and service providers), as well as clear expectations from supervisors.

Investors piloting the Taxonomy identified several substantive issues on which further guidance should be provided. These are in addition to recommendations for further development of the Taxonomy framework, discussed below. Key guidance requests included:

- Development of a more structured approach for demonstrating compliance with minimum safeguards and qualitative DNSH criteria (such as a checklist). This is particularly challenging outside of the EU as some DNSH criteria are aligned to EU regulations.
- Tools to support the application of the Taxonomy in non-EU markets. In particular, the development of correspondence tables for alternative, non-EU standards as proxies (building from the TEG's own recommendations, for example, in green buildings).
- Further development of the adaptation criteria, which are challenging to interpret due to their qualitative nature.
- Clarity on the time period for a Taxonomy assessment. For example, how frequently should investors review companies for potential violations of DNSH or minimum safeguards?
- Guidance on reporting investments that may substantially contribute to more than one environmental objective.
- Further guidance on treatment of financial metrics. For example, whether to use an income statement or cash flow approach when calculating turnover.
- Further specificity on expenditure metrics – for example, identifying situations when Opex would be an appropriate metric.
- Further guidance on accounting for GBs. For example, in cases where GBs proceeds directly finance loans or equity investments rather than expenditures.
- How to address potential double counting in multi-asset strategies.
- How to interpret Taxonomy requirements for funds beyond the typical listed equity funds. For example, for funds with a defined fundraising and deployment period, advice is needed for different stages of investment (fundraising capital fully committed, deployed or in the process of being invested). We noted that none of those undertaking case studies attempted to assess the alignment of sovereign bonds, which indicates that investors do not yet consider this assessment feasible. Significant methodology development is likely to be necessary here.
- Though the proposal to allow a “potentially aligned” category was welcomed, investors also identified it as a significant possible source of divergence, dependent on strictness of interpretation, and that greater clarity would help preclude this risk.

Alongside this further guidance, greater clarity around supervisory expectations was requested. In particular:

- Due to the time periods within the Taxonomy regulation, the data required to properly perform a Taxonomy assessment may not be available before the first mandatory reporting period. Capacity gaps mean it is likely to be imperfect even after it becomes mandatory. Supervisors should ensure that investors are able to clearly communicate the limitations of their analysis and the underlying data.

- Ensure greater alignment with other EU disclosure requirements, in particular the forthcoming Regulation on Sustainability-Related Disclosures in the Financial Services Sector.
- Finally, supervisors should give consideration to how Taxonomy regulation interacts with other regulatory requirements, including marketing and product communication.

## TAXONOMY DEVELOPMENT

Investors desire greater clarity on the selection, and exclusion, of some indicators and activities. Consistent with other studies, investors recognise the need to avoid creating competition between international Taxonomy frameworks.

When considering the specific indicators and presentation of the Taxonomy, group members suggested that policymakers should:

- Where possible, simplify presentation on the criteria and remove subjectivity, or provide greater clarity through guidance (for example, what does it mean to be “near” a sensitive site for biodiversity in the context of DNSH criteria?)
- Develop some of the existing criteria to provide greater certainty and clarity (for example, the IT criteria were felt to be under-developed).
- Widen the sectors covered. Investors indicated a desire to see more enabling activities/solutions reflected in the Taxonomy.
- Provide greater clarity on which sectors have been intentionally excluded from the Taxonomy and therefore are always considered to cause significant harm.
- Clarify the role of “neutral” activities that neither substantially harm nor significantly contribute to environmental objectives – this may help to contextualise the relatively low proportion of Taxonomy alignment seen in some case studies.

Beyond the specific technical screening criteria, policymakers should:

- Consider and reflect on the use of expenditure metrics. Capex and Opex, while useful for assessing how a company’s spending is in line with environmental commitments, may lead to unintended consequences such as bias against capital-intensive industries.
- Work internationally to encourage harmonisation of Taxonomies (while also supporting investors required to analyse non-EU securities for immediate Taxonomy implementation, for example through the development of correspondence tables).
- Provide greater clarity on the future development of Taxonomy criteria.
- Support the development of Taxonomy-aligned activities through sectoral regulation (e.g. the forthcoming renovation wave policy programme).
- Carefully monitor implementation to avoid unintended consequences (for example, bias towards sectors with simpler compliance requirements). Passive products in particular should be carefully examined, as they do not benefit from human judgement to counterbalance potential biases.

“Ensuring that the Taxonomy is aligned with company non-financial reporting requirements is integral to the success of the regulation.”

“Compliance, at least at this stage, will be on best-efforts basis. This will hopefully change as better data becomes available.”

“We would suggest the following: Providing an exhaustive mapping tool with all NACE sub-sectors and systematic matching with the following information: Activity, definition, and if such activity (1) has a positive contribution and technical criteria; (2) has no positive contribution; (3) has positive contribution but no technical criteria yet; (4) has not been covered yet.”

“Push to ensure that the Taxonomy becomes a global standard that is widely used by leveraging market participants and institutional investors.”

# APPENDIX 1: GLOSSARY

GLOSSARY OF TERMS	
<a href="#"><u>Technical Expert Group on sustainable finance (TEG)</u></a>	The TEG was set up by the European Commission in July 2018 to aid the development of, among other things, the technical screening criteria of the Taxonomy and the EU Green Bond Standard. The group consists 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.
<a href="#"><u>Taxonomy</u></a>	The (EU) Taxonomy is a tool to help investors to understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. Establishing a common language between investors, issuers, project promoters and policymakers, it helps investors to assess whether investments are meeting robust environmental standards and are consistent with high-level policy commitments such as the Paris Agreement on Climate Change. The creation of this Taxonomy was Action 1 of the EU's 10-point Action Plan on Financing Sustainable Growth in March 2018.
<a href="#"><u>EU Green Bond Standard</u></a>	<p>As part of the <a href="#"><u>European Green Deal Investment Plan</u></a> (January 2020), the Commission announced it will establish an EU Green Bond Standard (GBS). This will be in Q4 2020 after the close of the <a href="#"><u>targeted consultation on the EU GBS</u></a>.</p> <p>The TEG published its <a href="#"><u>recommendation for an EU GBS</u></a> in June 2019, proposing that the Commission creates a voluntary EU Green Bond Standard to 'enhance the effectiveness, transparency, comparability and credibility of the GB market and to encourage market participants to issue and invest in EU GBs.'</p> <p>The TEG then provided further usability guidance and an updated recommendation in its <a href="#"><u>March 2020 report</u></a>.</p>
<a href="#"><u>TEG Final Report On EU Taxonomy</u></a>	This Final Report on the EU Taxonomy, written in March 2020, provides recommendations for the overall design of the Taxonomy and advice on how companies and financial institutions can use it to disclose their level of sustainability.
<a href="#"><u>Technical Annex to the TEG Final Report on the EU Taxonomy</u></a>	This Annex within the TEG Final report contains technical screening criteria for 70 climate change mitigation and 68 climate change adaptation activities, including criteria for Do No Significant Harm (DNSH) to other environmental objectives. It also provides further guidance around the methodology of the technical screening criteria.
<a href="#"><u>Excel Tool - TEG Report on the EU Taxonomy</u></a>	This tool helps market participants implement the Taxonomy for their own activities.
<b>DNSH</b>	Do No Significant Harm (DNSH) is one of the requirements for an economic activity to be considered Taxonomy-aligned [see Aligned]. The thresholds for an activity to DNSH are defined in the Technical

	Annex. Not all activities require DNSH thresholds for all six environmental objectives.
<b>ALIGNED</b>	An economic activity is considered aligned with the Taxonomy if it substantially contributes to at least one of the six environmental objectives, does no significant harm to the other five and complies with the minimum safeguards.
<b>NACE</b>	Nomenclature Statistique des Activités Économiques dans la Communauté Européenne
<b>BICS</b>	A mapping of the NACE classification system to the Bloomberg Industry Classification System
<b>GICS</b>	Global Industry Classification Standard, property of MSCI Inc. and Standard and Poor's
<b>ICB</b>	The Industry Classification Benchmark is a global standard to categorize and contrast companies by industry and sector. It is the official sector classification used across FTSE Russell indexes for analysis, attribution and performance measurement.
<b>TRBC</b>	A mapping of the NACE classification system to the Thompson Reuters Business Classification system

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