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Taxonomies for sustainable debt instruments issuance

13 May 2024

Bhutan

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Advanced taxonomies for green activities

What is a Taxonomy?

In the context of sustainable finance, a Taxonomy is a classification tool or system meant to help investors and companies to make informed investment decisions on sustainable economic activities. It aims at establishing market clarity on what is robustly and consensually “sustainable” when it comes environmental or social issues

A TAXONOMOY IS …



- A list of projects/ technologies/ products/ activities exhibiting a set of green or social patterns, benefits or performance criteria
- A framework supporting product structuration & integrity safeguards
- A classification tool fit for different investment styles and strategies
- Anchored into latest scientific findings & industry experience
- Dynamic, responding to technological and scientific knowledge changes

A TAXONOMOY IS NOT …



- A rating of companies
- A mandatory list of “potential”
- investments
- Judgmental on the financial
- performance of an investment (i.e. only about environmental performance)
- Inflexible or static

Source: Natixis

Back to basics: what is generally regarded as "green"?

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Climate Awareness Bonds of EIB

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- Pioneer with use of proceeds bonds: 2007 Climate Awareness Bond (CAB)
- **Renewable Energy & Energy Efficiency**
- Expanded in 2020 to
  - Research, Development and deployment of innovative low carbon technologies
  - Electric rail infrastructure and rolling stock and electric buses
  - Projects inside and outside Europe
  - 1,000 MW WIND FARM GULF OF SUEZ



Source: EIB CAB

European Investment Bank The EU bank

ICMA GBPs green project categories

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» ICMA's GBPs provide high-level classification for green projects categories

» With a little bit more of explanation than ASEAN ones

» **Examples**

- Renewable Energy: Including production, transmission, appliances and products
- Energy Efficiency: Such as in new and refurbished buildings, energy storage, district heating, smart grids, appliances and products
    - Pollution prevention and control: Including reduction of air emissions, greenhouse gas control, soil remediation, waste prevention, waste reduction, waste recycling and energy/ emission-efficient waste to energy
    - Environmentally sustainable management of living natural resources and land use: Including environmentally sustainable agriculture, environmentally sustainable animal husbandry, climate smart farm inputs such as biological crop protection or drip-irrigation, environmentally sustainable



Source: ICMA

Green categories according to CBI



CLIMATE BONDS STANDARD CERTIFIED

CERTIFICATION

Energy

ELECTRICITY & HEAT PRODUCTION

	Asset type	Asset specifics	2 degree compliant	Screening indicator	Certifiable
SOLAR	Generation facilities (power & heat)	Photovoltaic generation facilities (onshore)	●	Facilities shall have no more than 15% of electricity generated from non-renewable sources	●
		Concentrated solar power facilities (onshore)	●		●
	Supply chain facilities	Manufacturing facilities wholly dedicated to onshore solar energy development such as PV cells & components, CSP dishes, troughs & components etc	●		●
		Dedicated storage, distribution, installation, wholesale and retail	●		
	Infrastructure	Dedicated transmission infrastructure	●		●
		Dedicated supporting infrastructure including inverters, transformers, energy storage systems and control systems	●		●

Source: CBI

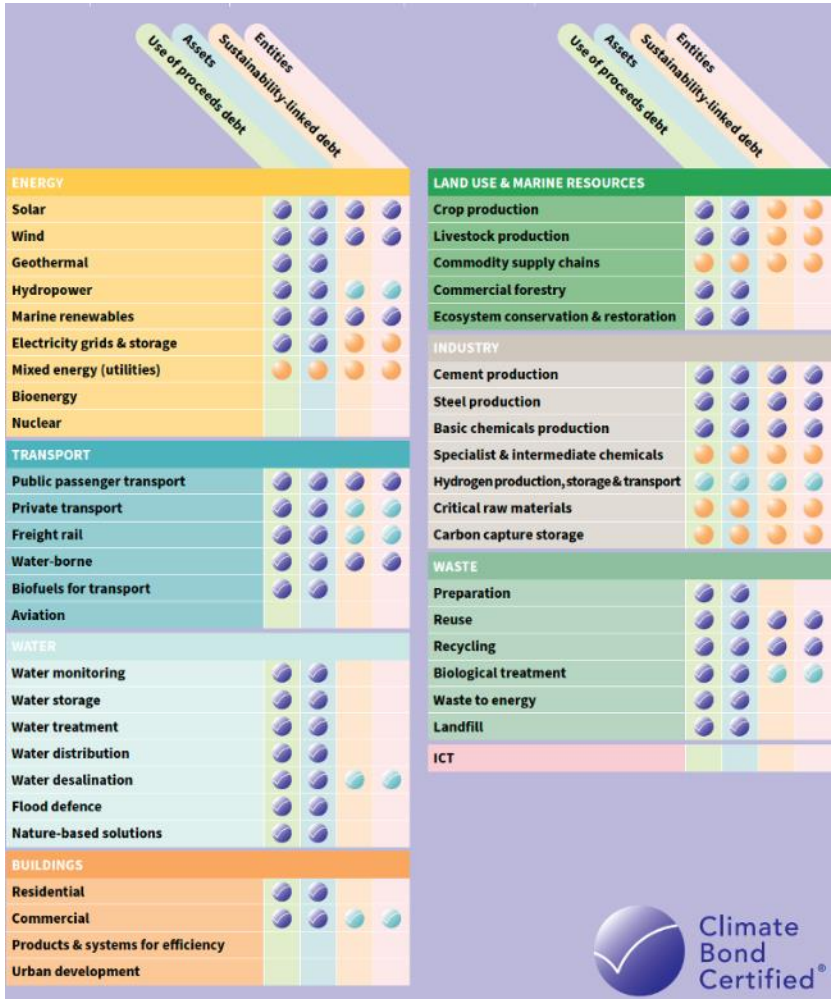
CBI extended certification scheme

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» Following market development, CBI extended its certification services to cover:

- Use of proceeds debt (Green bonds)
- Assets
- Sustainability linked debt (SLBs)
- Entities



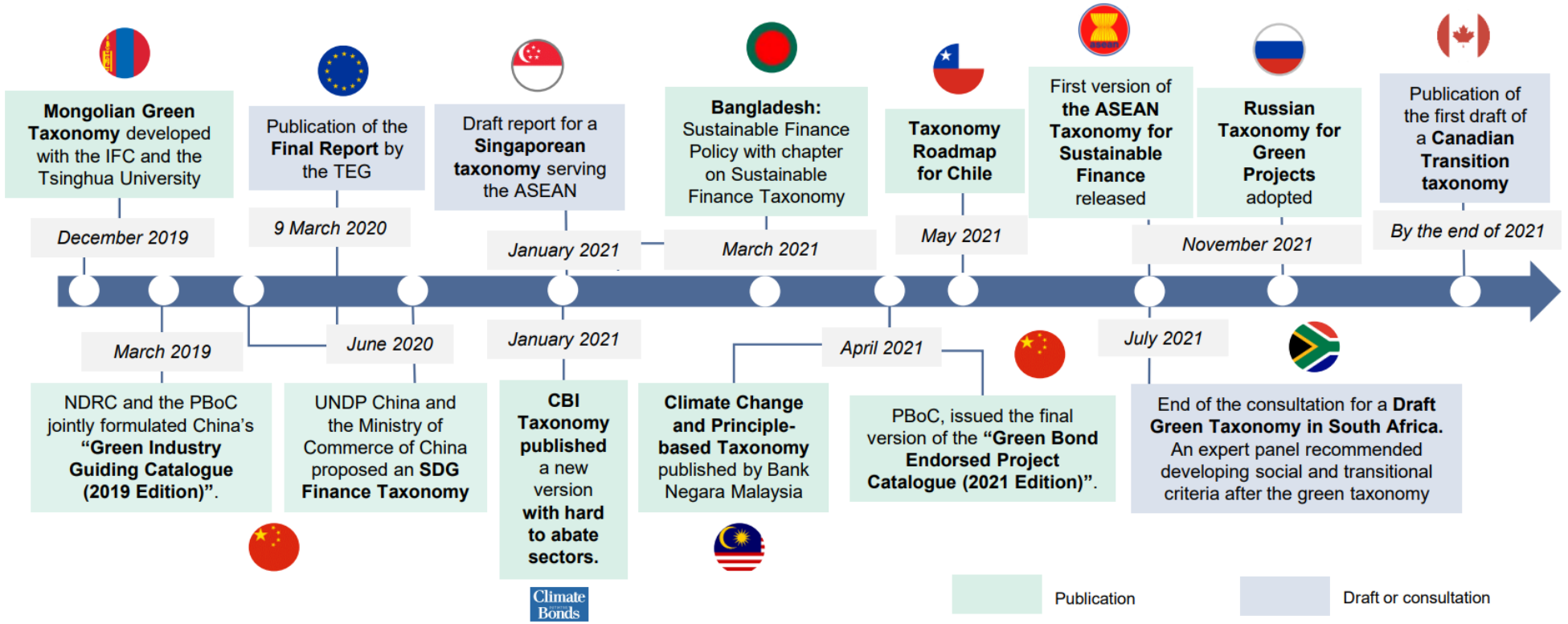


Source: CBI

Taxonomies progress status: 2021

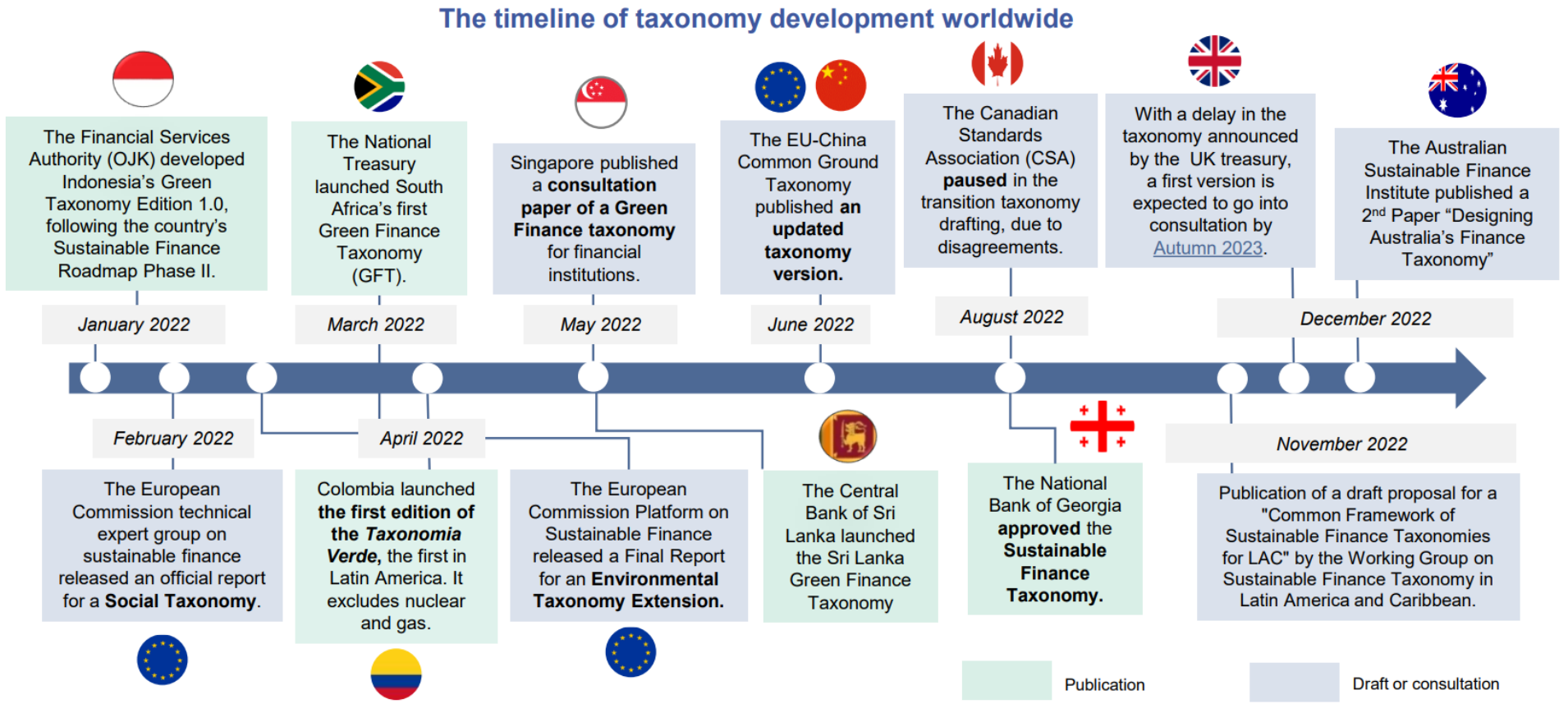
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The timeline of taxonomy development worldwide



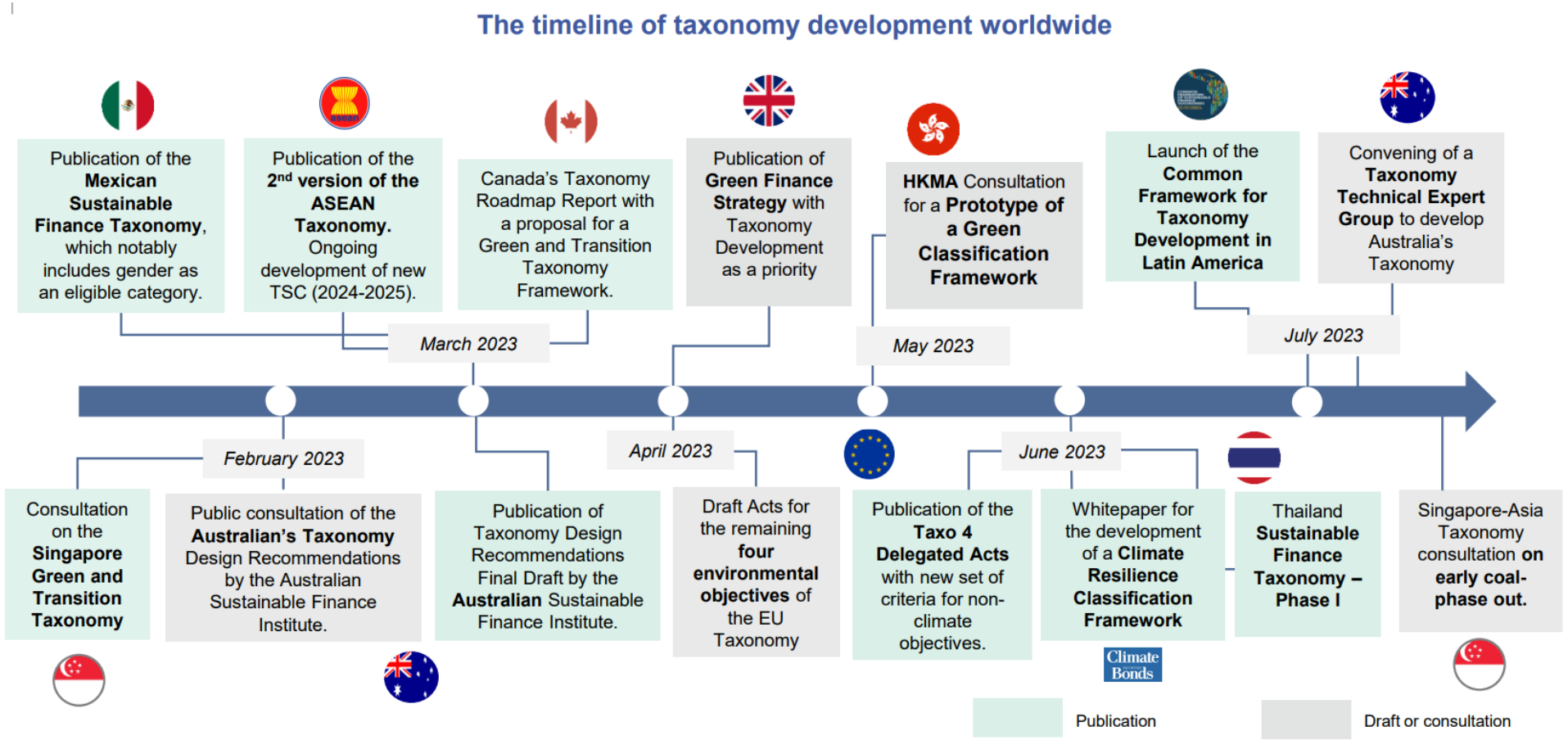
Source: Natixis

Taxonomies progress status: 2022



Source: Natixis

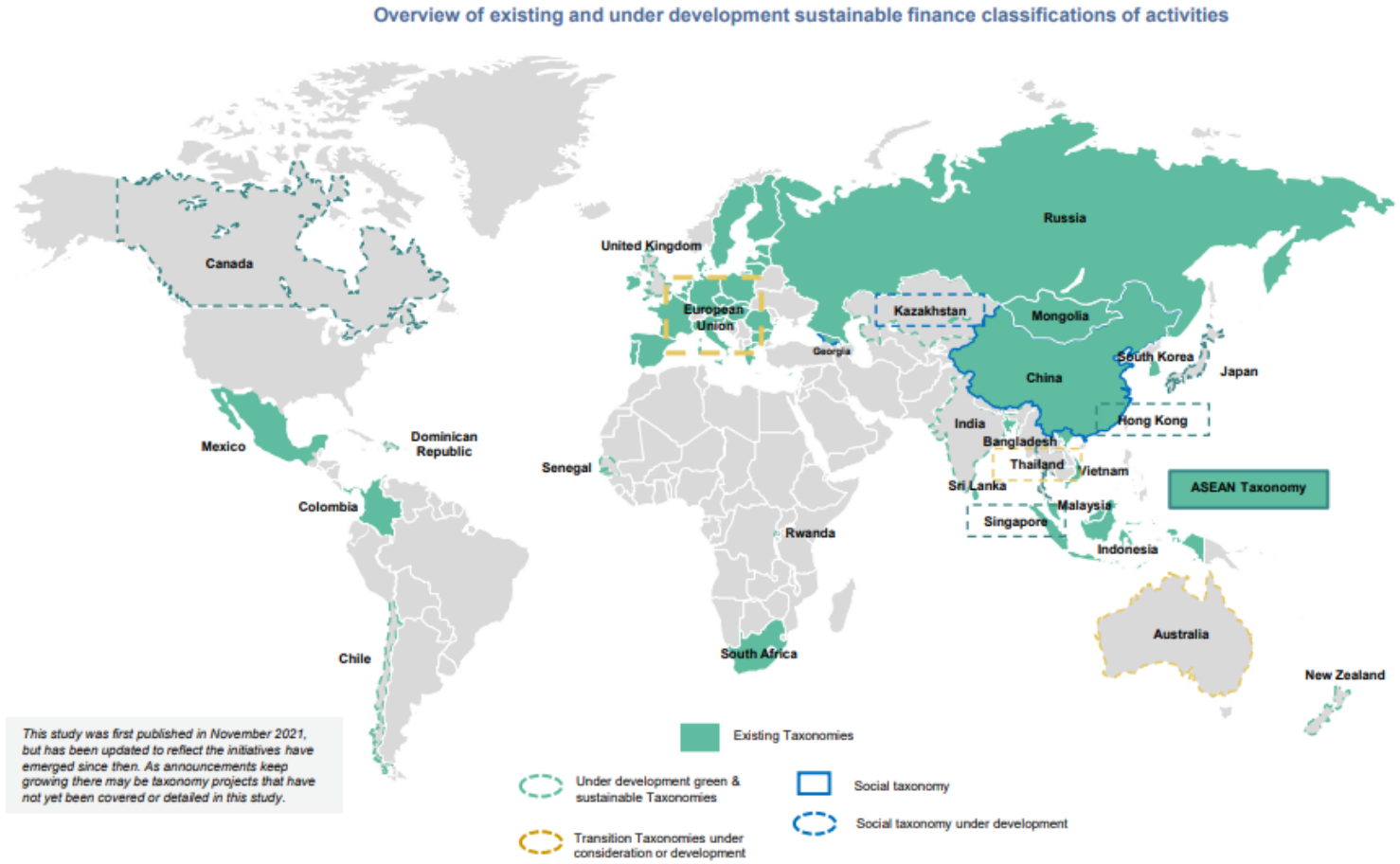
Taxonomies progress status: 2023



Source: Natixis

Multiplication of Taxonomies

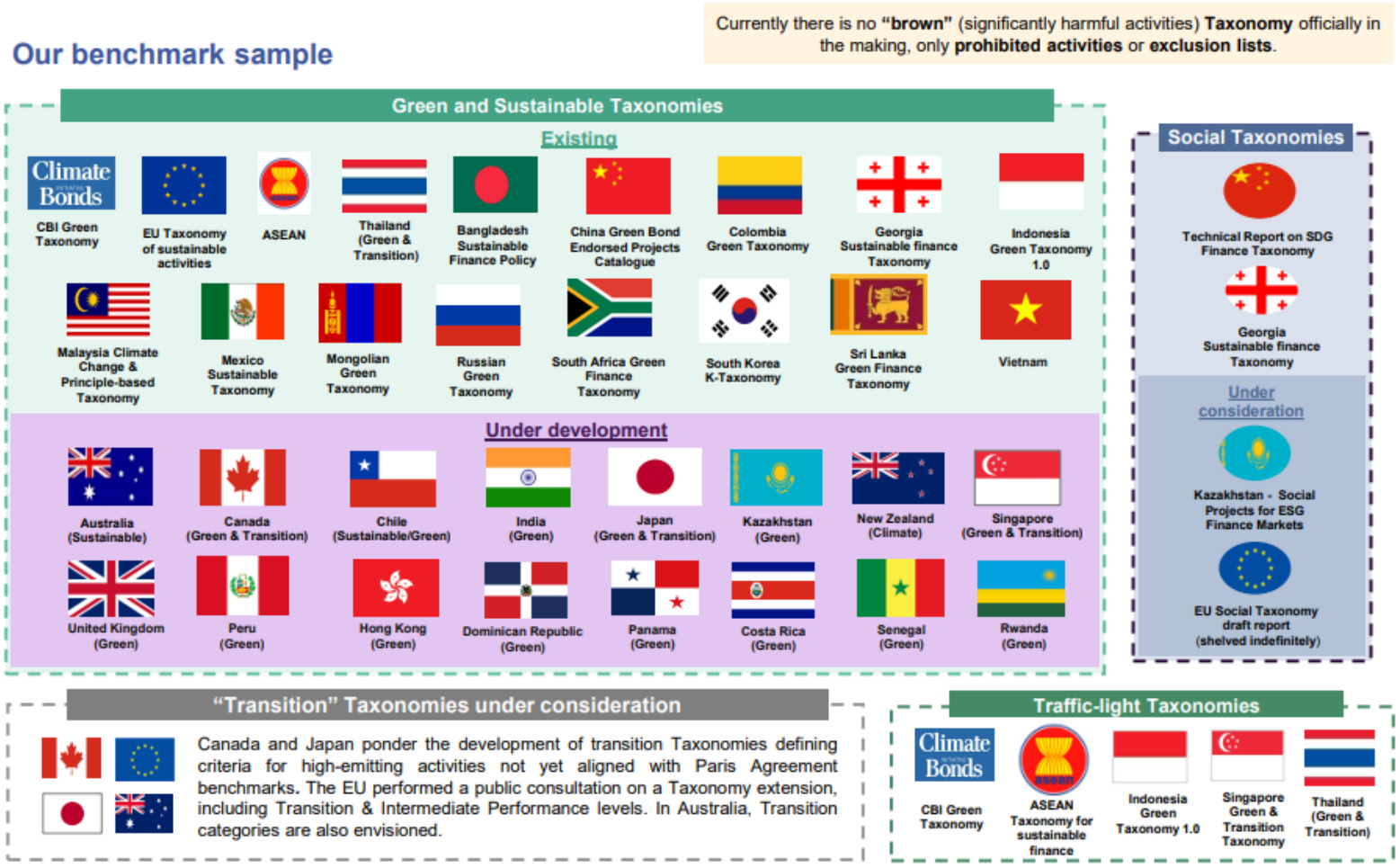
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Source: Natixis

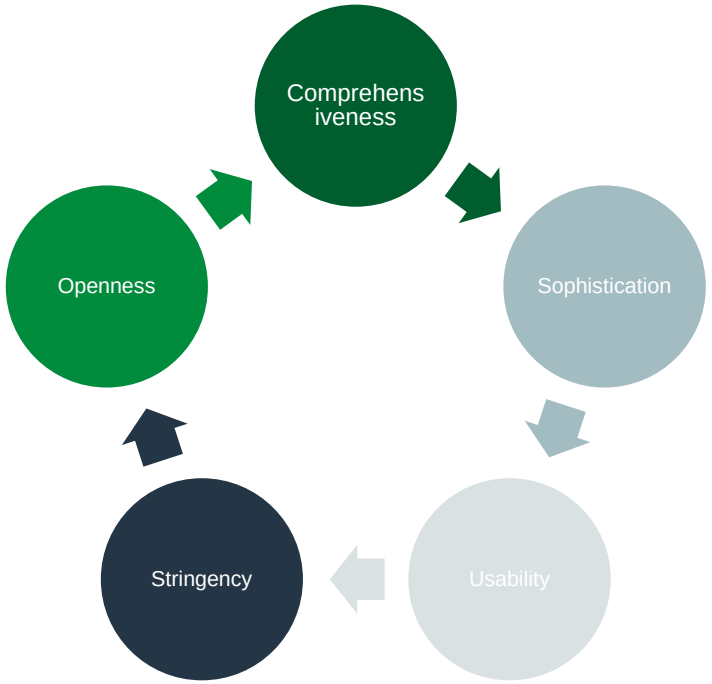
Continuously growing number of taxonomies

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Source: Natixis

Why some taxonomies are more influential



The overall acceptance and Legitimacy of a taxonomy

+

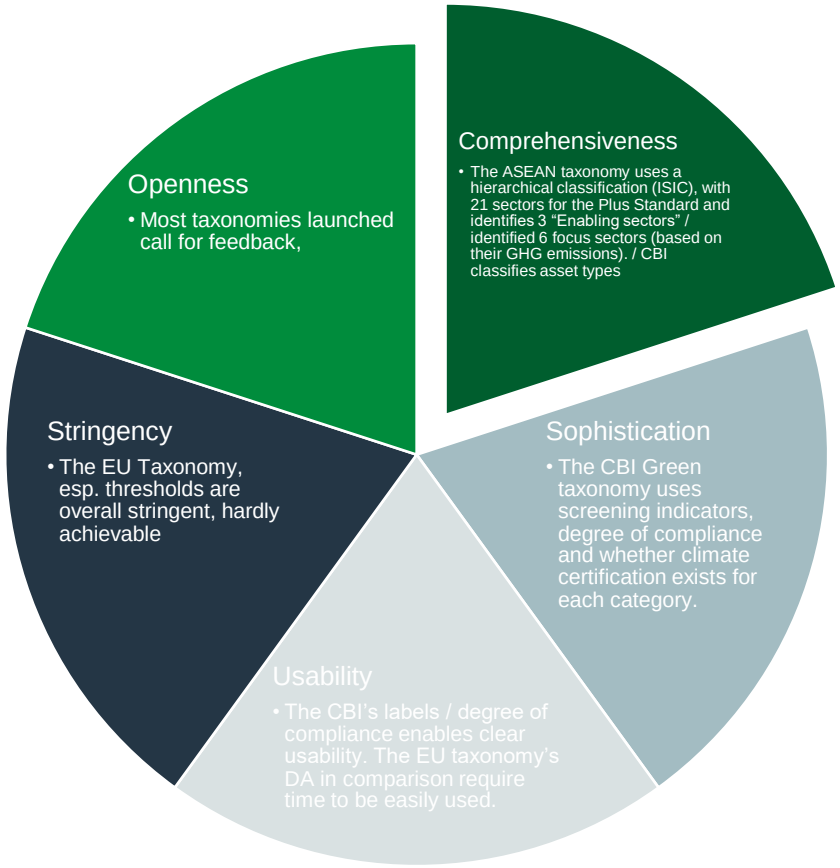
The economic weight of the Taxonomy's jurisdiction and the role played by its currency and law in international business affairs (extra-territorial effects)

=

The global Influence of a Taxonomy

Source: Natixis

Why some taxonomies are more influential



The overall acceptance and Legitimacy of a taxonomy

+

The economic weight of the Taxonomy's jurisdiction and the role played by its currency and law in international business affairs (extra-territorial effects)

=

The global Influence of a Taxonomy

EU Taxonomy of sustainable activities

CBI Green Taxonomy

ASEAN Taxonomy

Three of the most influential taxonomies

Source: Natixis

The EU Taxonomy: What is it (in a nutshell?)

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- The EU Taxonomy is a list of economic activities with performance criteria for their contribution to 6 environmental objectives:
  1. Climate change mitigation
  2. Climate change adaptation
  3. Sustainable use and protection of water and marine resources
  4. Transition to a circular economy
  5. Pollution prevention and control
  6. Protection and restoration of biodiversity and ecosystems
- To be Taxonomy-eligible, an economic activity must go through 4 steps:
  1. Contribute substantially to one or more of the environmental objectives
  2. Not significantly harm any of the environmental objectives
  3. Be carried out in compliance with a minimum safeguards
  4. Comply with technical screening criteria specified by the Commission



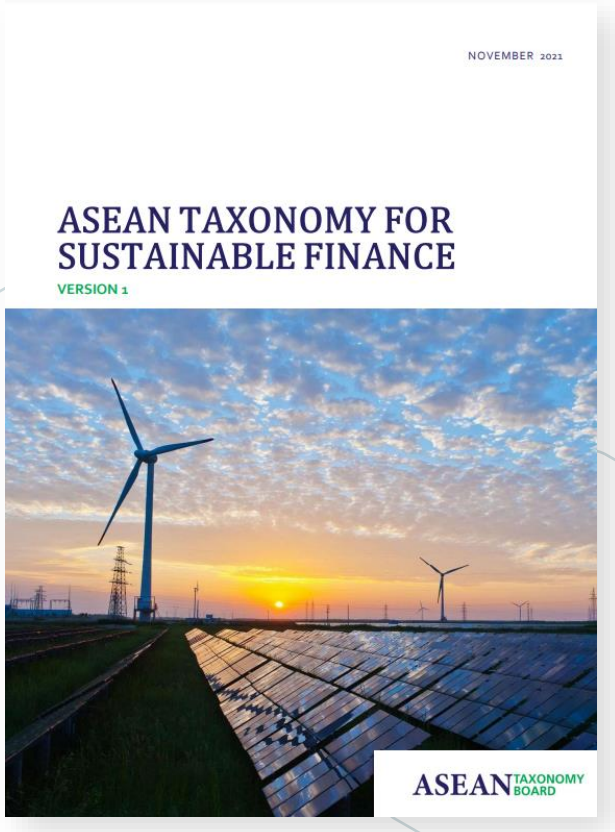
Source: European Commission adapted by LGX

ASEAN Taxonomy for Sustainable Finance

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ASEAN TAXONOMY CLASSIFIES ACTIVITIES INTO GREEN AMBER AND RED

- Released in November 2021
- Principles based, qualitative assessment with metrics and thresholds
- Not legally binding (contrary to the EU Taxonomy)
- 4 environmental objectives with two essential assessment criteria
- Contrary to the binary EU Taxonomy, ASEAN taxonomy takes a multi-tiered approach in classifying activities
- Multiple decarbonisation pathways for each activity to cater for the different starting points of entities



Source: ASEAN TAXONOMY

China Catalogue

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中国人民银行
THE PEOPLE'S BANK OF CHINA

OVERVIEW

» Green bond catalogue issued in 2015 by the People's Bank of China (PBOC) is usually referred to as "a taxonomy"

» Very similar to Western standards

» "Clean Coal" included when launched in 2015.

- Represents the most up-to-date, unified and clear green definitions at the activity and project level in China
- Clarifies which activities are green: Green coal is out since May 2021
- Unifies between PBoC, NDRC (National Development and Reform Commission) and CSRC (China Securities Regulatory Commission) domestic green definitions



REUTERS

China excludes clean coal projects from list eligible for green bonds

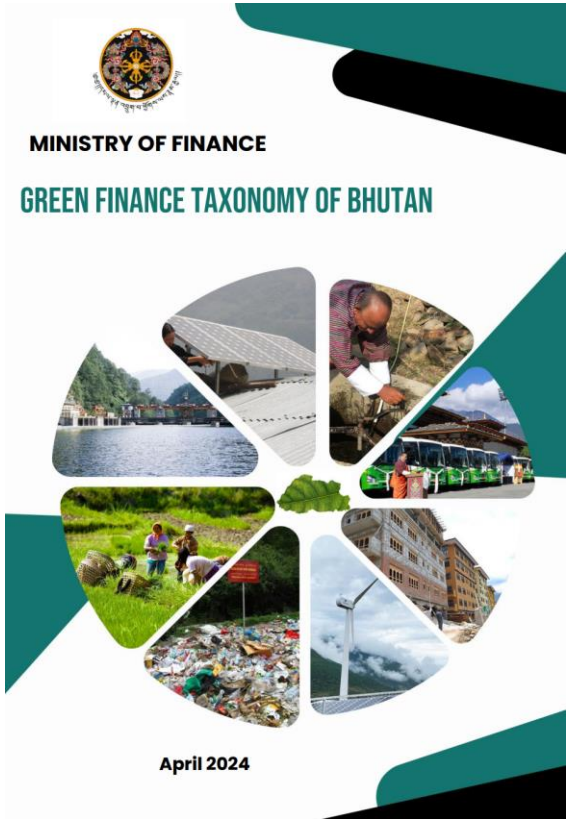
Source: The China catalogue adapted by LGX, IFR , IPSF

Green Finance Taxonomy of Bhutan

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STEPS TO DETERMINE ECONOMIC ACTIVITY ALIGNMENT

- Only activities contributing to Mitigation and Adaptation (further enlargement of the scope)
- Only activities included in the scope of the taxonomy (further updates)
- Technical Screening Criteria
- Do No Significant Harm (To Gross National Happiness)
- Sustainable Financing Framework of Bhutan refers to this Taxonomy to determine green projects eligibility to be financed by Green Bonds



How do you choose which taxonomy to align with?

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FOR A GREEN BOND ISSUER:

- All taxonomies are voluntary in principle
- Chinese issuers align with the PBOC catalogue
- To align with the ASEAN GB standards:
  - An issuer should be from ASEAN region
  - Projects financed by the proceeds to be located in the ASEAN region
- MDBs follow their own climate finance methodology when it comes to climate finance tracking
  - For their sustainable issuances, they follow ICMA's principles
  - EIB is currently aligning with the EU Taxonomy
- The EU Taxonomy is the most stringent
  - Avoid greenwashing



The sovereign thematic bonds (green) issued in Bhutan will have to refer to the taxonomy of Bhutan according to the sustainability finance framework

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International Harmonisation Efforts

International Platform on Sustainable Finance-IPSF

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- Launched together by the EU with the relevant authorities in Argentina, Canada, Chile, China, India, Kenya and Morocco
- Since its launch, Indonesia, Japan, the United Kingdom, New Zealand, Norway, Senegal, Singapore, Switzerland also joined the IPSF
- The ultimate objective of the platform is to scale up the mobilisation of private capital towards environmentally sustainable investments
- It offers a multilateral forum of dialogue between policymakers that are in charge of developing sustainable finance regulatory measures to help investors identify and seize sustainable investment opportunities that truly contribute to climate and environmental objectives
- IPSF “Common Ground Taxonomy” published in September 2021



Source: European Commission

IPSF “Common Ground Taxonomy-CGT”

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MAIN FEATURES

» The technical screening criteria focus on factors that indicate substantial contribution to climate mitigation (only)

» Different scenarios:
- Scenario 1: Areas with clear overlaps
- Scenario 2: EU criteria are more stringent
- Scenario 3: China criteria are more stringent
- Scenario 4: Identifiable overlap
- Scenario 5/6: Unclear overlap or obvious divergence

» Pending activities

» Critics:
- Partial, only mitigation and not covering all sectors
- Does not tackle transition
- EU Taxonomy is not yet complete

The Common Ground Taxonomy is…	The Common Ground Taxonomy is not…
✓ An analysis on approaches of the EU taxonomy and China taxonomy, and the methodology for comparing and identifying commonalities and differences between some features of the two taxonomies	- A legal documentation by the EU and China which entails requirement/obligation for either jurisdiction to change their taxonomy.
✓ An evolving tool that may help different actors to understand the types of activities that could be covered under the respective taxonomies within the scope of the comparison exercise	- A single taxonomy or exclusive definition of environmentally sustainable economic activities covering all environmental objectives, such as biodiversity, pollution prevention, etc.
✓ A technical document for voluntary reference by interested parties within the limits of the scope of the comparison exercise	- Covering all eligibility features or all activities in the EU and China taxonomies as explained in the instruction report.
✓ An analytical tool or reference for other jurisdictions to consider when developing their own taxonomies	- A proposal for international standards or legal document that imposes any global standard on other jurisdictions.

Source: European Commission

IPSF “Common Ground Taxonomy-CGT”

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- Chinese issuers have started labelling their green bond issuances as “CGT aligned
- China Construction Bank took the lead in issuing the first ever offshore Common Ground Taxonomy aligned floating green note in December 2021
- More recently, in June 2022, Bank of China Frankfurt Branch issued the first 3-year 500m USD green bond based on the Common Ground Taxonomy Updated Version

- June 2022: Updated CGT report
- additional activities (e.g. manufacturing and building activities)
- Covers 72 climate change mitigation activities that share common ground for both the European Union and China taxonomies, with regard to the “substantial contribution” criteria
- The updated version of CGT only covers climate change mitigation objective
- Other environmental objectives will be progressively covered in the future

Source: LGX observations, European Commission

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What about non green Taxonomies?

WHAT ABOUT NON-GREEN TAXONOMIES?

Social Taxonomies

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- Sustainability is not limited to environment
- A Social Taxonomy, a classification system stating which activities can be considered to “make a substantial contribution to social objectives”
- 5 jurisdictions have or consider having classification systems around social objectives







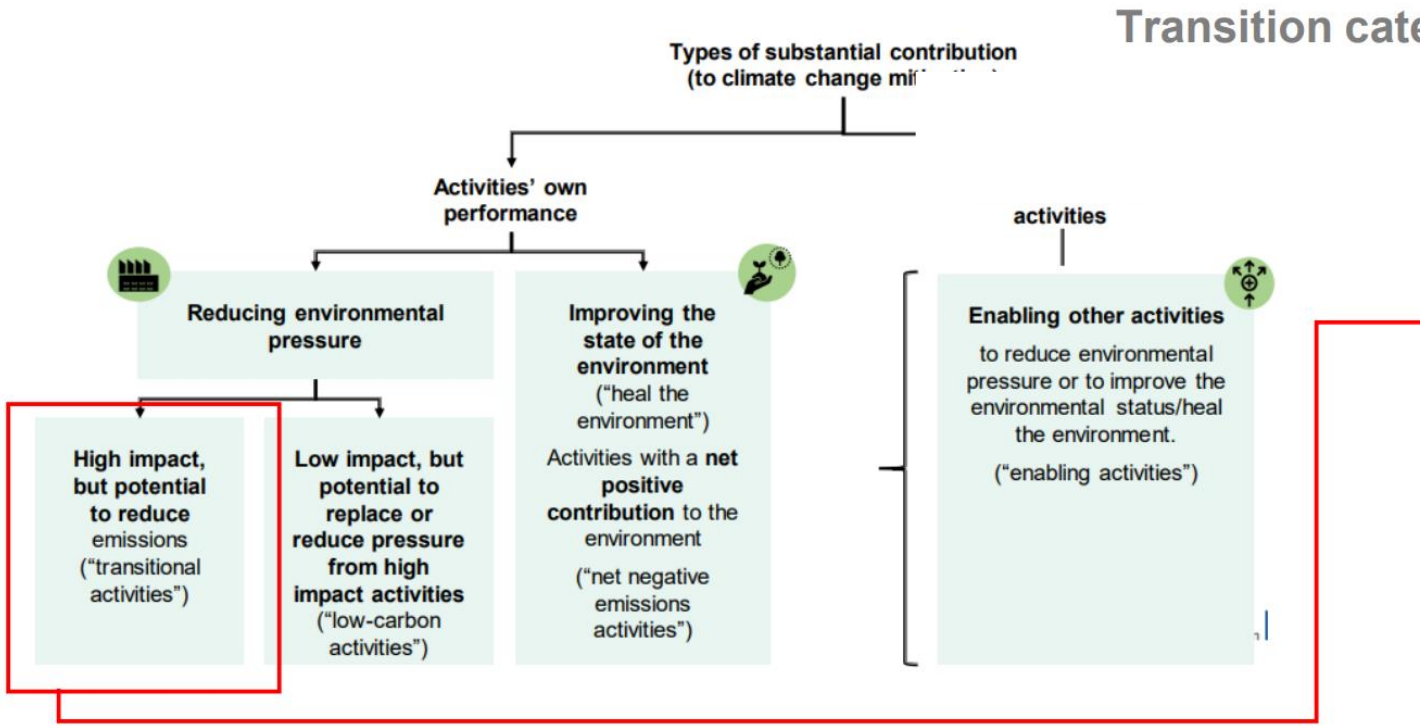
Source: Natixis

Transition Taxonomies

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» Many Taxonomies include elements on transition. They either:

- Categorise Transition activities : EU, South Africa, Vietnam, South Korea, Malaysia, Indonesia



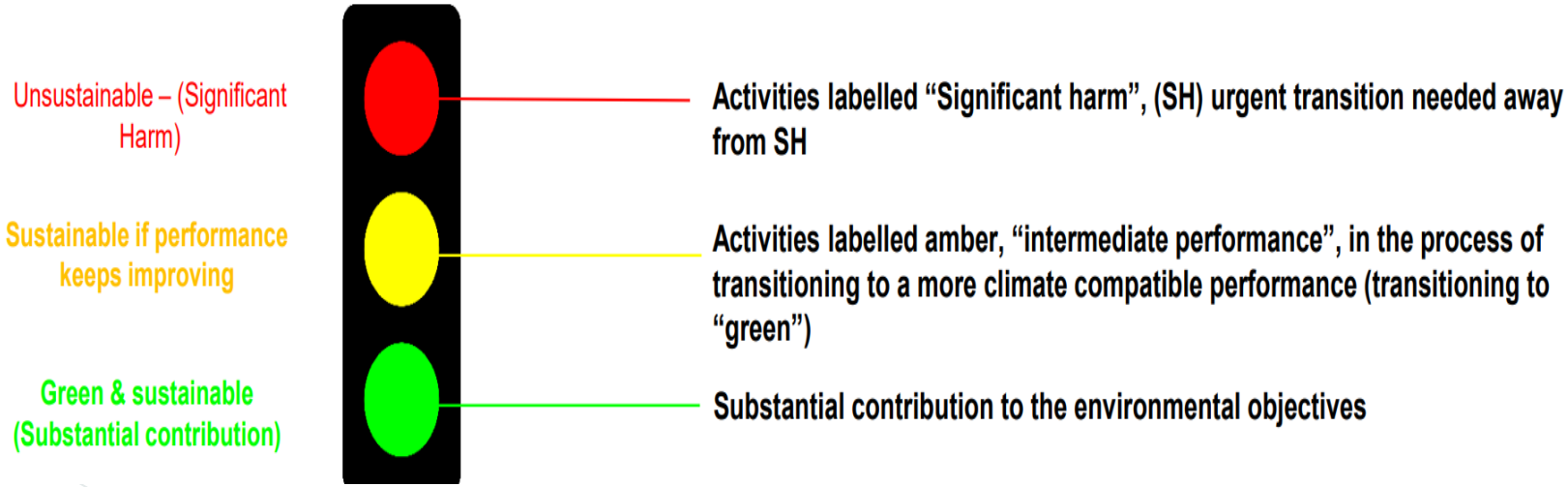
Source: Natixis

Art 10.2 of the EU TR: "*An economic activity for which there is no technologically, and economically feasible low carbon alternative shall be considered to contribute substantially to climate change mitigation as it supports the transition to a climate neutral economy (…)*

Transition Taxonomies

» Many Taxonomies include elements on transition. They either:

- Use a traffic light system : (green, amber, red), with an amber categories usually being used for activities on path to (Singapore, ASEAN, CBI, EU)



Source: Natixis

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The EU Taxonomy in practice

EU Taxonomy compliance: Future requirements

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Compliance Criteria

- Principle
- Metric
- Threshold
  - *Demonstrate emissions reduction*
  - *% emissions reduction*
  - *20% reduction minimum*

Do no significant harm

- Adaptation
- Water
- Circular Economy
- Pollution
- Ecosystems

e.g. an environmental impact assessment must have been undertaken, best available techniques used etc.

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Source: European Commission adapted by LGX

The EU Taxonomy: What it is & what it is not

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THE EU TAXONOMOY IS …

- Flexible to adapt to different investment styles and strategies
- Based on latest scientific and industry experience
- Dynamic, responding to changes in technology, science, new activities and data



THE EU TAXONOMOY IS NOT …

- A mandatory list to invest in
- Making a judgement on the financial performance of an investment – only the environmental performance
- Inflexible or static

Source: European Commission adapted by LGX

The EU Taxonomy: To whom is it addressed?

EU INSTITUTIONS

- EU Institutions
- Public spending frameworks at EU-level
- Setting requirements for financial products and/or for labels & standards
- Reflecting sustainability in prudential rules from a risk perspective
- Support the European Central Bank's policies, especially Taxonomy-based Green Quantitative Easing …

LARGE COMPANIES (6,000 COMPANIES UNDER NFDR)

- Disclosure on alignment of Turnover, CAPEX, OPEX

MEMBER STATES

- Public spending
- Sovereign green bonds
- Green public procurement …

INSTITUTIONAL INVESTORS (E.G. INSURERS, ASSET MANAGERS, PENSION FUNDS) SELLING IN EUROPE

- Institutional investors promoting financial products labelled as ESG or impact
  - Promoting "mainstream" financial products not marketed as green

Source: European Commission adapted by LGX

The EU Taxonomy: Climate change mitigation & adaptation

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CLIMATE CHANGE MITIGATION (70 ACTIVITIES)

- **MITIGATION ACTIVITIES:** Economic activities that make a SUBSTANTIAL CONTRIBUTION based on their own performance, those are activities that are already low-carbon and activities contributing to a transition to a net-zero-emissions economy by 2050
- **Activities ENABLING mitigation:** Economic activities that, by provision of their products or services, enable a substantial contribution to be made in other activities. For example, an economic activity that manufactures a component that improves the environmental performance of another activity

CLIMATE CHANGE ADAPTATION (68 ACTIVITIES)

- **ADAPTED ACTIVITIES:** Economic activity is adapted to all material physical climate risks identified for the economic activity to the extent possible and on a best effort basis
- **Activities ENABLING ADAPTATION of an economic activity**: Activity that reduces material physical climate risk in other economic activities and/or addresses systemic barriers to adaptation and is itself also adapted to physical climate risks

Source: European Commission adapted by LGX

Key features of EU Taxonomy: Do no significant harm

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"DO NO SIGNIFICANT HARM"

- Ensures that progress against some objectives is not made at the expense of other objectives - implicit view that different environmental objectives mutually strengthen each other
- Reflects legal requirements from other EU regulations

Regulations and directives			Guidelines, decisions, practices
Biocidal products regulation	Non-road mobile machinery regulation	Sustainable Use of Pesticides Directive	
Ambient Air Quality Directive	Type-approval requirements for the general safety of motor vehicles	Rolling Stock regulation	**Council decision on limit exposure to electromagnetic fields**
Eco-design Directive	Clean and energy efficient road transport vehicles	Water Framework Directive	**Best Available Techniques (BAT) / EU Best Available Techniques reference documents (BREFs)**
Urban Wastewater treatment Directive	EU F-Gas regulation	Birds Directive	
Regulation on fertilizers/soil improvers for agricultural use	Environmental Impact Assessment (EIA) Directive	Habitats Directive	**EU Waste List**
Landfill Waste Directive	Strategic Environmental Assessment (SEA) Directive	REACH regulation	**Construction and demolition waste management protocol**
Directive on Geological Storage of Carbon Dioxide	**EU Water Legislation**		

Source: European Commission adapted by LGX

Key features of EU Taxonomy: Social safeguards

NEW MINIMUM SAFEGUARDS INTRODUCED TO REFERENCE:

- The UN Guiding Principles on Human Rights
- OECD Guidelines for Multinational Enterprises including the principles and rights set out in the eight fundamental conventions identified in the International Labor Organization's declaration on Fundamental Rights and Principles at Work and the "International Bill of Human Rights"
- More stringent requirements in EU law can also apply



Source: European Commission adapted by LGX

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Thank you!

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