PLATFORM ON
SUSTAINABLE FINANCE

The Extended Environmental Taxonomy:

Final Report on Taxonomy extension options supporting a sustainable transition

March 2022

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Executive summary

A Taxonomy for transitions across the economy

The European Union's original 'green' and sustainable finance Taxonomy ('the Taxonomy') has been developed to provide investors, governments and many other organisations within the EU with a science-based classification system to use in financial decisions responding to the global climate and environmental emergency. Its aim is to provide robust definitions and transparent reporting to support increased finance for activities that substantially contribute to solving climate and environmental crises. The Taxonomy therefore focuses on the performance levels of activities that are making a substantial contribution (SC) to the EU's environmental objectives while doing no significant harm (DNSH) to any of those objectives and meeting minimum social safeguards.

The Taxonomy's substantial contribution criteria can be challenging to achieve because Europe's environmental goals are challenging to achieve, and directing more finance to the green transition is essential. But many sectors of the economy included in the Taxonomy must transition to more sustainable models even if they cannot reach the green performance level defined by the Taxonomy criteria. Moreover, some activities may not be included in the Taxonomy, either because they have no sustainable transition options or because they are low-impact activities. All these activities need specific finance for urgent investment to make the specific transition needed in their case, which can range from activities that must transition away from significantly harmful (SH) performance levels (e.g. inefficient gas-fired power production and conventionally powered vehicles) through to activities with a low environmental impact and no likelihood of making a substantial contribution to environmental objectives (e.g. the provision of accounting services to small businesses or childcare).

The current Taxonomy leaves a wide variety of economic activities non-classified. Some stakeholders may incorrectly interpret this non-classification or "not green" as a negative signal and there are fears that finance would simply dry up for activities that fall outside the current Taxonomy. However, the current design of the Taxonomy does not intend to convey a negative signal over all these other non-aligned or not-included activities, it simply started with the key priority to provide clarity on green classifications at the top end of environmental performance levels.

Since the proposal of the Taxonomy Regulation (TR), it has become increasingly clear that many Taxonomy users could benefit from an extension of the Taxonomy framework to introduce other performance levels. Doing so would enhance transparency and would also allow for more nuanced decision-making and lend wider support to an environmental transition in the whole economy. The Taxonomy Regulation requires the European Commission to deliver a report on the possible extension of the Taxonomy to other economic activities. This report constitutes the Platform's input to the European Commission's forthcoming report under Article 26, and additionally, it provides clear signals to and recommendations for financial markets and other stakeholders.

Over the past 15 months, the Platform has considered the premises, issues and options for and against extending the environmental Taxonomy 'beyond green' to classify a wider range of economic activities. We have consulted with a wide variety of potential Taxonomy users and published our interim report for public feedback. In addition to this work on an extended

environmental Taxonomy: focussing on the six environmental objectives and on transition across all sectors of the economy, the Platform has recently published its proposal for an EU Social Taxonomy, which is compatible and coherent with ideas in this report.

The Platform considers the balance of arguments to be in favour of an extended environmental Taxonomy, which would introduce greater transparency and clarity for investors and ensure market practices are aligned across the EU. In fact, the current Taxonomy already defines different performance levels and allows financial market participants and institutions to apply them voluntarily. However, it does not clearly label these levels or make them easily applicable by markets and other financial actors. An extended Taxonomy framework therefore offers the opportunity to improve communication between Taxonomy users; it can also inform the further development of sustainable finance policy instruments under the EU's Sustainable Finance agenda, e.g. by helping to define the non-green share of funds and credit portfolios. From a Taxonomy design perspective, it is possible to have a Taxonomy that does one thing well, such as clarifying what constitutes a green, substantial contribution to environmental objectives. It is also possible to have a Taxonomy that does that and more, such as robustly describing different environmental transitions by referencing different performance levels. This is what an extended Taxonomy can help achieve. However, as the Platform's consultation shows, there are trade-offs which must be considered as well, particularly the higher level of complexity of the extended Taxonomy framework for the different economic actors, the costs of additional reporting obligations and the potential reputational risks linked to the increased clarity on non-aligned disclosure, all while the original Taxonomy is just starting to be used and before the impact of its use can be formally assessed.

Ultimately, Sustainable Finance and the Paris-alignment of all finance flows (as per Article 2.1.c. of the Paris Agreement) require greening in the entire economy, recognising that different sectors and different countries will have different starting points and different transition potential. In Taxonomy terms, the way to recognise these different transitions is to describe the contribution of economic activities accurately, based on how they relate to environmental objectives, and describe what level of environmental performance change can be achieved through the use of sustainable finance and wider transition finance. The wrong way to go about this would be to call every activity and every transition 'green', as this would add little to clarifying the financing and economic transition needed to meet a given environmental objective. Many activities have urgent reasons to be supported, accelerated and stepped up — such as vaccine development in response to a global pandemic or support for elder care — but the fact that these activities and actions are important does not make them green, and they should not be labelled as such.

A Sustainable Finance approach, when addressing environmental objectives, must of course robustly define and incentivise finance for all those activities that can substantially contribute to solving the global climate and environmental crises, but the above-mentioned wider understanding of sustainable finance and the Paris alignment of finance flows demonstrate that it should also:

- define and incentivise opportunities for finance to urgently transform activities which can improve but are (based on their current level of performance) causing or worsening climate and environmental crises;
- define those activities that cannot transition and for which the only action compatible with environmental goals would be mobilising finance for exiting/decommissioning/shutting down those activities — along with robust measures needed for the people and economies dependent on those industries;

- incentivise finance for all parts of the economy to improve environmental performance to secure an aggregate benefit, even when the individual contribution of assets or activities might suggest that their contribution is, in general, not substantial.

This wider discussion of environmental transition and transition finance is developing in the global markets and in international discussions, such as in the International Platform on Sustainable Finance and in the G20 Sustainable Finance Working Group. The need to recognise transitions that are not environmentally green in their own right was highlighted by the Commission's recently adopted Complementary Delegated Act (CDA). The CDA addresses one sector (energy) and one objective (climate change mitigation), and it proposes criteria for economic activities (gas and nuclear energy) that should improve their environmental performance in the future, recognising that they are not green today, and taking a systems-wide approach to the low-carbon transition. The extended Taxonomy framework, with its focus on use of the existing 'do no significant harm' (DNSH) concept and criteria that are already laid down in the Taxonomy Regulation and Climate Delegated Act, would provide an alternative approach to defining how these activities fit within economic activities in transition. The extended Taxonomy framework would acknowledge the reasons why these activities are not green, and the criteria that demonstrate that, explaining why, in some cases, these activities may be significantly harmful, but also showing that there is potential for valid and urgent transitions away from significantly harmful performance. This extended framework for transition can then feed into the ongoing international discussions mentioned above, supporting similar thinking in other jurisdictions.

However, the concepts of the extended Taxonomy go far beyond energy transition and extend much wider than the low-carbon transition. It is essential that a usable extended Taxonomy framework addresses all six environmental objectives and all parts of the economy, as the need for urgent transition cuts across all those objectives, looking at all sectors. In every system in transition, there are individual activities, some of which may be helping solve the environmental problem, some of which may be causing significant harm and need to be decommissioned or transitioned urgently, and some of which are between these two performance levels. An extended Taxonomy framework clarifies which activity, depending on its performance level, fits where, and hence what its transition should be within the overall system transition. Importantly, the extended Taxonomy framework provides a framework based on already existing parts of the Taxonomy for the identification and support for much wider transitions across the economy in many high-emitting, hard-to-abate sectors, and also for transitions in terms of climate resilience needed across the whole economy, and for the avoidance of significant harm to biodiversity and other EU environmental goals.

There are broader arguments as to why investment in these activities may still be required, particularly to support them to urgently transition to a more sustainable level of performance. An extended Taxonomy framework with a more nuanced approach to recognising activities at different performance levels could therefore prove useful to ensure these non-green investments are labelled clearly and transparently.

The Platform is therefore recommending to extend the Taxonomy framework to classify activities as follows:

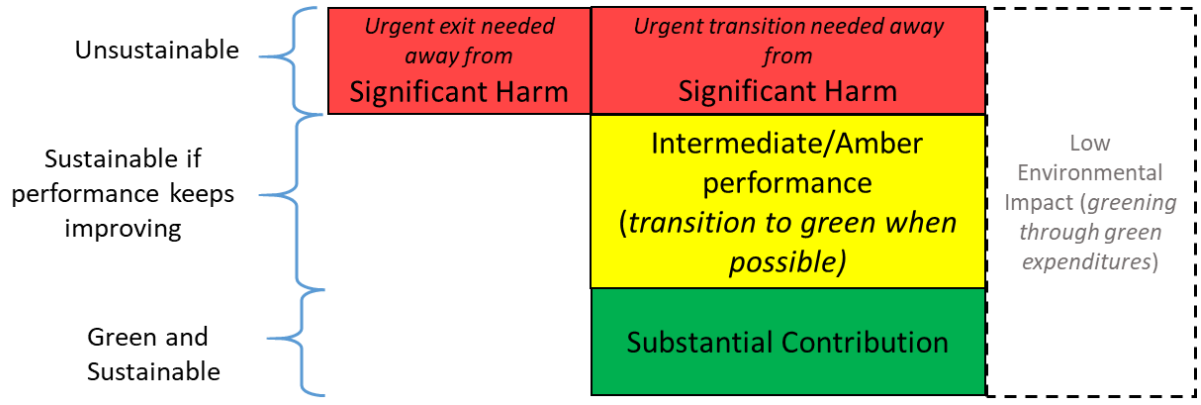
- **Unsustainable performance requiring an urgent transition to avoid significant harm:** These are activities that need to be improved urgently and could qualify for Taxonomy-recognised investment as part of a transition plan to avoid their current significantly harmful performance and move to intermediate performance levels.
- **Intermediate (or Amber) performance:** These are activities that operate between significantly harmful and substantial contribution performance levels and could qualify

for Taxonomy-recognised investment as part of an **intermediate/amber transition** plan under which they continue to improve to stay out of significantly harmful performance.

- **Unsustainable, significantly harmful performance where urgent, managed exit/decommissioning is required:** These are activities that cannot be improved to avoid significant harm and will therefore remain always significantly harmful (ASH) and should be prioritised for Taxonomy-recognised transition investment as part of a decommissioning plan with a Just Transition effort.
- **Low environmental impact (LEnvI) activities:** These are activities that do not have a significant environmental impact and should not be regarded as either red, amber or green. This could allow enterprises or entities to show that their overall activities, while not considered green, do not cause environmental or social harm. It could also enhance their environmental credibility by ensuring that an entire portfolio, with a number of non-green investments, does not cause significant environmental harm. This classification should also encourage 'LEnvI enterprises' to access green Taxonomy-aligned finance for their green investments and expenditures.

The Platform highlights the importance of urgent transition pathways and the need for clarity on the dynamic nature of the environmental transformation required, such that finance for the transition is needed in most of the economy. It therefore recommends the extension of the Taxonomy in all of these extensions but with a priority on the first three in this list, focussing on activities supporting urgent environmental transition.

Diagram 1. Simplified graphic showing how an extended environmental Taxonomy fits across the whole economy



The Taxonomy already exists, different environmental performance levels are laid out within it already and markets and investors and others are already using it, including the DNSH criteria.[1] There may be concern then that large parts of the EU economy may be seen to "fail" a DNSH test, which may well be true for example for DNSH to climate change adaptation. Labelling the transitions that relate to these different performance levels is therefore urgent, so as to show where finance needs to flow to support transitions away from that environmental

[1] For example, DNSH technical screening criteria for climate objectives are referenced as the baseline for the 2020 Paris alignment approach for new operations of the European Investment Bank. See: The EIB Group climate bank roadmap 2021-2025.

performance. In the aforementioned case of adaptation, this would finance for investments to transition to improved climate resilience. For this, guidance and positive examples are needed which should be simple and usable. The dynamic nature of the Taxonomy, with many criteria requiring regular review, must also be taken into account in this guidance and in the examples. This dynamic aspect is particularly important, as innovative responses to the urgency of the climate and environmental crises may well drive faster change in many sectors than we can currently anticipate, as lower-carbon, more circular and more nature-based solutions develop.

At the same time, it is clear that whilst use of the DNSH criteria that work well for this purpose — quantitative and process-based criteria — can start without delay, the review of DNSH criteria for usability and ambition levels, which is strongly needed for the operationalisation of the Green Taxonomy, should additionally include the aspect of their use for the wider Taxonomy framework and the usability aspects specific to that wider use. This is important if an extended Taxonomy, and indeed the Green Taxonomy, is to reach its full potential.

Introducing these additional performance levels over time, starting with voluntary reporting, would allow entities in impactful industries to tell their transition stories and access finance for the necessary transition investment programmes. Future reporting obligations and approaches could be assessed based on this voluntary use by feeding into a reporting options analysis and into an impact assessment, also taking stock of the parallel implementation of the current framework. This would help ensure future reporting coherence, aiming to avoid overburden when formally bringing in the wider Taxonomy framework, noting that the performance levels already exist in the Taxonomy and future reporting requirements would provide users of the Taxonomy with a more detailed and granular view upon which to make decisions and increase transition finance.

Noting that more than one-third[2] of the European economy is based on activities that are unlikely to be included in an environmental Taxonomy for many years, if ever (these are largely service industries such as financial services, legal services, travel services, health services and education), the Platform also believes that the identification and then voluntary reporting of such low environmental impact activities would allow them to have full access to green finance through their green expenditures. Additionally, by identifying them, together with the activities that are always harmful and need urgent action for exit or decommissioning, a clear picture would then be painted of residual economic activities, clarifying those remaining industries and activities that will need to be included in the Taxonomy in the next few years. Some of these low environmental impact activities might be included in a future Social Taxonomy, but the current need, which we believe can be addressed in the first instance by voluntary reporting, is to ensure in a robust way that these activities do not get muddled with the rest of the non-green activities, which are far more impactful in environmental terms.

The Platform considers that clarity and a wider understanding of these additional performance levels will allow for more informed discourse about the investment in transitional activities (which are already included in the current, green Taxonomy), and in environmental transition more generally, as part of a plan to achieve the EU's environmental objectives. Importantly, we expect it will remove the fear held by some that 'not green' is a negative signal that requires no finance at all. In fact, exactly the opposite is true. Clarification of these wider concepts of transition finance and on the wider Taxonomy framework, including a future Social Taxonomy, would also help in the future by making interconnections with other parts of the EU Sustainable Finance framework, including investor sustainability preferences, future benchmarks and,

[2] Estimated based on data available from Eurostat.

product and instrument labels and standards etc. Voluntary action on this proposal could start immediately, noting that markets can get started using these concepts based on the Climate DA already in law, where criteria are clear, quantitative or process based, progressing through examples, guidelines and voluntary reporting, including through, for example, “Amber” use of proceeds instruments and other market-driven approaches. This voluntary phase can give markets, companies and investors the opportunity to use these concepts, and this can then lead to a future assessment of reporting options, proceeding to the formal creation of the wider framework through legislative steps following the necessary impact assessments.

An extended environmental Taxonomy is intended to increase TRANSPARENCY across the entire economy, ranging from green, to low environmental impact, to activities in urgent need of transitioning, to activities to be discontinued. This transparency will help companies and other economic actors tell their own transition stories whilst robustly ensuring that clarity is brought to bear on what really makes a substantial contribution, what makes a lesser but important contribution, and what is actually causing the problem, where urgent action is needed.

In summary, the Platform recommends:

- Extending the environmental (‘green and sustainable’) Taxonomy with priority on extension to activities supporting urgent environmental transition;
- Defining key parts of an extended Taxonomy;
- Identifying further economic activities with no technological possibility of improving their environmental performance;
- Clarifying that significant harm is the same concept whether it requires an urgent transition or an urgent exit;
- Extending the Taxonomy with a transition focus and with coherent supporting policies;
- Naming the Intermediate (or ‘Amber’) Performance space, acknowledging ‘’Intermediate’’ or “Amber” transitions;
- Aiming for a rapid phasing in of an extended Taxonomy;
- Technically assessing DNSH criteria for clarifying environmental performance levels requiring urgent transition and intermediate performance levels;
- Defining intermediate transition, corresponding investments and plans;
- Technically identifying and developing criteria for activities that have no technological possibility to transition away from a significantly harmful performance level;
- Establishing how a low environmental impact (LEnvI) Taxonomy extension could potentially be created with NACE[3] code analysis and voluntary guidance.

For a full list and description of the Platform’s recommendations, please see Section 8.

[3] Statistical Classification of Economic Activities in the European Community

Glossary

ASH: Always Significantly Harmful

CC: Climate Change

CSRD: Corporate Sustainability Reporting Directive (Previously NFRD)

DA: Delegated Act

DNSH: Do No Significant Harm

EFRAG: European Financial Reporting Advisory Group

ESG: Environmental, Social and Governance

EU GBS: EU Green Bond Standard

GHG: Greenhouse Gas

IP: Intermediate Performance

LEnvI: Low Environmental Impact

M(S)S: Minimum (Social) Safeguards

NACE: Statistical Classification of Economic Activities

PAI: Principle Adverse Impact

SC: Substantial Contribution

SFDR: Sustainable Finance Disclosure Regulation

SH: Significantly Harmful/Significant Harm

TCFD: Task Force on Climate-related Financial Disclosures

TR: Taxonomy Regulation

TSC: Technical Screening Criteria

TWG: Technical Working Group

1 Introduction to the EU Platform on Sustainable Finance

The EU Platform on Sustainable Finance ('the Platform') is a permanent expert group of the European Commission.[4] It incorporates a balanced representation of sustainability experts from EU organisations, the financial industry, the corporate and public sector, as well as academia and civil society. Its role is to advise the Commission on tasks and topics related to the implementation and further development of the EU Taxonomy.

The Commission asked the Platform to work on a possible extension to the Taxonomy, beyond green, to classify a wider range of activities. In particular, there is interest in activities that are significantly harmful to environmental sustainability, activities with intermediate environmental performance levels and activities with low environmental impact, informing the Commission report according to Article 26 para. 2 (a) of the TR.

The Platform would like to emphasise that the Taxonomy is a naming and classification system that aims to provide a clear, consistent and scientifically informed terminology for use throughout the EU. The Platform's view is that any possible extension should be seen as a way to better direct investment towards companies and organisations requiring additional help to achieve an urgent transition towards more sustainable activities. The 'polluter pays' principle should remain in place, but a carefully structured and scientifically sound extension may offer stakeholders a common language through which to debate the optimal means of achieving Europe's climate and environmental ambitions.

[4] The Platform is established under Article 20 of Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ L 198, 22.6.2020.

2 Purpose of this report

This report responds to the Commission's request for advice from the Platform on possible extensions of the EU Taxonomy on green and sustainable finance. The purpose of this report is to inform the Commission, capital markets, companies and other economic actors and stakeholders on the ways in which an extended environmental Taxonomy can become a Taxonomy for transitioning the whole European economy. When read together with the Platform's report on a future Social Taxonomy,[5] this report presents a fuller picture of how the Taxonomy can and should develop in the near future to signal and support financing of the most urgent transitions needed.

The Platform has considered the premises, issues and options for and against extending the EU Taxonomy 'beyond green' to classify a wider range of economic activities that include:

- Activities that must urgently transition, or exit, away from Significantly Harm (SH)
- Intermediate Performance (IP) ("'Amber" transition) activities;
- Low Environmental Impact (LEnvI) activities.[6]

The Platform has prepared this report by taking into account the latest environmental science, IPCC reports, and the EU's own legislated climate targets, plus the most recent scientific information on biodiversity loss, pollution and the perilous state of the natural world on which humans depend. The report is intended to support ambitious climate, environmental and social action that responds appropriately to the 'code red for humanity'[7] climate emergency facing us, as well as the critical status of the environment. The report takes note not only of longer-term goals, such as netzero by 2050, but also the need for finance for urgent transitions in this critical decade to 2030, such as the 55% greenhouse gas (GHG) reduction goal, the EU biodiversity targets for 2030 and others.

The report relates primarily to Article 26.2(a) of the Taxonomy Regulation[8] which requires the Commission to publish a report describing the provisions that would be required to extend the scope of the regulation beyond the economic activities that do not have a significant impact on environmental sustainability and economic activities that significantly harm environmental sustainability. The Platform has interpreted its brief to address environmental sustainability by taking into account the six environmental objectives of the Taxonomy Regulation. However, with this report, the Platform, beyond the scope of Article 26.2(b) of the Taxonomy Regulation, aims to provide advice that can accelerate investments targeting urgent sustainable improvement in environmental performance in a way which secures a prosperous future for Europe's economy and society.

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[5] See Report of the Platform on Sustainable Finance on Social Taxonomy, 28 February 2022, available here: 4.

[6] Previously referred to as 'no significant impact' (NSI) activities, note that this change does require the climate change adaptation objective, which can be equally important for activities with a significant environmental impact and those without, to be addressed separately.

[7] See: UN secretary-general calls latest IPCC climate report 'code red for humanity', stressing 'irrefutable' evidence of human influence, Meetings Coverage and Press Releases (un.org).

[8] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, OJ L 198, 22.6.2020.

In early October 2021, the Commission also asked the Platform to provide more specific advice on key matters, including:

1. The provision of more practical examples of how activities already covered in the Climate Delegated Act[9] would be affected by a possible extension.
2. An analysis of usability aspects, including:
   - A consideration of how extension options could interact with existing EU standards and labels;
   - An exploration of links to other relevant Commission initiatives, including the EU Green Bond Standard (EU GBS), Article 8 Delegated Act[10] reporting, Corporate Sustainability Reporting Directive (CSRD) and EFRAG work, the Sustainable Finance Disclosure Regulation (SFDR) disclosures and the proposal for a Directive on corporate sustainability due diligence; and
   - Advice on different mandatory and voluntary reporting options and what can be further done to address usability given the amount of public feedback dedicated to these aspects.
3. The consideration of links to the July 2021 Strategy for financing the transition to a sustainable economy.[11]
4. Further advice on some aspects of the Platform's Transition Finance report, including:
   - More analysis on sectoral pathways and transition plans (both corporate and activity levels) and further work on the envisaged SG3[12] report annex on transition plans;
   - Better links to the 'transition finance' policy area, including options for recognising intermediate performance and incentivising the financing of credible transition efforts, including through links to transition bonds; and
   - Inputs related to the 'resilience and contribution' policy area, including links to double materiality and alignment of the financial sector with sustainability targets.

The Platform assessed these wide-ranging additional questions, and in discussion with the Commission determined certain areas of further work until January/February 2022. These areas were:

- Work on EU legislative interlinkages;
- Further sectoral activity examples of Amber transition;
- Financial examples of extended Taxonomy use in practice;
- Identification of other similar extended Taxonomy concepts;
- More detailed implementation approaches.

[9] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives, OJ L 442, 9.12.2021

[10] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation

[11] See: Strategy for financing the transition to a sustainable economy, European Commission (europa.eu).

[12] The Platform on Sustainable Finance is organised in different subgroups, and subgroup 3 (SG3) is the subgroup that has worked on the topics covered by this report.

This report sets out the Platform's advice to the Commission in these focus areas in response to the additional requests as well as the Platform's work up until September 2021 on its original mandate on these topics, informed by its outreach and public consultation undertaken during 2021. This Report is expected to also be of interest to markets, companies and other entities and stakeholders who are interested in the concept of a wider environmental Taxonomy, including the international and global markets discussions on these topics.

3 Why extend the Taxonomy?

3.1 The present EU Sustainable Finance or 'green' Taxonomy

The EU Taxonomy is a classification system to identify economic activities that achieve performance levels making a 'substantial contribution' to at least one of six environmental objectives[13] whilst ensuring that the activity will 'do no significant harm' (DNSH) to any of the other five objectives and also meet minimum safeguards (Article 3 of the Taxonomy Regulation). Such activities with a level of performance meeting the relevant technical screening criteria (TSC) thresholds for 'substantial contribution' and 'do no significant harm' are referred to as 'Taxonomy-aligned' or 'green'. The purpose of the Taxonomy is to increase financial flows towards green activities and avoid green-washing by setting science-/evidence-based criteria for different categories of performance.

Activities considered most environmentally impactful and with the most impact-reduction potential have been prioritised for the Taxonomy, and related technical screening criteria defining 'substantial contribution' and DNSH performance thresholds for each of those activities are established in Delegated Acts adopted by the Commission. At the time of writing, the first (Climate) Delegated Act had been published in the Official Journal of the European Union,[14] covering the objectives of climate change mitigation and climate change adaptation, while a complementary Delegated Act, covering economic activities related to nuclear and fossil gaseous fuels, has been adopted by the European Commission[15] and is subject to scrutiny from the European Parliament and the Council. At the time of publishing this report, work is on-going to identify activities and TSCs for the remaining four environmental objectives, as well as work proposing criteria for some further activities for the two climate change objectives, which is being carried out by the Technical Working Group (TWG) of the Platform. A report on this work is expected to be published by the Platform at the end of March 2022.[16]

The Taxonomy, as described in the Action Plan for Financing Sustainable Growth (2018)[17], is the cornerstone of a larger framework for EU sustainable finance involving several interlinked regulations and actions on sustainable finance products, disclosures and reporting requirements, which reference the Taxonomy. Other EU policies refer to the Taxonomy as a benchmark for identifying green financial products and environmentally sustainable activities. The ambition of the EU Taxonomy is to become the gold standard for green finance, not just

[13] The six environmental objectives covered by the taxonomy are: climate change mitigation; climate change adaptation; the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems.

[14] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021, available here.

[15] Commission Delegated Regulation amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities, C/2022/0631 final, available here.

[16] Add link for the TWG Report

[17] COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan: Financing Sustainable Growth. Available here.

in Europe but also in international Taxonomy efforts. In addition to the environmental Taxonomy focused on the six environmental objectives, the Platform has recently published its report on a proposal for an EU Social Taxonomy, which is compatible and coherent with ideas in this report.

3.2 The 'binary classification' problem

In its frequently asked questions document (Q&A europa.eu), the Commission underlined that the Taxonomy covers activities that are both 'green' and sustainable but that activities that are not 'green' are not necessarily unsustainable. The current design of the Taxonomy is often, however, misinterpreted as binary. As a result, activities unable to report being green may mistakenly be considered by some users as environmentally 'unsustainable'. In reality, the Taxonomy is not binary, but rather it only allows activities meeting its high standards of environmental performance judged against objective criteria to be classified as green. Taxonomy-aligned activities do not have to be making the most substantial contribution, but they do all need to make a substantial contribution.

For financial market participants and undertakings reporting against the Taxonomy, activities not classed as green can include a range of environmental performance levels alongside activities not yet listed with the technical screening criteria in Delegated Acts. Many of these activities will have an extremely low environmental impact. On the other hand, some of these activities may have significantly negative impacts on the environment. To increase transparency, a completion of the current green Taxonomy, with additional categories of activities and performance levels, can help improve clarity in financial markets and facilitate financial flows towards transition activities that do not yet reach substantial contribution performance levels and to activities with a low environmental impact. This report, in Annex 3, provides a high-level review of other "Transition Finance" initiatives and Taxonomies, showing that transition finance is not a new concept and has already been considered by other organisations, governments and initiatives.

Even before the Taxonomy Delegated Acts enter into force for their first reporting in 2022, concerns have been raised during the Platform's outreach activities (see Annex 1) and in other market events/fora about the risk of some financial market participants and financial undertakings using the Taxonomy as a binary instrument separating green and not green activities and finance for non-green activities being limited by this. Although increased information and education about what the Taxonomy does or does not include should help mitigate such risk, it might not be sufficient to remove it entirely. In addition, concerns have been raised in the same fora mentioned above that the current Taxonomy design does not give sufficient recognition to the activities of corporates and other entities transitioning towards a more sustainable business model and risks penalising them and potentially restricting their access to capital because their activities fail to meet substantial contribution criteria or because they have an insignificant environmental impact.

Some actors in the investment markets have also raised the prospect of a 'green bubble' existing, arguing that with the current design of the Taxonomy, a large demand for sustainable financial products would seek out the narrow supply of Taxonomy-aligned assets. Estimates put the volume of finance that would currently meet Taxonomy-alignment green criteria at 1–5% of all financial assets (see FAQ EU Taxonomy p. 6), not least because the design of the Taxonomy itself targets green and best performance to incentivise best practice with a ground-breaking new approach regarding Doing No Significant Harm to any objective and meeting social safeguards, which up until now have not been necessary to report green finance.

The Platform published its Transition Finance Report in March 2021[18]. The report details how the current Taxonomy, and the financing of activities included in it, do not amount to a binary system. For instance, by including capex and opex as the key variables, companies can demonstrate their commitment to transition and raise green financing, even if they have no green revenues yet. Nevertheless, the Platform believes that an extended Taxonomy, with additional categories of activities and performance levels, can help improve clarity in financial markets regarding different environmental performance levels and different levels of environmental impact. It can also support companies and other entities in their transitions and transition planning. This can make transition finance more widely available without diluting incentives to 'go green'. The Platform believes that these extensions would aid in supporting the urgent transition to a low-carbon, climate-resilient and more sustainable economy, as laid out in the EU Green Deal[19].

Whilst this may be the case for certain activities with the potential for significant environmental impact, it may not be the case for activities that do not have a significant impact. A balance needs to be struck between additional complexity in reporting versus the addition of more information being made available.

3.3 Feedback from outreach and consultation

Feedback from a wide range of stakeholders during Platform outreach events and the public consultation on the intermediate draft report (see Annex 1) revealed a range of opinions and arguments for and against the need for an extended Taxonomy, as summarised in Table 3-1. The Platform sought to understand the potential uses and risks of introducing an extended Taxonomy from the perspective of four groups of users:

- financial market participants and financial undertakings (e.g. asset managers, banks, insurers etc.);
- private and public non-financial undertakings (e.g. large corporates, municipalities, small- and medium-sized enterprises [SMEs] etc.);
- financial market regulators and associated actors (e.g. central banks, micro-prudential financial regulators, rating agencies etc.); and
- wider society (e.g. consumers, retail investors, employees, researchers, civil society organisations etc.).

Overall, the balance of opinion was in favour of some form of extension, although a number of risks and important caveats were raised which the Platform has further considered.

The main arguments for extending beyond green were transparency for all investors — retail and institutional — who want to support finance for urgent and ambitious environmental transitions, need to manage their climate and environmental risks (including avoiding investing in investments not making a transition away from environmentally harmful performance), want

[18] Report from the Platform on Sustainable Finance on transition finance, March 2021, available here.
[19] COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS The European Green Deal. Available here

better tools to identify stranded assets and wish to increase the scope of their financing for a positive impact. Additional reasoning included:

- Achieving greater transparency in environmental performance, including and distinguishing activities that are significantly harmful from those with a low probability of having a significant negative impact on the environment.
- Contributing to better risk management by both banks/investors and supervisory authorities.
- Allowing the financial industry to develop specific products and instruments to deal with significantly harmful activities.
- Improving consistency between regulations and policy measures.
- Identifying subsidies for harmful activities.

The main case against a Taxonomy extension came from some corporates fearing 'blacklisting', which might lead to problems raising finance for transition or accelerating the risk of stranded assets. Corporates, including those supporting the idea of an extension, therefore asked to test the existing Taxonomy before any extension. On the other hand, it should be noted that some corporates indicated that clarity on the aspects of significant harm would enable them to make better transition plans, inform their investors more clearly on those plans and avoid being at the 'whim' of a variety of different stakeholders and shareholders with different views.

3.4 The balance of arguments

Whilst acknowledging that there are arguments for and against extending the EU Taxonomy beyond green, the Platform considers the balance of evidence to show that sustainable finance initiatives to date, combined with the built-in inertia in the economic system and perhaps in some businesses, have neither significantly increased transition finance nor driven sufficiently ambitious environmental transitions. Alongside the growth in finance labelled as green, global investments in and financial support given to fossil fuel industries and other environmentally harmful economic activities continue.[20] Greater transparency is needed on whether financial flows are directed to activities substantially contributing to solving environmental and climate crises, activities that undermine environmental objectives or other activities that have little impact on the environment.

An extended Taxonomy could potentially accompany more ambitious greening of the whole economy across all six environmental objectives. It could do so through helping to identify and prioritise the economic activities for which the urgent transition towards better environmental performance has to be supported and prioritised to avoid significant harm, which can in turn also inform sufficiently ambitious environmental legislation. This positive impact needs to be balanced against greater complexity, reporting burden, usability and proportionality. An extended Taxonomy would also address the lack of clarity surrounding what is considered 'not green' in investment portfolios, address concerns about the perceived binary nature of the current EU Taxonomy classification and help to provide greater clarity surrounding the nature of low environmental impact activities.

[20] For example, large commercial banks provided $750 bn in financing to coal, oil and gas companies last year, according to the *Financial Times*, while many pledged to back the Paris Climate Accord and cut their funding for fossil fuels. See https://www.ft.com/content/c1e31c6f-6319-4bfc-bde3-3ace80b46a2b

Whilst a low environmental impact (LEnvI) extension could help to provide greater clarity on low environmental impact activities not yet covered by Delegated Acts, a LEnvI Taxonomy could further complicate an already fast-moving and complex sustainable finance architecture, suggesting additional reporting when current Taxonomy reporting is not yet in force. This implies a need for a careful usability assessment of LEnvI proposals, including a further examination of options that may involve a longer-term phased approach from the issuance of an initial non-binding guideline towards determining whether or not there are sufficient benefits of incorporation into a full Taxonomy at a later stage.

Table 3-1. General pros and cons of SH/IP and LEnvI extensions from stakeholder dialogues and Platform discussions

	POSITIVE ASPECTS	NEGATIVE CONCERNS
SH/IP	• An SH/IP extension will help identify and prioritise the economic activities for which the urgent transition towards better environmental performance has to be supported. Much of the economy will be in need of such transition finance. • An SH/IP extension would increase transparency, completeness of environmental performance levels of activities, providing encouraging descriptions for activities with intermediate performance levels between SC and SH. • An SH/IP extension and associated "Intermediate Performance/intermediate transition area labelling would improve framing, understanding and communication of transitions and transition plans on activity level, while improving the ability of corporates to develop strategies and investment plans to meet environmental objectives. • An SH/IP extension is a prerequisite to help markets define and develop efficient instruments for financing the urgent transition away from environmentally unsustainable activities by supporting investments to move activities away from significantly harmful performance. • An SH/IP extension may enhance the risk-management frameworks of both banks/investors and supervisory authorities as it can be assumed that SH activities are most exposed to transition risk. Financing of associated transition plans can reduce risk. • An SH extension could be used by policymakers to provide subsidies to the decommissioning of harmful activities and monitor changes in capital flows. • An SH/IP extension could provide clarity that other activities in an investment portfolio, even if not yet included in the Taxonomy, are not in the SH category. • An SH extension will help at the EU level (not only in products/portfolios) to follow up progress on the Sustainable Finance Action Plan and for the Platform to fulfil its task to monitor and regularly report to the Commission on trends regarding capital flows towards sustainable investments.	• An SH extension may be perceived as a departure from the positive spirit of the green Taxonomy, which aims to encourage companies to move towards sustainable activities. • An SH extension may risk negatively impacting the ability of high carbon intensity sectors and companies carrying out harmful activities to raise finance for transition and to innovate (blacklisting risk). • An SH extension could create 'stranded assets by legislation' or at least increase transparency on risks that are already there, thus increasing the transition risk. • SH could impact the financing of companies with a high share of turnover deriving from environmentally harmful activities. Difficulties could arise linked to specific banks which frequently lend to such companies, impacting on both retail customers and on the wholesale markets. • An SH extension may disadvantage EU companies vs. non-EU jurisdictions, which would call for further efforts for alignment internationally. • An SH extension may increase complexity, reporting burden and may affect usability and proportionality dimensions. • Without an appropriate impact assessment, the scope of activities in the real economy potentially covered by a Taxonomy extension would remain unknown, with potentially detrimental effects for a due preparation and phasing-in of the extension.

	POSITIVE ASPECTS	NEGATIVE CONCERNS
LEnvI	• Mitigates the risk of LEnvI activities being compared unfavourably to green investments by markets, even when their environmental impact may be far lower than green activities in some high-impact sectors. • Supports the greening of all parts of the economy by bringing low-impact sectors clearly into the discussions on sustainable finance and supporting finance for green capex and opex in these sectors. • Potentially improves access to finance for low-impact sectors and activities. • May be helpful for investment portfolio risk diversification. • May allow corporates to take a 'whole business' view of transition needs and support them in the greening of their supply chain. • Allows for an emphasis on climate resilience in small businesses, which are often the most vulnerable to climate change impacts. Without LEnvI, these activities could be left behind in access to finance for adaptation as well as other important green actions such as the energy efficiency of buildings, electric vehicles etc.	• Potential complexity when looking to define all activities and questionable benefits compared to market-led environmental, social and governance (ESG) labelling. • Usability considerations would prioritise developing an SH Taxonomy first, including DNSH criteria for otherwise low-impact activities, in which case a LEnvI Taxonomy may not be needed. • The logic of the Taxonomy argues against the revenues of LEnvI activities ever being counted as green, only the green capex/opex expenditure of the entities that conduct those activities. In principle, 'green services' could be included within the existing Taxonomy. • The scientific basis may not be well defined for all sectors. • Potential challenge of choosing which sectors to develop criteria for first and then how to maintain an up-to-date list of LEnvI activities in the dynamic services sector. • Some doubts as to whether no significant impact exists when all six objectives are considered and whether any activity should be classified as LEnvI without having to check DNSH criteria. • Overly complicated reporting, especially for financial institutions (particularly banks), with little gain.

4 Framework for extension

4.1 Conceptual framework

The Taxonomy regulation defines a particular approach to classifying environmentally sustainable economic activities through applying environmental performance criteria to those activities, as set out in Delegated Acts. Article 26 of the Taxonomy Regulation cites a future Commission report describing the provisions that would be required to extend the scope of the regulation. These provisions would cover economic activities that have a low environmental impact (LEnvI, or no significant impact — previously described by the Platform as NSI activities) on environmental sustainability, along with economic activities that significantly harm environmental sustainability. The Platform interprets this extended framework as potentially applying to the whole economy, such that every economic activity should fall into one of four 'boxes', as illustrated in Figure 4-1. This would not limit in any way the possibility for some activities to also be included in any future social Taxonomy and for the activities to fall into different boxes in relation to social objectives. For example, an activity that falls into the 'no significant environmental impact' category in relation to environmental objectives may well be listed in potential Delegated Acts that prioritise activities with significant social impact.

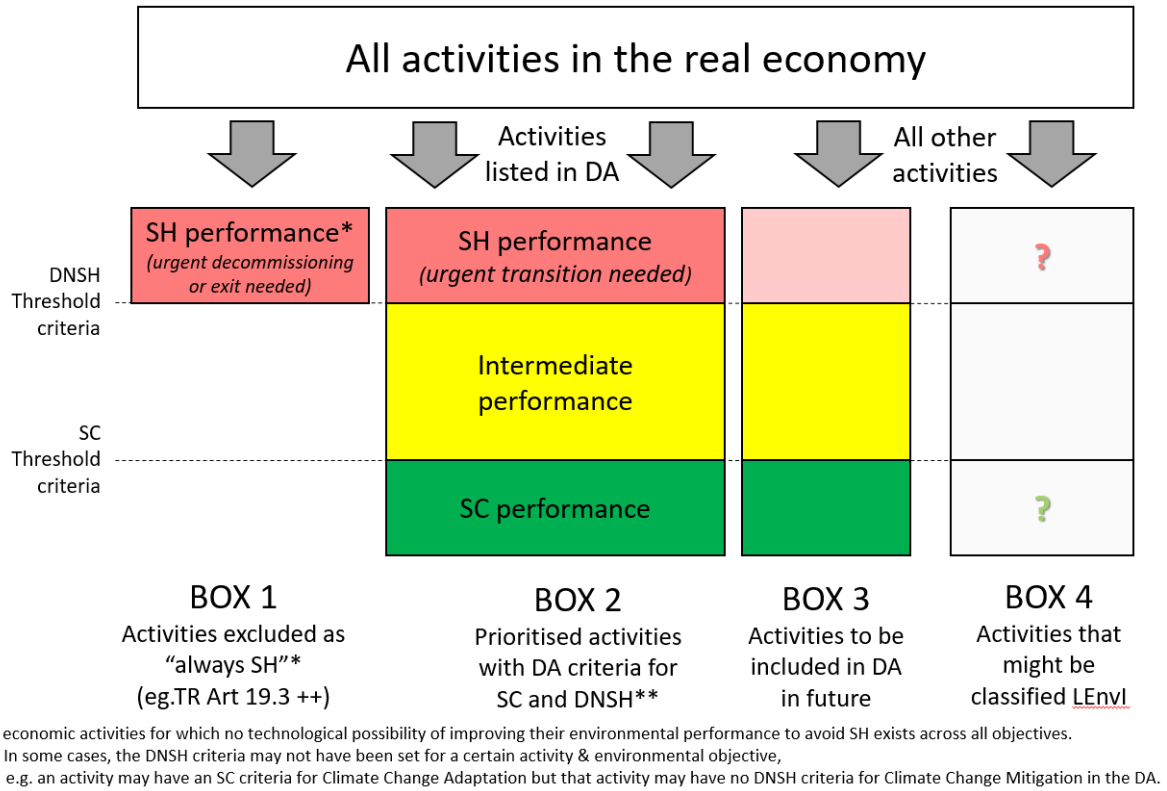

Figure 4-1. Conceptual model of extension categories for economic activities and their performance levels.

Starting with the existing Taxonomy, **Box 2** represents the existing green Taxonomy for activities, which are listed in a Delegated Act and for which the technical screening criteria for substantial contribution and do no significant harm were set in the Climate Delegated Act or will be set in the Environmental Delegated Act (sometimes called TAX04 DA). It should be noted that there are activities for which no DNSH criteria are defined, implying that there is no significantly harmful performance, such as for many service sector activities that have no DNSH criteria for the depollution objective. For other activities, substantial contribution criteria may never be achievable for the whole activity, such as energy-efficiency performance standards for historic building renovations or very low leakage rates for existing urban water supply systems. Where both substantial contribution and DNSH criteria are set for the same activity and the same objective, a middle space is automatically created. This middle, or intermediate performance space covers a level of environmental performance against that objective from “almost significantly harmful” up to “almost making a substantial contribution”. It is not in any way “neutral”.

Box 1 represents activities that are excluded from the green Taxonomy as they are significantly harmful to one or more of the six environmental objectives and are by their nature unable to transition. The current Article 19 (3) of the TR recognises only one activity to be excluded from the green Taxonomy: power generation from solid fossil fuels. The Platform recognises there are other economic activities for which no technological possibility of improving their environmental performance to avoid significant harm exists across all objectives and which might be thought of as ‘Always Significantly Harmful’ activities. These could be identified for any of the six environmental objectives and subject to further analysis, could include activities such as:

- Thermal coal mining and peat extraction (climate change mitigation).
- Construction of new housing in extreme high-risk flood areas (climate change adaptation).
- Activities destroying ecosystems with high biodiversity value etc.

Box 3 represents environmentally impactful (positive or negative) activities that have the potential to make a substantial contribution to one of the objectives but are not yet included in the Taxonomy. They are expected to be included in the green Taxonomy in future Delegated Acts.

Box 4 represents a set of residual activities that have low impact across the six environmental objectives covered by the Taxonomy. For this reason, they will never be included in a green or significantly harmful Taxonomy, or at least, not for a long time. Such activities may be candidates for a category of activities with a LEnvI. However, even such low-impact activities may need to be adapted and made resilient to climate change. They may need to have some minimum environmental safeguards in place and may want to make and report green investments; hence the green and red **“?”** symbols in Box 4 in Figure 5-1.

The interpretation and different levels of performance within each box are discussed further under the SH and LEnvI report sections (Sections 6 and 7, respectively). At this point, the Platform chooses to highlight three important concepts to be borne in mind when examining this conceptual framework:

1. Much has been written about ‘green’ and ‘brown’ Taxonomies and the use of green/brown ratios in financial reporting. Whilst acknowledging that all colour schemes have some interpretation challenges in different cultural settings, the Platform believes that a colour

scheme is needed so that graphics can be developed that help explain concepts and to facilitate discussions on sustainable finance — both within Europe and internationally. Given that green is universally understood in markets and that the original purpose of the EU Taxonomy was to assist in the avoidance of green-washing, clearly that colour has to remain. The Platform aims to incentivise continuous improvements towards higher levels of environmental performance across the economy rather than side-lining specific activities or sectors in static categories. The Platform has therefore decided to use the dynamic traffic light colour system, which is used around the world.

> The **TRAFFIC LIGHTS FOR SUSTAINABLE FINANCE**: **Green**, Amber (orange, yellow) and **Red** are universally understood. Although there are sometimes different interpretations of the amber (orange–yellow) traffic light, **the meaning of the green traffic light is always go,** while **the meaning of the red traffic light is always stop and go forward only when a new signal is given.** The amber (orange–yellow) **traffic light is always between the two other colours**. The Platform considers this as the most practical and easily understood global colour system to use when discussing and explaining the important topics discussed in this report. The Platform notes that other global discussions are emerging on this point including at least one other use of an "Amber category.[21]

2. Fundamentally, there is no difference between the significant harm to environmental sustainability and to the environmental objectives caused by the activities in Boxes 1 and 2. This is not a distinction between higher and lower levels of significant harm. **The difference between significant harm in Boxes 1 and 2 pertains to the options available for that activity to transition to a future low-carbon, climate-resilient and environmentally sustainable world**.

The activities shown as Significantly Harmful in Box 1 are not Paris aligned, or are not compatible with achieving other environmental goals, and cannot transition to such a state. Therefore, the only viable option for these activities to stop causing significant harm is that they cease operation in a well-managed fashion. On the other hand, the activities in the Taxonomy performing at an significantly harmful level (Boxes 2 and 3) do have options to transition and are needed in a low-carbon, environmentally sustainable future economy. Therefore they can, and must, transition urgently away from levels of performance that cause significant harm.

3. It is a common misunderstanding that LEnvI activities (Box 4) are the same as the middle (amber) space, labelled 'intermediate space' in an impactful, Taxonomy-covered activity. This is not the case, and the Platform believes it is vital to understand that the area between the substantial contribution and DNSH criteria is likely to still have a big impact on the environment. This is most commonly negative — for instance, in areas such as renewable or other power generation, heavy industry or transport sector activities with environmental performance between the substantial contribution and DNSH criteria. The LEnvI sectors, meanwhile, could be thought of as mainly service sectors with very little impact on the environment either positive or negative — for example, hairdressers, crèches, tax advisers or lawyers. Clearly, some specific entities operating within the LEnvI activities may wish to

[21] https://asean.org/wp-content/uploads/2021/11/ASEAN-Taxonomy.pdf

‘become more green’, and this will be discussed in more detail in the LEnvI section of this report.

Figure 4-2 below indicates how the extended Taxonomy concept can allow for improved clarity in a portfolio of activities, either held by an investor or being carried out by a private or public entity, distinguishing between the different types and levels of environmental performance. It can help provide an understanding of how activities under the existing green Taxonomy that are currently just ‘not-aligned’ can now be seen as clearly split into (a) activities with an intermediate performance level and (b) activities that need to urgently transition away from significant harm.

The extended Taxonomy can also help provide an understanding of how ‘non-covered’ activities (not currently Taxonomy eligible) can, with this new approach, be split into (i) Low Environmental Impact activities and (ii) activities that need to be urgently decommissioned/exited to avoid significant harm.

The remaining activities (Box 3) can then be better understood as activities that will be included in the Taxonomy in coming years.

This increased clarity surrounding all non-green activities in the portfolio can help focus attention on the necessary transitions that our economies are facing. The change from red to amber and ultimately, whenever possible, to green levels of performance can also be seen as ladder steps to a more sustainable economy, helping companies, investors and other economic actors to more clearly see an appropriate path forward. It can also enable companies, investors and other entities to better understand, develop and explain their transition stories, improving access to finance for these transitions. This wider discussion of environmental transition and transition finance is developing in the global markets and in international discussions, such as in the transition finance workstreams of the International Platform on Sustainable Finance and in the G20 Sustainable Finance Working Group, and more information can be found in Annex 3.

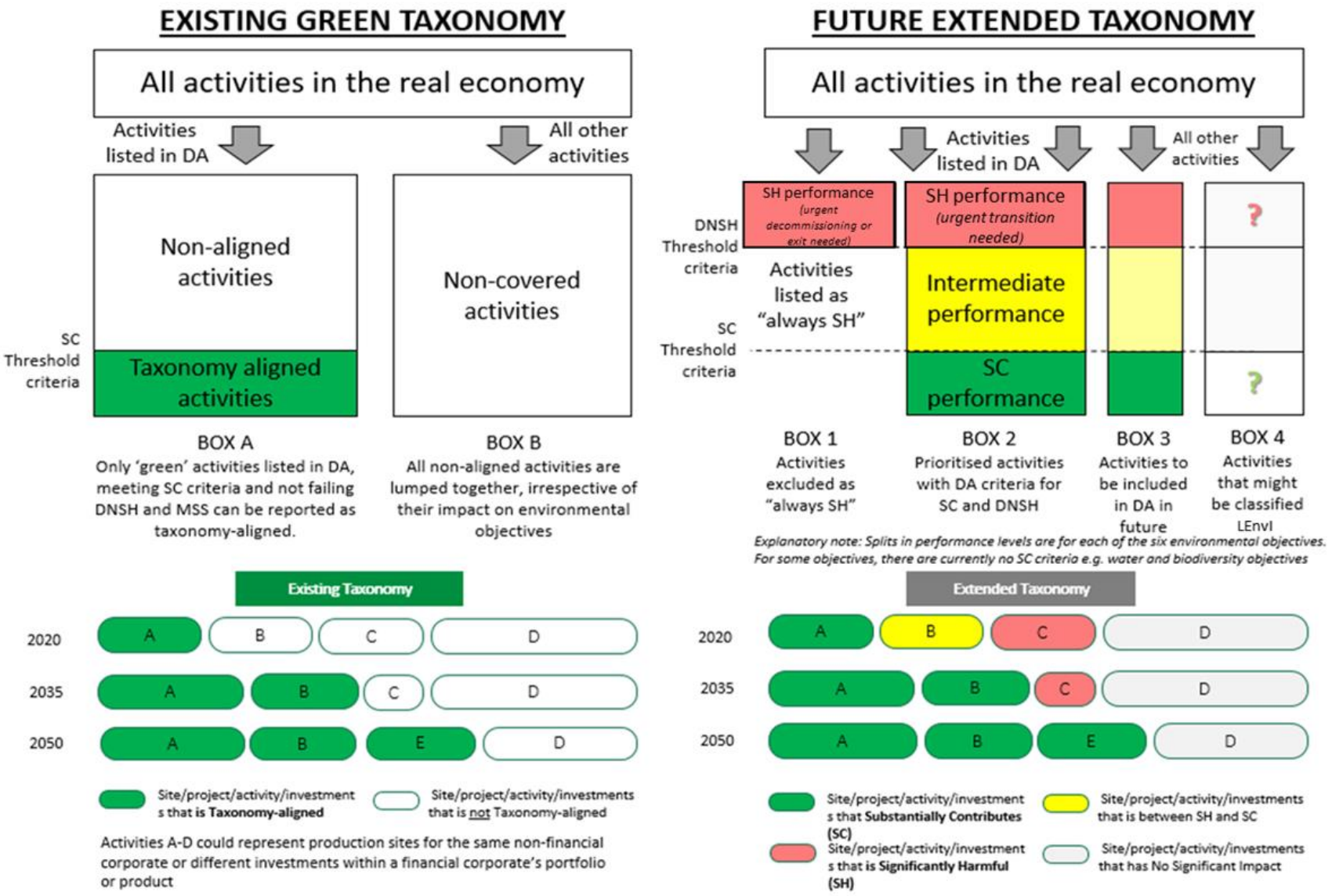

Figure 4-2. Extension of the Taxonomy can facilitate clarity and an improved understanding of the environmental performance of portfolios of activities and can thereby support improved transition strategies and access to financing.

4.2 The dynamic Taxonomy

For each economic activity, the Taxonomy can be both constant (with set levels of performance) and dynamic (with changes in performance levels over time), either of which may form the basis for setting the values of technical screening criteria. For example, many activities are described in terms of both 'construction and operation of …', whilst others include 'renovation of …' or 'renewal of …' the same activity. Some technical screening criteria are defined in terms of an absolute level of impact (for example, GHG emissions), whereas in exceptional cases, a few technical screening criteria are described as a percentage reduction in impact[22] — for example, a 20% reduction in water leakage rates or improvement in building energy performance.

Additionally, Taxonomy technical screening criteria are themselves dynamic, where regular monitoring and evaluation are needed to update technical screening criteria in line with market developments and based on available scientific evidence. The Platform has the task of advising on these reviews. For transitional activities contributing to the Climate Change Mitigation objective, this review period is set as every three years (Article 19 of the TR).

In the case of quantitative criteria, such as GHG emissions, this process of tightening criteria over time can be visualised as 'falling curves' of stricter SC and DNSH (SH) thresholds dropping over time towards an overall target of net zero by 2050 (see Figure 4-3(i)).

A few points are useful to bear in mind when reviewing these curves.

Clearly, when the concept of 'falling curves' is translated into Taxonomy criteria, lines defining the three coloured areas become 'falling steps', perhaps in three- to five-year steps, since substantial contribution and DNSH criteria are to be reviewed at regular intervals, and that would normally lead to lower thresholds. However, for the sake of clarity, to present the concept of decreasing substantial contribution and DNSH criteria over time, and because it is not possible to determine when exactly any step will occur, the falling curves drawn below are represented by a smooth curve and not by 'falling steps'.[23] Moreover, please note that lines representing SC and DNSH before 2020 are assumptions of how these curves might have looked, since the concepts of SC and DNSH were not yet established at that point in time.

Not all sectors would follow the same curves, or series of steps, as some have low-carbon technologies already available at scale, and others do not. For this reason, certain groups of economic activities, where low-carbon alternatives are available, may need to reach net zero earlier than 2050 — for example, in the global electricity generation sector, by 2040[24] (see Figure 4-3(ii)).

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[22] Note that care needs to be taken when using percentage reductions for TSC, e.g. where the activity is contributing to systematically accumulating significant negative impacts (even if less so than before the activity). DNSH needs to be below thresholds of harm, not reducing the level of unsustainable above-thresholds of harm, e.g. reducing levels of pollutants, which will nonetheless continue to accumulate in biosphere, or improving water use efficiency whilst not reducing the overall level of water consumption in a water-stressed catchment, etc.

[23] For one example of a graphic showing 'falling steps', please refer to the intermediate/amber transition example in Section 5.9.

[24] As reported by the International Energy Agency's report: 'electricity generation will need to reach net-zero emissions globally in 2040'. See: Net zero by 2050: A roadmap for the global energy sector.

Keeping in mind the same approach, 'falling curves' could in some cases reach net zero later than 2050, as could be the case with heavy industries in emerging markets and developing economies[25], since they face major challenges in finding and implementing low-carbon solutions (see Figure 4-3(iii)).

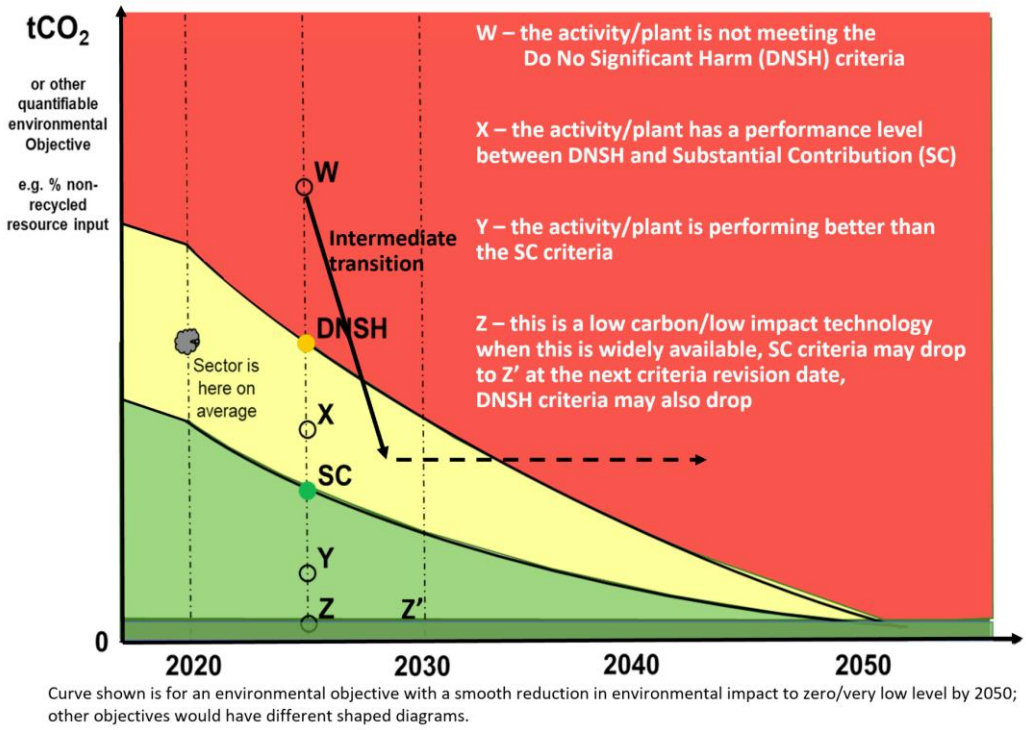
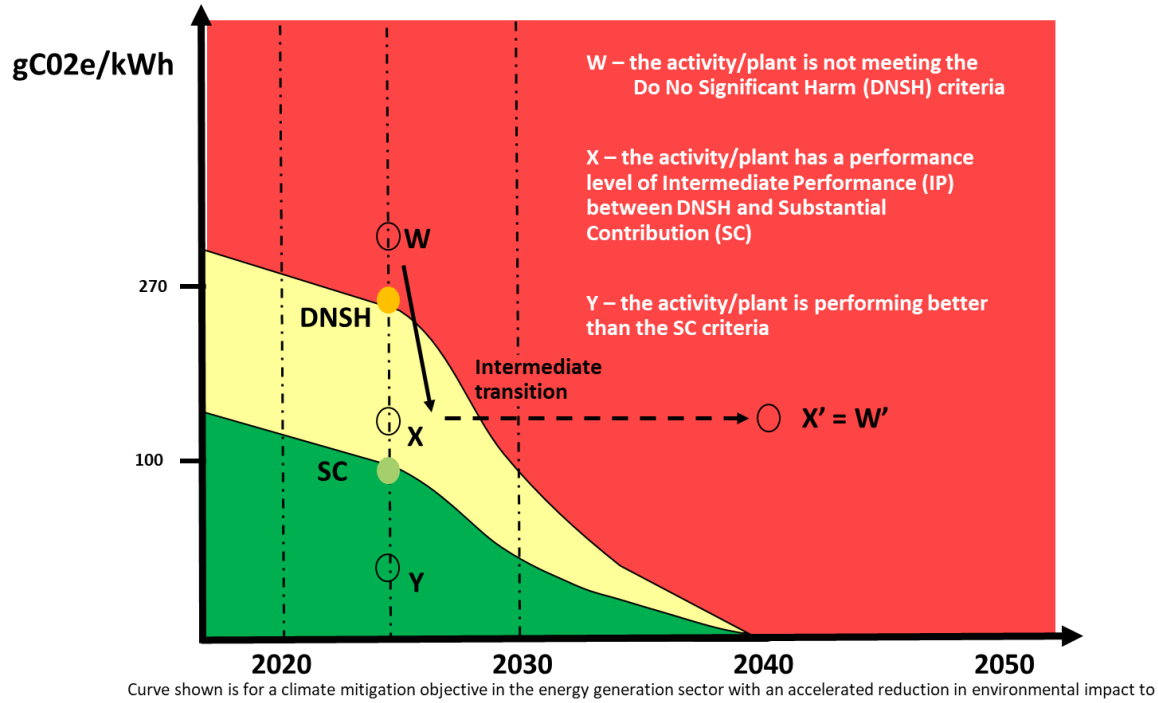


Figure 4-3(i). Example of a 'falling curves'-shaped diagram for an environmental objective, e.g. climate change mitigation for a high-impact activity moving to net zero by 2050.

[25] As reported by the International Energy Agency, 'CO2 emissions from heavy industry decline by…93% by 2050'; therefore, in that year, heavy industries could still emit 7% of today's CO_2 emissions. See: Net zero by 2050: A roadmap for the global energy sector.



Curve shown is for a climate mitigation objective in the energy generation sector with an accelerated reduction in environmental impact to zero/very low level by 2040 according to IEA 2020 recommendations; other sectors and objectives would have different shaped diagrams.

Figure 4-3(ii). Example of a 'falling curves'-shaped diagram for an environmental objective, e.g. climate change mitigation for a high-impact activity moving to net zero earlier than 2050, for instance, the global electricity generation sector by 2040 (in Europe by 2035).

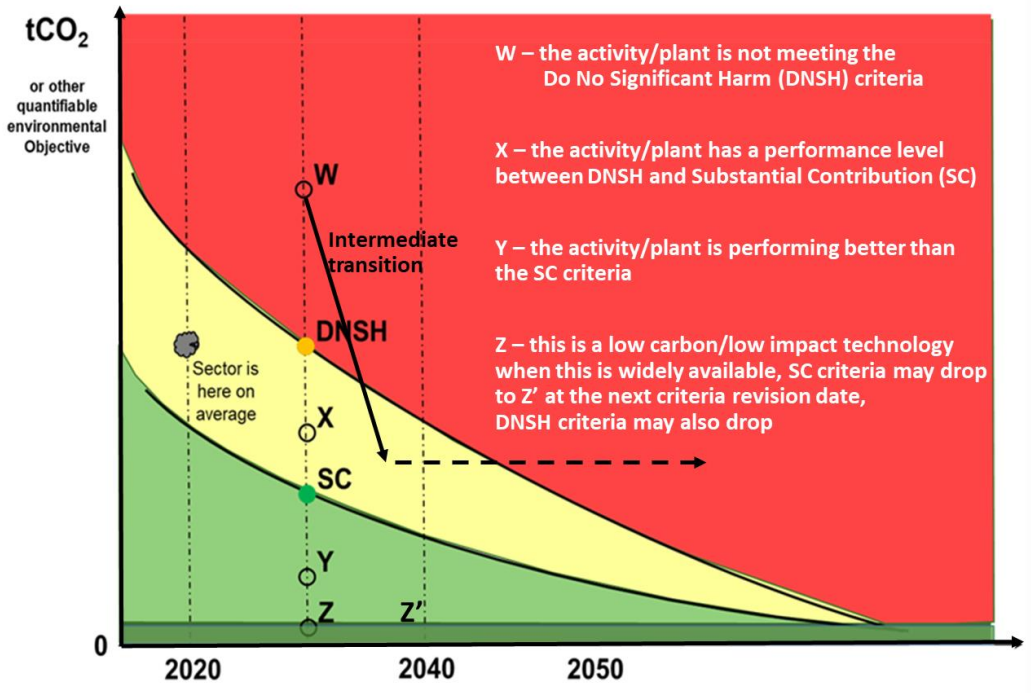


Figure 4-3(iii). Example of a 'falling curves'-shaped diagram for an environmental objective, e.g. climate change mitigation for a high-impact activity moving to net zero later than 2050.

There could be cases where, for a certain economic activity and for a specific environmental objective, no substantial contribution criteria are (yet) defined while the DNSH criteria could instead already be in place, given in the published DA. In this hypothetical case, falling curves could still be sketched, such as the one in Figure 4-4(i). In such a case, it is possible to see that for one environmental objective, such as the protection and restoration of biodiversity and ecosystems, the curve shows a smooth reduction in environmental impact to a very low level by 2050; it could also be possible that in the future, such as from 2030, substantial contribution criteria may be defined for such a hypothetical activity in reference to the biodiversity objective.

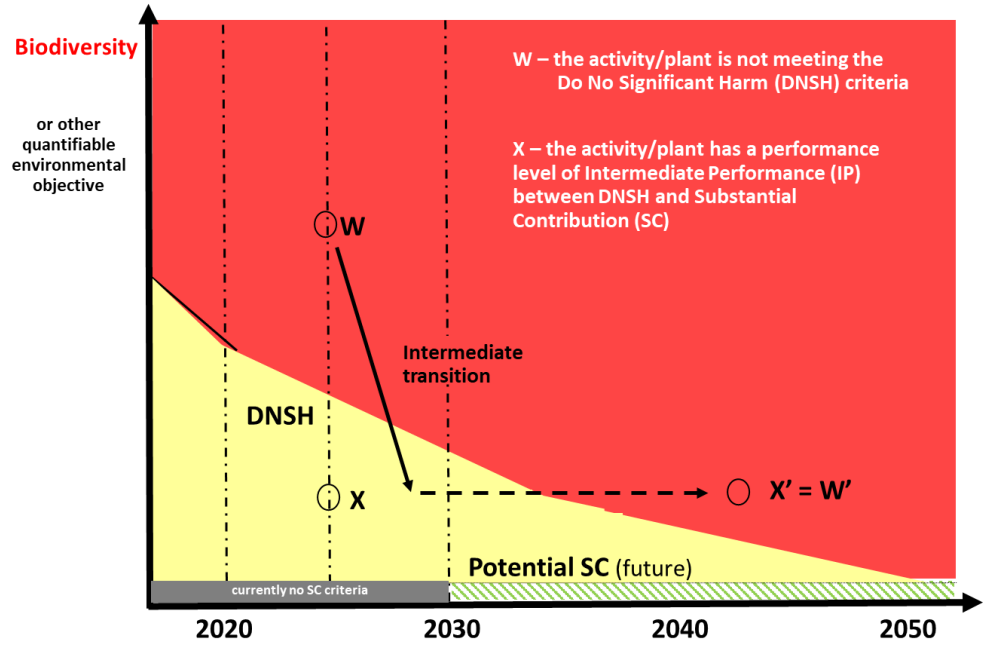


Figure 4-4(i). Example of a 'falling curves'-shaped diagram for an environmental objective for which only DNSH criteria are currently available, while SC are missing but may be introduced from 2030, for example.

Following the same rationale, there can be economic activities for which substantial contribution criteria, in reference to a specific environmental objective, have already been defined in a DA, while the DNSH are still missing. Also, in this case, the falling curve can be drawn, as in Figure 4-4(ii). Also, in this case, it is possible that additional criteria for DNSH for the economic activity may be defined at some point in the future, and the red dotted line in Figure 4-4(ii) considers such a case.

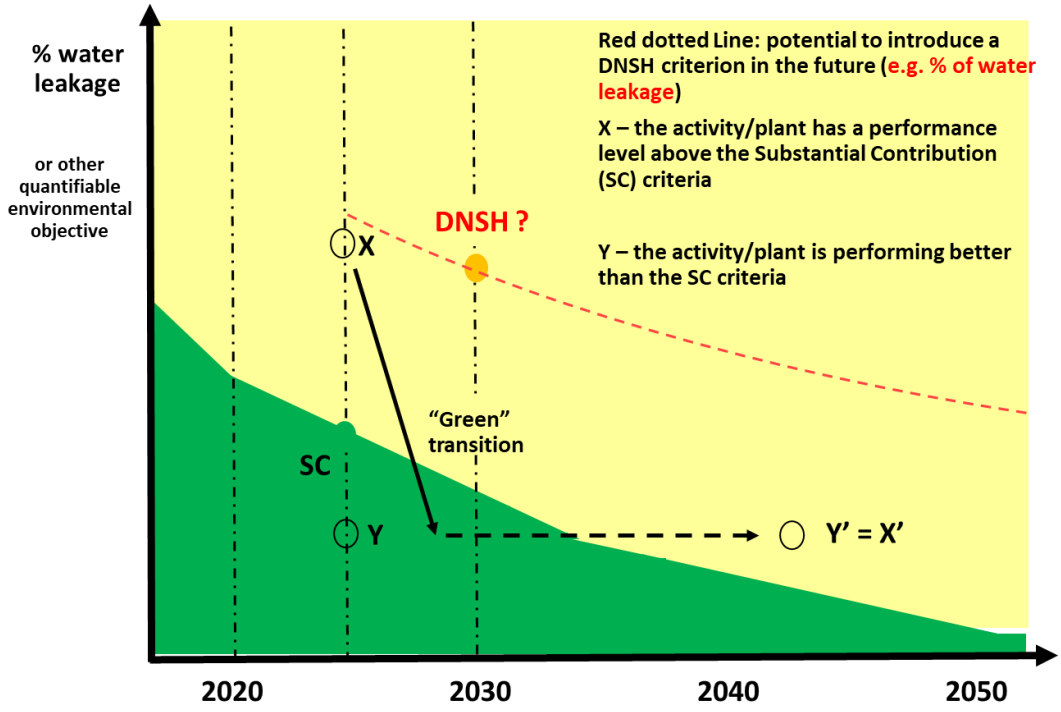


Figure 4-4(ii). Example of a 'falling curves'-shaped diagram for an environmental objective for which only SC criteria are currently available, while DNSH are missing but may be introduced from 2030.

Another aspect to consider when drawing an example of a falling curve is the case where, for instance, a break-through low-carbon technology in the manufacturing sector (that could also be a technology or solution in other sectors of the economy substantially contributing to any other environmental objective) suddenly becomes largely available at a commercial scale at some point in the future. In such a case (see Figure 4-5), SC criteria will drop fairly suddenly, as soon as the technology or solution is widely commercially available, while DNSH could also drop at the same time and then move closer to the same environmental performance as SC after few years (the exact time frame will depend on a number of variables, such as the type of economic activity, the environmental performance of the alternative technologies, solutions already on the market etc.).

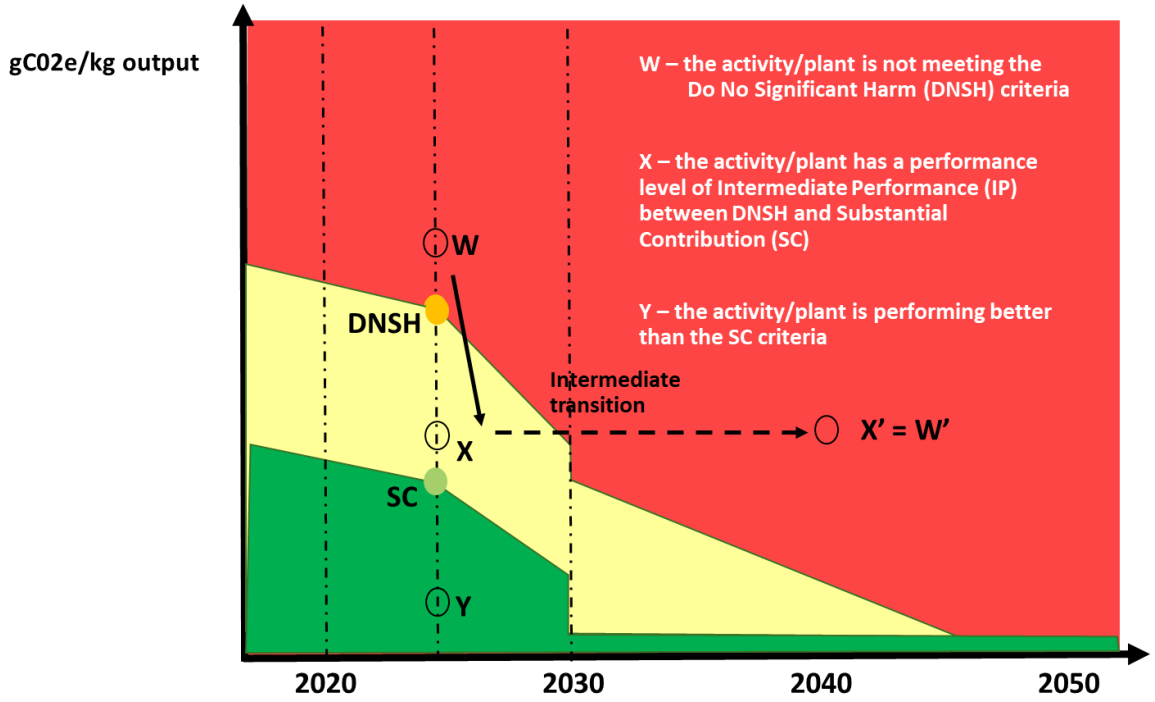


Figure 4-5. Example of a 'falling curves'-shaped diagram for a case where a break-through low-carbon technology suddenly becomes largely available at a commercial scale in 2030.

Falling curves diagrams for other objectives and economic sectors may take other shapes. Figure 4-6 gives an example for the climate change adaptation objective, where criteria are process based and the diagram does not take a falling curve shape.

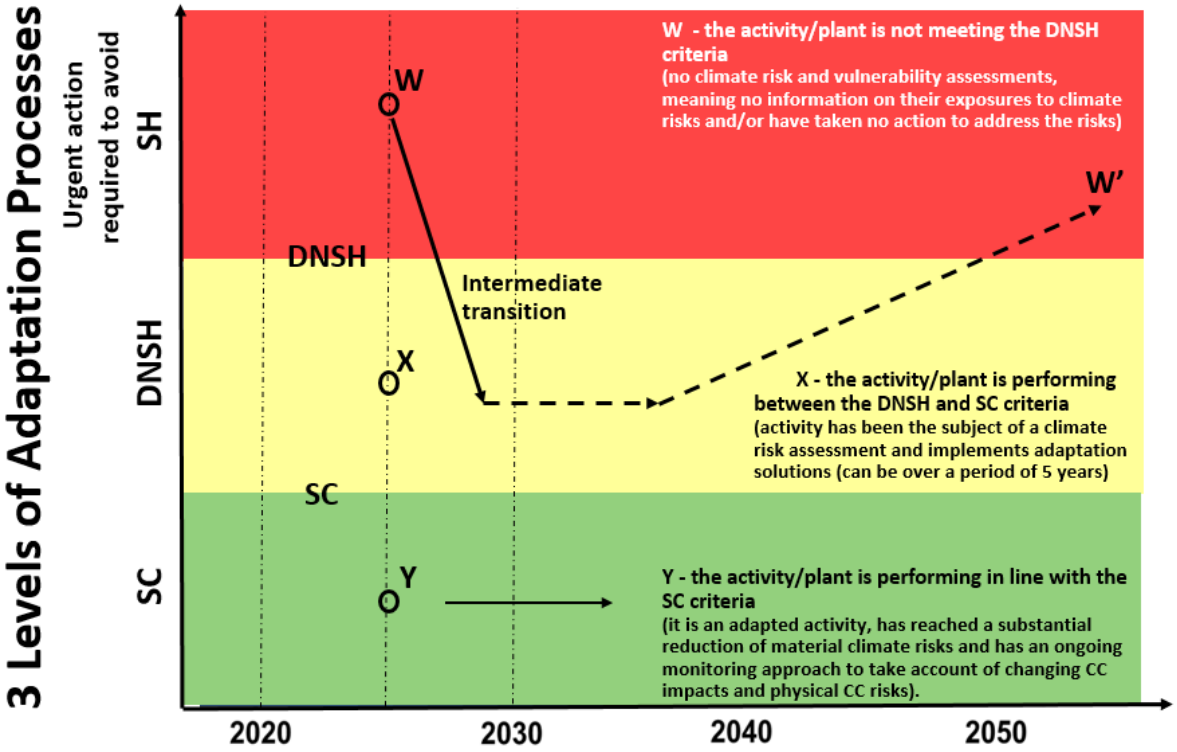


Figure 4-6. Example of a non-'falling curves'-shaped diagram for an environmental objective with process-based technical screening criteria for SC and DNSH, i.e. climate change adaptation.

The dynamic nature of the Taxonomy can still be seen in the diagram for climate change adaptation in Figure 4-6. A fully adapted activity performing at the level of the SC criteria has done a risk assessment, has implemented adaptation measures substantially reducing physical and climate risks, has an inbuilt monitoring of climate change impacts and the activity's response to them and can adjust the activity's adaptation processes. The entity carrying out the activity is able to respond to changing climate impacts, new climate risks and climate vulnerabilities that develop.

An entity operating in the Intermediate performance space (i.e., amber space) may initially be climate resilient, but if it carries out no monitoring and does no further assessment of the activity's vulnerability to climate change, it might eventually find that the activity has fallen back towards the SH space, becoming increasingly vulnerable to the changing climate.

An entity that has not done risk assessments and has therefore little idea about its exposures and vulnerability, or an entity for which risk assessments have been done and have identified material risks but no adaptation action has been implemented, is not climate resilient and is doing significant harm to the adaptation objective. In this case, the **intermediate transition** out of this SH space is vitally important to reduce the activity's climate vulnerability. Its adaptation plan could be financed as intermediate transition investments.

The examples provided above, outlining a number of possible ‘falling curves’, are not meant to be exhaustive or to represent all types of economic sectors and environmental objectives; however, they help the reader to understand the concept of a dynamic Taxonomy. Following the learnings and evidence from such examples, the following implications can be reported:

- ‘Green’ activities, or activities performing at or better than a Substantial Contribution level, reach a ‘green’ level of environmental performance and generally may need to continue to improve their environmental performance levels over time to continue to transition and make a substantial contribution to the environmental objective.
- ‘Intermediate Performance’, or ‘amber performance’ activities with environmental performance levels between the technical screening criteria for SC and DNSH need to continue to improve their environmental performance levels over time — at least in line with regional and global goals and targets — so they avoid falling back into doing significant harm to the environmental objective in a few years’ time (see the dotted horizontal arrow in Figure 4-3 to 4-6).
- Any valid transition, activity-specific transition plan or entity-level transition strategy benefits from being forward looking, and all would benefit from having good-quality sectoral pathway information and a clear understanding of the revision cycle of different criteria and how the criteria are likely to be adjusted in the future.

Interlinkages between EU Sustainable Finance policies and the SH/LEnvI concepts

	CSRD & EFRAG Taskforce	Article 8 TR	Sustainable Corporate Governance Initiative
Scope	CSRD (to replace NFRD) provides for a disclosure regime of companies fulfilling certain size criteria. The disclosure entails sustainability strategy, risks, targets and progress as well as principal and potential adverse impact, governance structure and due diligence processes.	Undertakings subject to the NFRD (and CSRD in future) are to disclose on the activities aligned with the EU Taxonomy.	Sustainable Corporate Governance Initiative will provide a framework for company directors` duties of care and due diligence duties with respect to sustainability topics
Cross reference to always significantly harmful, significantly harmful and intermediate performance (ASH & SH/IP)	CSRD will refer to the taxonomy. Through the extended Taxonomy incl. ASH & SH/IP, companies would provide a transparent and granular perspective at enterprise level including a wider range of their activities. ASH & SH/IP would support the double materiality approach of the CSRD by providing transparency on the impact of the company on environment and society. Without an extended Taxonomy, Transition-Plans could interlink with the proposals for IP (within-amber transition) The DA for implementing the CSRD could consider requiring reporting on indirect SH impacts/activities associated with "green" (as in "SC") activities.	Art. 8 TR requires disclosure of percentages of Revenues, CapEX and OpEx that meet the criteria of SC, DNSH and minimum safeguards. ASH & SH/IP would complete the picture of taxonomy reporting However, risk of multiplying reporting complexity has to be considered. Prioritization will be important	ASH & SH/IP disclosure has potential to ensure the materiality-focus in corporate governance. The consultation summary Indirectly links to ASH & SH/IP by making reference to awareness of companies' negative impacts and contribution to a more sustainable development, also discussed as to what extent sustainability risks, impacts and opportunities to be integrated into the company's strategy, decisions and oversight
Cross reference to low environmental impact (LEnvI)	Similar to ASH & SH/IP In addition, LEnvI allows to identify part of the company with low impact inside-out and low impact outside-in (= financial materiality) apart from physical risks	Yes, TR article 26 2a identifies economic activities that do not have a significant impact on environmental sustainability . A voluntary approach is proposed for reporting on LEnvI.	An extended LEnvI taxonomy would help identifying part of the company with low impact inside-out and low impact outside-in (= financial materiality) apart from physical risks
Disclosures	Risks and opportunities based on global standards and best practices	TR: disclosures include turnover, capex and opex. ASH & SH/IP: tbd LEnvI: at least turnover	-
Governance	ASH & SH/IP would allow for better risk management and accelerated transition management and perceived challenge of access to finance LEnvI: less need for governance structures and practices as transition risks of LEnvI activities are low. In case of physical risks, adequate governance structures and practises will be needed like for the rest of activities	ASH & SH/IP would allow for better risk management and accelerated transition management and perceived challenge of access to finance LEnvI: less need for governance structures and practices as transition risks of LEnvI activities are low. In case of physical risks, adequate governance structures and practises will be needed	(A)SH/IP activities help identify focus areas for enhanced corporate governance LEnvI activities are neutral from a environment impact and (transition) risk perspective. LEnvI needs reasonably less management attention in this sense. Efforts can be focussed on red, amber, and green activities

	SFDR	Investor Preferences MiFID II / IDD	EU Ecolabel
Scope	SFDR provides for a disclosure regime for Asset Managers, Fund Management Companies, Insurers Pension Fund providers regarding sustainability risks / principal adverse impacts (PAI) on company level as well as approaches on product level including (comply-or-explain) consideration of PAI in strategy	Distributors of insurance based investment products (IDD) or financial instruments (MiFID) including shares, bonds, structured products and investment funds, in particular with respect to advice and management of segregated accounts. Need to enquire sustainability preferences of clients	Currently, the proposed scope for the Ecolabel comprises UCITS funds and alternative investment funds (AIF), and fixed-term deposit or savings deposits The Ecolabel is aiming at being the gold standard for impact focused products.
Cross reference to always significantly harmful, significantly harmful and intermediate performance (ASH & SH/IP)	TR refers to SFDR products for Taxonomy disclosure ASH & SH/IP taxonomy would be helpful to provide a granular perspective at portfolio level (IMAs, funds, pension products, insurance based investment products) DNSH-assessment in Art. 8 / 9 products of a sustainable investment or according to SFDR or a taxonomy-aligned investment requires use of PAI indicators. ASH & SH/IP categories could make DNSH assessment through PAI (principle adverse impact) indicators redundant and could mitigate conflict between activity based approach (taxonomy) and entity based approach. This would require an amendment to SFDR.	Taxonomy-alignment for a whole of portfolio view For Sustainable investments (*positive contribution and avoiding significant harm*) as defined in SFDR, the ASH&SH/IP taxonomy could facilitate the DNSH assessment (see SFDR box)	SH and ASH could help identifying exclusions. An Amber Ecolabel using IP would facilitate trajectory.
Cross reference to low environmental impact (LEnvI)	TR refers to SFDR products for Taxonomy disclosure If there are LEnvI activities in an SFDR product then these activities could be seen as 'neutral' from a Art. 8 & 9 product perspective. Efforts can be focussed on red, amber, and green activities LEnvI could complete a sustainable portfolio, providing clarity on the rest (unlabelled parts) of the portfolio, even in voluntary reporting context LEnvI could help to rule out environmental PAI on product level in a future review.	Not directly, however, one of the three aspects of sustainability preferences is the share of Taxonomy alignment. LEnvI activities could clarify remaining share of investment and reduce the need for all environmental PAI to be considered (ie share of LEnvI activities would not need to be covered by env. PAI).	No explicit reference, but LEnvI would be most relevant for the "diversification share" of funds, which is not in compliance with the Ecolabel criteria for an "environmentally sustainable economic activity"
Disclosures	Reporting of share of ASH & SH/IP and LEnvI activities for the whole portfolio would complete transparency. However, companies would have to provide respective transparency under CSRD.	N/A	Tbd, so far only recommendations from stakeholder consultation
Governance issues	N/A	N/A	N/A

	Low-Carbon Benchmarks & significant Benchmarks	ESA workstreams (Alternative: *Supervision of the Financial Sector*)	Sustainable Finance Strategy (…)
Scope	Paris-aligned (PAB) and Climate Transition Benchmarks are basically benchmark labels. Market Benchmarks are required to provide more transparency on sustainability	Micro- and macro-prudential duties Addressing 'Greenwashing'	Broad, covering Finance for the transition of the real economy towards sustainability, macro-prudential and fiscal supervisory, usability and inclusion of SMEs
Cross reference to always significantly harmful, significantly harmful and intermediate performance (ASH & SH/IP)	Both PAB and CTBs need to adhere to exclusion list and exclusion criteria (CTBs from end of 2022) for significantly harmful activities. ASH & SH performance levels could be used to identify harmful activities.	ASH & SH/IP classifications (and disclosure) has potential to facilitate identification of environmental & financial risks in the financial system - Pillar 3 reporting: exposures to significantly harmful sectors could support comparable ESG reporting. In the absence of an ASH & SH taxonomy, EBA is referencing exclusions in the low carbon benchmarks for pillar 3 ESG reporting. Potential mandate to implementation guidance for Art. 8 TR disclosure including transition plans. - Pillar 1: Taxonomy can be useful as supporting tool to categorise assets as a basis to conduct research on potential risk differentials. - Transition Plans: ESMA & EBA possibly addressing them subject to receiving specific mandates and depending on the outcome of CRD revision.	Enabling the transition for economic activities at various starting levels of environmental performance is a key element. Introducing Intermediate Performance level is mentioned as an option
Cross reference to low environmental impact (LEnvI)	LEnvI could become relevant for further defining any "non-green" or "non-taxonomy compliant" share of such benchmarks LEnvI useful for diversification/sectoral balance	LEnvI disclosure has potential to allow the focus on environmental risks (except physical climate change risk – adaptation obj.) to be on other sectors. Lower priority of ESAs	no explicit reference made to LEnvI, the concept could be relevant across the four building blocks of the strategy. By labelling activities as LEI, economic actors could address the risk of facing financing constraints and investors will better understand risks in a large segment of the economy not covered by the "green taxonomy"
Disclosures	Compulsory disclosure of ESG factors Benchmark regulation. significant benchmarks have to disclose against sustainability issues	Disclosure to be used: current share (e.g. for products also falling under SFDR, reported taxonomy share), for certain SFDR products also committed share (according to SFDR pre-contractual disclosure).	Promoting disclosure and reporting initiatives on climate and ESG related concerns under Pillar 3
Governance	N/A	N/A	Enhancing governance frameworks of financial and non-financial entities under Pillar 1, 2 and 3

Table 4-1. Summary of interlinkages between EU sustainable finance policies and SH/LEnvI concepts

4.3 Taxonomy activities are not directly comparable to NACE activities

The economic activities listed in Delegated Acts are described on the basis of their relevance to environmental objectives. They often do not correspond directly to economic activities listed under the NACE codes that form the basis of most economic activity reporting. There is no simple relationship between the way Taxonomy activities are described and NACE code activities (see Table 4-2). Some Taxonomy activities have no NACE code equivalent (e.g. the restoration of wetlands), whilst others cover multiple codes.

Table 4-2. Differences between Taxonomy activities and NACE codes

Taxonomy activity	Relevant NACE codes
2.1. Restoration of wetlands; 4.10 Storage of electricity	None
3.5 Manufacture of other low-carbon technologies	C10 to C33
5.6 Anaerobic digestion of sewage sludge	E37.00, F42.99
4.14 Transmission and distribution networks for renewable and low-carbon gases	D35.22, F42.21, H49.50
7.5. Installation, maintenance and repair of instruments and devices for measuring, regulation and controlling energy performance of buildings	F42, F43, M71, C16, C17, C22, C23, C25, C27, C28

This somewhat complicated situation presents challenges for identifying activities that might fall into the no significant impact category. These, on the one hand, will need to be identified proactively as low impact, if necessary, looking at linkages across sectors, and hence taking a wider approach than a simple NACE code approach. On the other hand, such activities can only be comprehensively covered using NACE code lists. Additionally, identifying "significant harmful" activities may require a wider view than single NACE code approaches when analysed in detail, so as to address supply chain and whole life cycle issues.

Identifying activities that are not included in the Taxonomy currently, and distinguishing those that may be included in the future, represents a considerable challenge. There are specific provisions in the Taxonomy Regulation for deciding whether to incorporate additional activities in future and set appropriate criteria. These issues surrounding the use of NACE codes are important when looking at practical options for extending the Taxonomy.

The Platform has identified the need for, and has commenced work on, an extensive mapping of NACE codes against other classification systems used in the market plus an analysis of NACE code data gaps. A first mapping of NACE codes in the Climate Delegated Act has already been completed and published.[26] The Platform is actively working with Eurostat and other partners on this continued mapping exercise to improve the Taxonomy's usability. This work will also support clarity in the deliberations by the market and others on the Platform's recommendations on the virtual or potentially, later, the formal use of SH and LEnvI Taxonomy extensions.

[26] See: Platform on sustainable finance: EU taxonomy NACE alternate classification mapping | European Commission (europa.eu)

5 Activities in need of urgent action (transition or exit) to avoid significant harm (SH) to environmental objectives

5.1 Why extend the Taxonomy to recognise the activities that need to transition away from or exit SH?

The Platform notes that stakeholders often have strong and divergent views surrounding what characterises economic activities with environmental performance levels in the significant harm space and what the pros and cons could be for an extension of the Taxonomy framework to include such activities. Such activities would include two different types:

- Activities for which no technological possibility of improving their environmental performance exists and for which urgent action, in this case exit or decommissioning, is required (see the red area in Box 1 in Figures 4-1 and 4-2);
- Activities for which there is a technological possibility of improving their environmental performance and which are in need of an urgent transition to avoid significant harm to environmental objectives (see the red area in Boxes 2 and 3 in Figures 4-1 and 4-2).

The Platform also notes that the building blocks of an extended Taxonomy, in terms of performance levels, are embedded in the current Article 17 of the TR and that SH performance levels are set through criteria in the Delegated Acts, which are already enshrined in law in the case of the Climate Delegated Act.

The Platform finds that it is both possible and justified to propose a balanced approach towards an SH extension that may reap the benefits of an SH extension while minimising the risks of its unintended consequences.

For this purpose, the Platform recommends that any SH extension of the Taxonomy should be accompanied by an appropriate supporting EU policy framework, including the provision of additional incentive structures and transition finance support. The following sections in this chapter outline the premises of and options for such a balanced approach.

5.2 Links with the legislative reforms of the 2018 Action Plan on Sustainable Finance and the 2021 Strategy for financing the transition to a sustainable economy

This section aims at identifying relationships between a potential Taxonomy for activities in the SH space (both activities for which no technological possibility of improving their environmental performance exists and those for which transition is technologically feasible and urgent) and other existing or planned legislative initiatives launched as part of the 2018

Sustainable Finance Action Plan, including the renewed sustainable finance strategy: the 2021 **Strategy for Financing the Transition to a Sustainable Economy** (a more detailed analysis is presented in Annex 4). The Platform believes that the new classification would complement the other regulatory initiatives and would act as a potential amplifier of their beneficial effects. In addition, some current EU financing initiatives already reference harmful activities.

Some examples concerning both European legislation that is already in force and others that are in the process of being enacted are offered in order to promote more in-depth reflections on the legal profiles and impact analyses:

- providing investors and lenders with a broader set of corporate information, including activities with an amber performance and amber transition plans, which would be complementary to the extension of the scope of application of the proposed Corporate Sustainability Reporting Directive with respect to the NFRD;
- increasing transparency on the non-green part of a financial portfolio/basket/product, also for the benefit of end-investors by:
    - requiring product providers to describe how and to what extent the investment underlying the financial product qualifies as financing an amber transition plan;
    - demonstrating, for the non-green parts of such portfolios/baskets/products, which parts finance an amber transition plan. For this, the notion of amber transition plans could be integrated into the ongoing work on the EU Ecolabel and the EU Green Bond Standard, supporting the development of a specific label and that of a specific standard for 'amber transition bonds'. In this way, it could also increase the investment opportunities offered to investors according to their sustainability preferences, consistent with the changes made in the MiFID II[27] and the IDD-delegated[28] regulations;
- defining 'principal adverse impact' from SFDR, and the exclusions policies envisaged in Regulation (EU) 2019/2089 on EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, and in the preparatory work on the EU Ecolabel, could be considered in light of an extended Taxonomy for harmful activities, the technical screening criteria of which have to be periodically reviewed to remain in line with scientific and technological developments.

Finally, the concepts of Intermediate performance and intermediate transition are clearly identified in the 2021 Strategy, and the Platform's recommendations in this report strongly support the usefulness and importance of these concepts. An intermediate transition and the need for a generally wider understanding of valid transitions beyond green and substantial contribution, to include the important transition avoiding significant harm to environmental objectives, is vital in the whole concept of sustainable and Paris-aligned finance.

Sustainable finance must inherently involve building a sustainable finance system to both **clearly signal and incentivise finance for the green activities that make a substantial contribution to solving environmental crises** and also **signal and incentivise finance to transition activities away from significantly harmful performance that is causing or**

[27] Directive 2014/65/EU of the European Parliament and the Council.
[28] Insurance Distribution Directive EU/2016/97 of the European Parliament and the Council.

worsening environmental crises. Both actions and both financing efforts are needed to accelerate the transition towards significantly better environmental performance overall in the economy (see the arguments in Annex 4).

Given the urgent need to accelerate the transition towards better levels of environmental performance, synergies could firstly be pursued with those regulations that are still being defined, such as the already mentioned EU GBS and Ecolabel. In other cases, the possibility of modifying the delegated regulation should be considered. For example, in the Commission Delegated Regulation of 6 July 2021 relating to Article 8[29] of the TR, the Key Performance Indicators (KPIs) to be disclosed by non-financial undertakings could also refer to the share of activities with intermediate or amber environmental performance and with capex associated with an amber transition plan. Since the latter would appear to require Level-1 legislative changes, this would need to be done after an assessment on reporting options and a detailed impact assessment.

5.3 Three performance levels

Article 17 of the Taxonomy Regulation defines, in general terms, the significant harm space under each of the six environmental objectives. Articles 10 to 15, instead, require that Delegated Acts define technical screening criteria to properly delineate the significant harm space.

The Platform has sought confirmation from the Commission that the existing Taxonomy Regulation does indeed provide a legal basis for developing an SH Taxonomy extension. The conclusion is that Article 19.1 of the Taxonomy Regulation outlines clear requirements for technical screening criteria for significant harm. This includes the requirement that those TSC shall specify the minimum requirements that need to be met to avoid significant harm to any of the relevant environmental objectives.

The Platform therefore concludes that failing to meet DNSH criteria is technically equivalent to causing SH. However, a review of published DNSH criteria may be needed for some activities to assess if their formulation is fit-for-purpose — not only to act as SH criteria but also in order to enhance their usability and practical application as SH criteria (see Section 5.4). Many of those included in the Climate Delegated Act[30] can be used as they stand, but some would benefit from a review. This is due to the fact that these criteria were set by the Technical Expert Group (TEG)[31] and later by the Commission as 'screening-out' criteria to avoid significant harm for activities that might be SC for another objective and not as 'screening-in' criteria for the same objective. Such a review is not intended to complete every DNSH box for every objective under every activity, which would add huge complexity with little benefit, but it may likely identify some material DNSH technical screening criteria that are missing. It is also not intended for reviewing the ambition level of the criteria, although this aspect could be included.

[29] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021

[30] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

[31] TEG final report on the EU taxonomy | European Commission (europa.eu); Technical annex to the TEG final report on the EU taxonomy | European Commission (europa.eu)

Some criteria set with process-based or quantitative performance levels work well both for screening out as DNSH and screening in as SH, such as the process-based technical screening criteria for DNSH to climate change adaptation or the figure of 270 g CO_2e/kWh for DNSH to climate change mitigation for electricity-generation activities. There are five types of issues, however, that would need to be addressed before the DNSH criteria might all be fit for purpose as SH criteria, and these are presented in Section 5.4.

From such section, it is clear that the Taxonomy Regulation definition of significant harm, when taken forward in the DNSH criteria in the Delegated Acts, technically defines the minimum requirements for significant harm performance levels (i.e. the DNSH and SH criteria are technically the same).

The Taxonomy Regulation therefore defines three performance levels of an economic activity that has been included in the Taxonomy by being listed in a Delegated Act:

- Substantially contributing to an environmental objective (SC) — Green — performance at or above the threshold set in the technical screening criteria for SC.
- Doing significant harm to the environmental objective (SH) — performance below the threshold set in the technical screening criteria for DNSH.
- Doing no significant harm to environmental sustainability nor substantially contributing to the specific environmental objective — performance that neither fails the TSC for DNSH nor reaches the technical screening criteria for SC.

This interpretation provides the formal basis for the conceptual model of the extended Taxonomy shown earlier in Figure 4-1.

In light of these considerations, the Taxonomy of activities in the SH space can be thought of as consisting of two components: (a) the activities **for which no technological possibility of improving their environmental performance to avoid significant harm exists**, as is the case for the power-generation activity using fossil fuels already identified in Article 19 (3) of the Taxonomy Regulation (see Section 5.5 for more details); and (b) the activities that fail performance levels set by DNSH technical screening criteria in Delegated Acts (where such DNSH criteria exist) and are in need of an urgent transition to avoid causing significant harm to environmental objectives.

The Platform identifies a high risk of misinterpretation and misunderstanding about the space between SC and SH, which covers a level of performance ranging from **almost making a substantial positive contribution to an objective to almost causing significant harm to an objective**. This space cannot be interpreted as either positive or negative in and of itself and should not be thought of as a medium contribution or as almost harmful. Because of this, and to avoid further misunderstandings, the Platform believes it requires an appropriate name. **The Platform therefore recommends calling the middle space of environmental performance between SC and SH the 'IP'** (or 'amber performance', as introduced in Section 4.2). The Platform notes that the Commission's 2021 Strategy for Financing the Transition to a Sustainable Economy will consider options for extending the EU Taxonomy framework to possibly recognise economic activities performing at an intermediate level.

The Platform could develop guidance on criteria for activity-specific intermediate capex plans[32] and entity-level transition strategies, as stated in the Platform's Transition Report. The initial thoughts on guidance regarding these plans are covered in Table 5-2.

The Platform stresses that the naming of this middle space and the overall concept of the **TRAFFIC LIGHTS FOR SUSTAINABLE FINANCE** (see Section 4.1), together with appropriate guidance and explanation, are important for avoiding misunderstandings. This clarity of terms and clear associated guidance is also essential to minimise and mitigate negative socio-economic impacts. It will also provide a basis for developing a framework in which initiatives aimed at improving the environmental performance of economic activities, and remaining permanently out of the significantly harmful space, find recognition and support.

The Platform wishes to make clear that introducing an SH Taxonomy and delivering clarity to companies, investors, issuers and other entities carrying out activities on where exactly that Significant Harm exists provides those companies and other entities with incentives to move away from such activities or performance levels over time (step by step) (e.g. to avoid reputational or financial risks). This clarity is essential to trigger activity-level intermediate capex plans or entity-level transition strategies, either within the Intermediate Performance space or the substantial contribution space. The concern raised by some: that occasionally the DNSH criteria set a level of legal compliance, does not damage the Platform's proposition, since legislation can be put in place to ensure an improvement in environmental performance, and finance would then likely be needed to be raised for investments to meet the new standard.

The Platform notes that other EU legislation in the area of sustainable finance, such as the Sustainable Finance Disclosure Regulation, requires that financial market participants on the entity level — and in some cases on the fund level — falling under the Regulation report on the principle adverse impacts (PAIs). Further guidance and cross-linking between different parts of the EU sustainable finance architecture are essential to build on such synergies, maximise the use of similar or compatible indicators and metrics and avoid duplicate, differentiated reporting. Annex 2 elaborates on some of those potential links.

5.4 Reassessment of the DNSH criteria for an extended Taxonomy

As mentioned in Section 5.3, the Platform has clarified that the DNSH criteria can in principle be taken to define activities in the SH space. Criteria setting quantitative performance levels or generic process levels work well for screening out as DNSH and screening in as SH. For example, many of the technical screening criteria already set in the Climate Delegated Act[33] can be used, such as the standard process-based technical screening criteria for DNSH to climate change adaptation or the threshold of 270 g CO_2e/kWh for DNSH to climate change mitigation for electricity-generation projects.

However, not all the DNSH criteria are easily used to define the three different performance levels for an extended Taxonomy. This is due to a number of reasons, including the complexity

[32] Note that intermediate capex plan is used throughout this document to define expenditures (capex and opex) that will be used for improvements into or within the intermediate performance space and is further elaborated in this document.
[33] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

of the nature of some of the environmental objectives. In some cases, the issue may be due to the fact that the DNSH criteria were originally drafted for the purposes of defining green activities.

While analysing the DNSH criteria included in the Climate Delegated Act, the Platform noted that DNSH criteria are not defined for all environmental objectives and for each economic activity (what might be called 'missing DNSH' (e.g. DNSH for a circular economy for material recovery from non-hazardous waste). The Platform wishes to stress that not all of these missing DNSH are needed, and there would clearly be an important cost–benefit consideration in adding additional DNSH criteria. Nevertheless, some key missing criteria may be found to be important for the purposes of defining the intermediate performance. Furthermore, when DNSH criteria are defined, the Platform notes that some DNSH criteria may differ in nature and their assessment might be difficult, making them challenging from a compliance perspective in the current regulatory framework and unfit for the Taxonomy extension. Table 5-1 below summarises the different types of DNSH criteria.

The Platform highlights that although some DNSH criteria work well as stand-alone criteria and clearly identify levels of performance that can be defined as significantly harmful and in need of urgent transition, an review of some DNSH criteria is being recommended by the Platform for a number of different reasons: usability and data, questions of appropriate ambition levels, and in this particular report, the need for DNSH criteria to be equally useful for supporting both the definition of green and sustainable activities and for identifying levels of performance urgently needing to transition to avoid significant harm. It is therefore important that when any reviews are done, or when new DNSH criteria are established, that all three aspects are considered together.

A regular review of technical screening criteria, as foreseen in the TR, will allow for more clarity on data that should be gathered, increased usability and will facilitate intermediate/amber transition finance as part of an extended Taxonomy. This use in an extended Taxonomy does not need to be delayed by a future review, as it can start with voluntary use based on the Climate Delegated Act TSC technical screening criteria, extending to address additional DNSH criteria in the Tax04 Delegated Act and can then build on further TSC reviews going forward. There is no suggestion that every activity will need DNSH criteria for every activity, nor is it suggested that all DNSH criteria should be proposed for revision; nevertheless, a robust review covering all three aspects can be highly useful.

Table 5.1 below provides the Platform's latest analysis of different types of DNSH criteria and is included here to assist with further discussion on these points.

For the purposes of this report, we summarise the table as follows: DNSH criteria can be quantitative (e.g. threshold criteria) and qualitative (e.g. requiring a company to conduct a climate risk assessment, an environmental impact assessment or an environmental degradation risk assessment); they can be based on legislation (e.g. EU legislation and international standards); and they can be imprecise (e.g. references to 'minimise').

Table 5-1. Different types of DNSH criteria: Types A–E

Type	Name		Example	Assessment
A	**Second Threshold**		*Climate change mitigation:* 'The direct GHG emissions of the activity are lower than 270 g CO2e/kWh'.	Quantitative
B	**Process Measure**		*Ecosystems:* 'Where relevant, maintenance of vegetation along road transport infrastructure ensures that invasive species do not spread. Mitigation measures have been implemented to avoid wildlife collisions'.	Quantitative & Qualitative
C	**International Standards & EU Legislation**		*Pollution:* 'Measures in place to minimise toxicity of anti-fouling paint and biocides as regulated in the Biocidal Products Regulation: (EU) 528/2012, which implements (in the EU) the International Convention on the Control of Harmful Anti-fouling Systems on Ships, which was adopted on 5 October 2001'.	Quantitative & Qualitative
D	**EU Only Legislation**	**D1.1 EU Regulation**	*Pollution:* 'The activity complies with Regulation (EU) 2019/1009 or national rules on fertilisers or soil improvers for agricultural use'.	Quantitative & Qualitative
		D1.2 EU Directive	*Ecosystems:* 'An Environmental Impact Assessment (EIA) or screening has been completed in accordance with Directive 2011/92/EU'.	
E	**Non-assessable Ambition**		*Circular Economy:* 'Peat extraction is minimised'.	Not possible

The issues mentioned above regarding different drafts of DNSH criteria as well as the wide variety of DNSH criteria not only raise concerns on the ease of implementation[34] or level of ambition[35] of some criteria in the current Taxonomy DAs but in some cases can affect its extension to clearly define intermediate performance and to provide clarity on performance levels requiring urgent transition to avoid significant harm. Indeed, it would be difficult to use a number of the existing DNSH criteria as currently written to define a stand-alone red/amber intersection since they do not clearly define a level of ambition/performance. As shown in the Intermediate/Amber Transition examples in Section 5.9 (including both easily applied and more difficult to apply DNSH criteria), some DNSH criteria may hamper the potential for non-financial companies (for instance) to show their transition efforts if they are not clarified or redrafted. This risk may be further accentuated for activities performed outside the EU when the DNSH criteria refer to EU legislation and are difficult to translate.

As the DNSH criteria were not initially developed with the aim of fitting into an extended Taxonomy, **we recommend a focused review of the existing DNSH criteria (Recommendation 8)**. For the purposes of this report, it should be noted that Recommendation 8 focuses on a specific aspect of a DNSH criteria review (i.e. screening in SH activities) and does not aim to preclude further revision recommendations by the Platform for the purposes of better usability and/or setting an adequate ambition level, as mentioned earlier. In an extended Taxonomy, the (DN)SH criteria will be important. There are therefore five types of issues that might need to be addressed before the DNSH criteria might all be fully fit for purpose as SH criteria:

- technical screening criteria for DNSH to climate change mitigation, found in Annex II of the Climate Delegated Act[36], may have been written only referring to the green activity where it is located (e.g. 'the adaptation measures should not…'), which means that it **does not function as a stand-alone SH criterion**.
- technical screening criteria for DNSH to climate change mitigation may **not have been set because it was deemed unnecessary** for climate change adaptation purposes, such as there being no level of leakage in a water supply system set as a technical screening criteria for DNSH to climate change mitigation. Yet, if starting from an SH standpoint, it is clear that there is a certain level of leakage (e.g. the average water leakage rate related to the economic activity, using the general approach to take the average performance level to set many DNSH criteria), that might need to be set as an SH criterion.
- Some technical screening criteria for DNSH may create **interpretation challenges** due to legally undefined terms. This is the case for Appendix C of the first Climate Delegated Act, defining TSC for DNSH to the pollution prevention and control objective using legally unclear terms, such as referring to 'essential' uses or 'substances of concern', or the DNSH criteria for the circular economy objective which use unquantifiable expressions such as references to 'minimising' damage.
- Some technical screening criteria for DNSH create **usability and ambition-level challenges**. This is the case for DNSH criteria for the biodiversity and ecosystem objective, which do not provide specific thresholds nor concrete measures to preserve biodiversity and which are therefore challenging when aiming to define SH activities.
- The **assessment** of some technical screening criteria for DNSH may be **challenging in territories outside the EU** when referring to EU legislation.

[34] Further usability considerations of the current Taxonomy will be provided in a future Platform's report on data and usability.
[35] Further considerations will be provided in a future Platform's report recommending new technical screening criteria.
[36] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

Improving the DNSH criteria for some activities where relevant would, on the one hand, reduce the risk of usability issues arising with the current Green Taxonomy (e.g. assessment and disclosure of Taxonomy-eligible activities and further usage in the EU Green Bond Standard) and, on the other hand, ensure that the level of ambition properly defines SH performance, thus helping operators to more easily use the extended Taxonomy as a 'transition tool' (see Section 5.7). Nevertheless, many DNSH criteria in the Climate Delegated Act are easily used, and the voluntary reporting proposed by the Platform for Intermediate Transition/Amber Transition instruments can start by using these criteria and will provide practical information on which DNSH technical screening criteria are harder to interpret and use for this purpose, providing robust inputs to the future review.

5.5 Activities with no technological possibility to transition away from significant harm

Based on the most recent scientific evidence,[37] and in line with the international agreement to phase down coal-fired power in the November 2021 Glasgow Climate Pact,[38] the Platform interprets Article 19 (3) as identifying one activity, solid fossil fuel power generation, that cannot transition to environmental sustainability (i.e. it is incapable of transitioning to a low-carbon, environmentally sustainable, Paris-aligned performance level).

Adequate attention will need to be given to identify other such activities for which there is no technological solution that allows for an improvement of their environmental performance to avoid significant harm. Identifying such activities would need to be done with respect to all six of the environmental objectives established by the Taxonomy. It may be that some activities are identified for which although a technological transition possibility exists at a small scale, it is not technologically possible to transition at the larger scale needed.

While the impact of both types of activities in the SH space may be equally harmful in principle, they differ in terms of their future perspective. While the former can only be decommissioned or exited, which is in and of itself environmentally beneficial, the latter can either be decommissioned or undergo an investment plan aimed at improving their environmental performance. Such a transition towards an environmental performance level that is out of the SH space and continues to stay out of that SH space (e.g., by an activity-specific investment plan) could target the SC or intermediate performance level.

Clarification of this important difference, along with the establishment of a list of economic activities which cannot improve their environmental performance to avoid significant harm, has the advantage that public and private actors can make appropriate plans to address the social consequences of the closure (or shut down/decommissioning/stopping/disposal, depending on the type of activity) of such SH activities. This may come fairly swiftly in the next few years as delivery on the 2030 targets looms nearer.

[37] For instance, the report Net zero by 2050: A roadmap for the global energy sector, mentions the requirement that unabated coal-fired generation be cut by 70% by 2030, including the phase-out of unabated coal in advanced economies, and phased out in all other regions by 2040, in order to meet the long-term climate targets set by the Paris Agreement.

[38] Document available at: https://unfccc.int/documents/310475.

Such plans may also be relevant in the future for Taxonomy-eligible economic activities where the company or operator chooses the closure option as part of its transition strategy and may raise green finance for the capex to make the closures. An identification of these activities does not pass any comment on what source of finance should be used to pay for such a closure. Any such transition strategies including decommissioning/closure, be they public or private, must comply with minimum (social) safeguards and must in parallel also carefully consider Just Transition-type measures — they may also need to take into account policies such as the EU Just Transition Mechanism.[39]

Voluntary application of these concepts could start with Article 19 (3) activities and their dedicated supply chain, where it is already internationally understood that urgent exit/decommissioning is needed. The further establishment of other activities of the same nature could build on that first type, based on Article 19 (3).

5.6 Transitions and Intermediate Performance levels

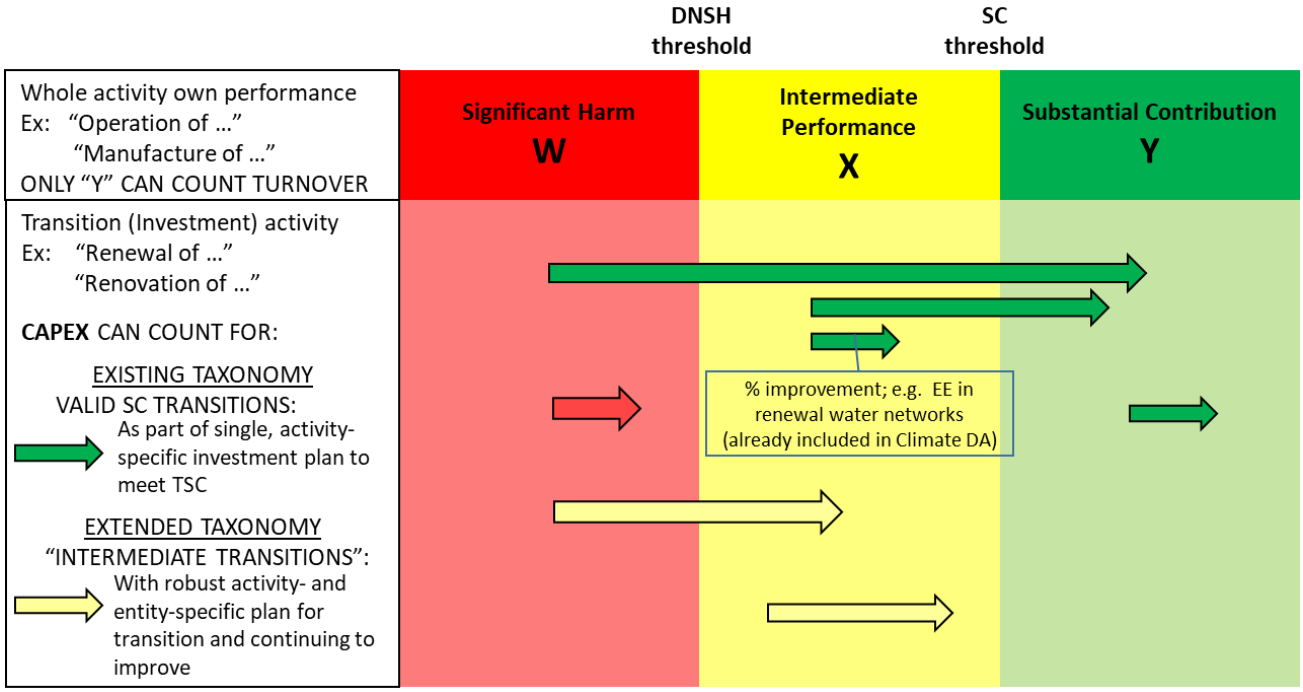


Figure 5-1. Performance levels and transitions.

Figure 5-1 illustrates different types of transitions between levels of absolute performance for an activity included in the Taxonomy. Any transition into SC levels of performance can count as green, the costs (including capital expenditures – capex) to finance the investments and the turnover associated with the activity once SC levels of performance are reached. These green transitions, subject to rules about activity-specific investment plans and reporting, are recognised by the

[39] See : https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal/actions-being-taken-eu/just-transition-mechanism_en

current Taxonomy and are shown above as **green** arrows. But what about the other transitions represented by the red and amber arrows?

Most activities in the SH space do have the potential to transition towards higher levels of environmental performance. A 'valid' intermediate (or 'amber') transition is recognised for any movements out of performance levels that define a damaging level of environmental performance if it is ensured that an activity is continuously staying out of the previous performance level. This is illustrated by the **amber** arrow. **Inversely, any improvement in performance staying within the significantly harmful space is not a valid transition since despite the relative improvement, the activity is still causing Significant Harm and hence undermining that objective (through its absolute impact)**. The latter improvement is indicated by the red arrow.

The Platform notes that whilst transitions into SC levels of performance are recognised by the current Taxonomy, including for 'transitional activities' for climate change mitigation, as per the requirements of Article 10(2), transitions towards levels of performance that do not meet SC criteria are not recognised. An extended Taxonomy therefore opens up a broader approach to describing transition opportunities by recognising activity-specific improvements out of the SH performance and into the intermediate performance space (or 'amber space') while considering the dynamic nature of the Taxonomy.[40]

Improvements within the intermediate (or 'amber') performance space

Additionally, some activities with a starting point in the intermediate space might make a 'significant improvement' but remain in the intermediate performance space. These improvements in environmental performance levels might also, under particular circumstances, be seen as a valid intermediate, or amber, transition. This is provided there is a robust activity-specific transition plan to continue to improve performance and that the activity is improving within an activity trajectory, going on to green performance where possible.

The Platform notes that some improvements are already included in the green Taxonomy as a substantial contribution (shown as the green arrow starting and ending within the amber space in Figure 5-1) when such improvements in the intermediate space cannot meet SC criteria for the whole activity (e.g., restoration of historic buildings which cannot meet SC criteria for new buildings) or the SC criteria for the whole activity have not been defined. In this instance, technical screening criteria for a specific improvement activity might be included in the green Taxonomy, making it a green activity. Such activities could be described as 'Renewal of…', 'Renovation of…', 'Rehabilitation of…' or 'Environmental improvement of…' and could follow the approach that has already been set out for some activities in the climate change mitigation Taxonomy which effectively define green investments/capex (e.g. in Climate Delegated Act sections **5.2 Renewal of water collection, treatment and supply systems** or **7.2 Renovation of existing buildings**).

As already noted in the Platform's Transition Report from March 2021, adding further green transition 'improvements' of this nature in the particular cases where these can be recognised (and where they can genuinely support a substantial contribution in line with the Taxonomy Regulation definition) is another option for expanding the range of transition finance possibilities without changing existing legislation.

[40] Other conceptual methodologies have been considered such as measuring the distance from SC and DNSH or dividing the intermediate performance zone in smaller fractions to get a more nuanced Taxonomy. However, such methodologies would increase the complexity and would not work well with the breadth of technical screening criteria used in the Taxonomy.

Depicting amber transitions superimposed on falling curves

It is also possible to depict the different types of intermediate, or amber, transitions (outlined in Figure 5-1) in the 'falling curve' diagram that was firstly introduced in Section 4.2. Looking at Figure 5-2 below, point W transitions to the intermediate space (to point T) thanks to an 'amber' transition. However, when reaching T, there is the need to keep improving (with another amber transition) in order to stay in the same intermediate space and not to fall back into the red area (i.e. the black dashed line). Considering instead point X, which starts in the amber space, it needs to keep improving in order to reach T and beyond (by means of an amber transition) to stay in the intermediate space and not to move into the significant harm space.

An important point to note is that the following graphic, and indeed all of the falling curves shown in this report, are drawn from the perspective of the **transition of the performance level of the activity** (which has to then be incorporated into the transition plan of the entity carrying out that activity). The graphics do not address grandfathering issues around financial products or instruments that include investments in these activities. This is an important, but different, issue which would be relevant for amber finance in an extended taxonomy framework, just as it is already for green finance.

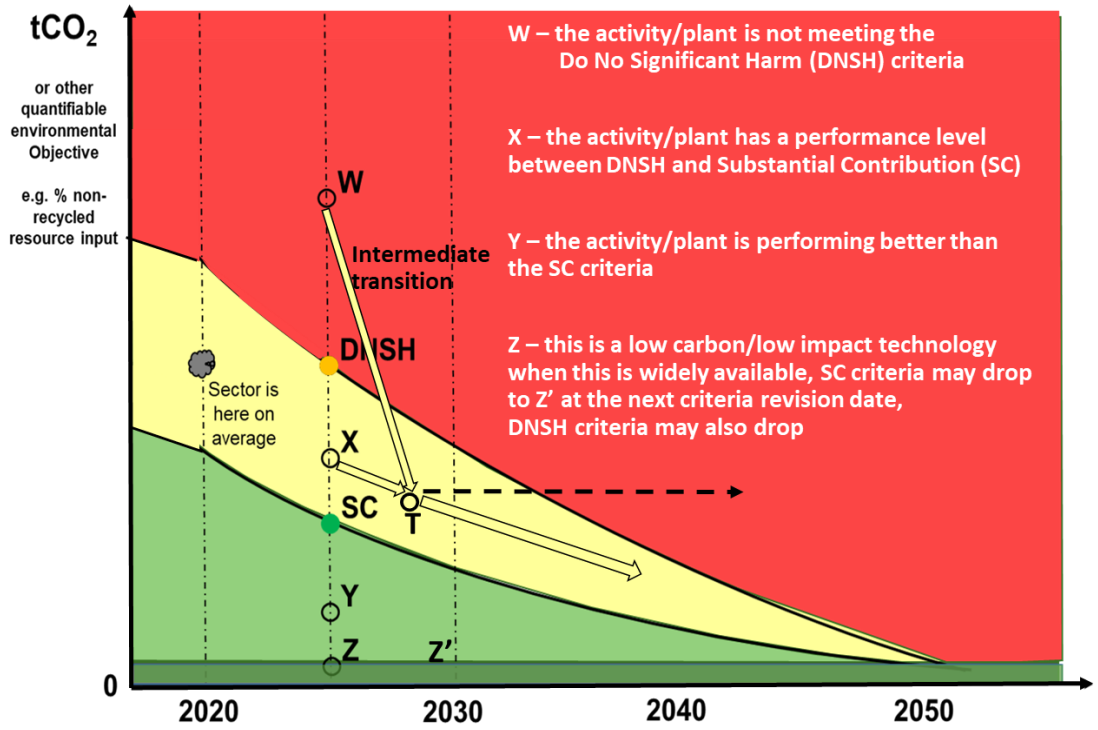


Figure 5-2. Amber transitions applied to a 'falling curve' diagram.

The Platform also recognises that an intermediate (or 'amber') transition is conditioned by the fact that the activity meets all DNSH criteria (and minimum [social] safeguards) at the end of the investment period (see Figure 5-3), and actually, even activities transitioning to substantial contribution for an environmental objective have to transition out from SH to any of the other five environmental objectives at the end of the investment period (see Figure 5-4). In this latter case, it should be highlighted that should the five to ten year transition plan result finally in the activity reaching substantial contribution to another objective, then these amber transitions as shown in

Figure 5-4 would in fact have been green transitions where capex and relevant opex could be reported as green.

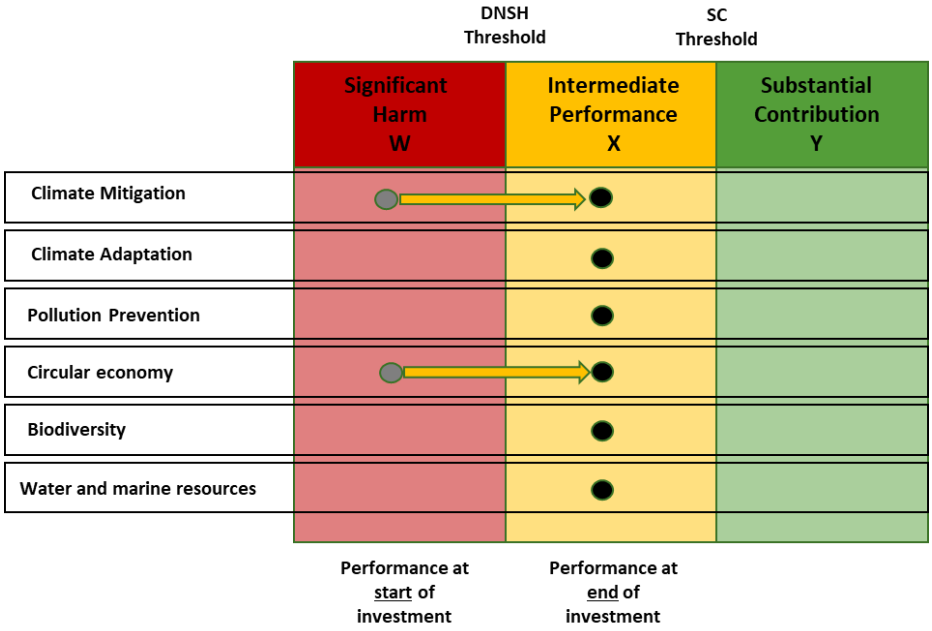


Figure 5-3. Example of intermediate transition on multiple environmental objectives.

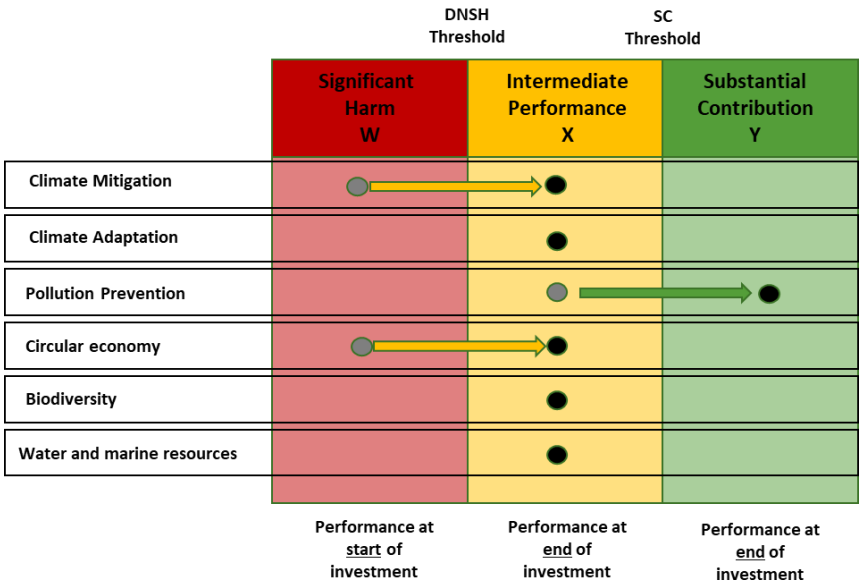


Figure 5-4. Example of a transition to a substantial contribution for one environmental objective and an intermediate transition to others.

5.7 Disclosure requirements for activity-specific intermediate capex plans

In order for an activity-specific investment plan to qualify for intermediate capex, the investment needs to include information that enables an assessment of the credibility and ambition of the improvement. Such an information has two parts:

1. Information about the investment's environmental performance improvement;
2. Putting the investment in the context of the entity-level transition plan.

5.7.1 Part 1: Information about the investment's environmental performance improvement

5.7.1.1 Features of an improvement target

- The environmental performance must be based on technical screening criteria defined in the Taxonomy Delegated Acts defining DNSH.
- An activity **baseline level and target** performance level.
- A **timeline** with a clear target when the activity-based investment will reach the desired intermediate environmental performance level. For activity-specific capex, this is generally not more than five years but could be extended up to 10 years, depending on the nature of the planned investments.[41]
- Establish that the capex leads to the improvement of the economic activity to the intermediate performance level and in addition links back to the company's entity-level transition plan (see Part 2).
- For dynamic criteria (i.e. technical screening criteria that have an improvement trajectory, such as for GHG emissions that are expected to trend towards zero), **there must be a plan over time to stay in the intermediate space, avoiding significant harm**[42] **Importantly, the plan should also justify why the current intermediate transition investment cannot reach an SC directly**.

[41] Article 8 DA.

[42] This is slightly different from any transition into an SC, as the distance to SH is closer in the intermediate performance space and therefore it is relevant to have a plan to continue to stay out of SH.

5.7.1.2 Governance

- The activity-specific intermediate capex plan needs to have been validated by the non-financial undertaking's administrative body or another corporate function to which such approval has been formally delegated.[43]
- It needs to be supported by independent assurance or verification, if possible, as part of the assurance process of financial filings. However, dedicated third-party verification may also be used as is common market practice for green bonds.

5.7.1.3 Transparency

- It needs to be at least partly publicly disclosed (if possible, in mainstream financing filings) as part of a longer-term entity-level transition plan. Disclosure of information from the intermediate capex plan should be at a level necessary to assess the credibility of the plan while not releasing any commercially sensitive or business-sensitive information. The verifier needs to confirm it has seen enough additional information to confirm that targets can be reached.
- Disclose progress and any deviations annually during the investment period.

5.7.2 Part 2: Putting the investment in the context of the entity-level transition plan[44]

Activity-specific expenditure or capex (and relevant opex) plans to improve environmental performance are generally set in the context of entity-level transition plans. Currently, most entity-level long-term transition plans refer to climate change mitigation, but increasingly, companies are setting targets for other environmental objectives. In order to assess the credibility of an activity-specific capex plan for intermediate transition, there is therefore a need to put it in the context of the entity's[45] transition plan. The activity-specific intermediate capex plan should therefore relate to:

1. The entity's long-term and interim targets for the environmental objective based on relevant science-based trajectories or scenarios or any breakdown of EU environmental goals, where applicable.
2. The entity's long-term plan to reach the entity-level targets while not releasing any commercially sensitive or business-sensitive information.

Table 5-2. Summary requirements of a robust intermediate transition plan

[43] This point will likely be addressed by the CSRD.
[44] Disclosure of the entity-level transition plan will likely be addressed by the CSRD.
[45] Drawing on ICMA's climate transition finance handbook.

Element of the activity-specific intermediate transition plan	Intermediate transition (from SH to IP)	Green transition (from anywhere to SC)
Improvement target	Yes	Yes
Improvement from SH to IP	Yes	No
Validation	Yes (Article 8)	Yes (Article 8)
Transparency	Yes (Article 8)	Yes (Article 8)
Part of entity-level transition plan	Yes	No

It should be noted that a transition plan may well additionally have a wider scope of what could or should be covered in an activity/entity capex transition plan that is either (a) going alongside the investment specifics to show the broader activity/entity-transition context and pathway or (b) covering the different base of an entity reporting their transition independently of a specific investment, as per the other significant use case for the Taxonomy. And this broader scope might incorporate capex, opex, other expenditures and actions which do not need investment at all (e.g. changing procurement policies, changing management systems etc.). It is important to consider that not all necessary action will need capex and that the Taxonomy has a wider application than just for finance/investment reporting — it is also a capacity-building tool.

5.8 Guidance to assess improvement in the context of intermediate transition

The technical screening criteria/DNSH metrics' nature depends both on sector activity and the type of environmental objective. An assessment of the current DNSH criteria is presented in Section 5.4. The assessment highlights that many DNSH criteria are not using quantitative KPIs. Where it is not possible to set a quantitative KPI, the KPI is qualitative, and the difference between significant harm and the intermediate category is defined by meeting different forms of qualitative criteria. It could be, for example, stopping certain practices or applying certain processes. The extent to which the DNSH is clearly defined in measurable terms will influence whether an intermediate transition can be established in practice.

Table 5-3 below aims to illustrate the requirements for an intermediate transition based on different types of DNSH criteria in order to qualify for intermediate transition capex in addition to the criteria already outlined above. It shows that an intermediate transition can happen in many ways and that the improvement will be dependent on the nature of the criteria. It is also worth noting that significant improvement within the IP space can only be considered if there is a defined transition trajectory. It is also worth stressing that this transition can only be possible if DNSH criteria are reassessed to suit the Taxonomy extension (Section 5.4) and with improved clarity on the development of falling curves criteria in the future.

Table 5-3. Intermediate transition requirements in relation to types of DNSH criteria

	QUANTITATIVE		QUALITATIVE
	DNSH trajectory	**No DNSH trajectory**	**Process based**
From SH to IP	• Land in IP space	• Land in IP space	• Start applying defined process

	• Improvement plan to stay in IP space		
From IP to IP	• Improvement plan to stay in IP space	• N/A	• N/A

There are some important differences when considering a transition out of SH to intermediate performance as compared to a transition to an SC.

Some stakeholders, noting that in some sectors of activity DNSH criteria have been set at the level of compliance with existing environmental legislation, have raised a concern that recognising economic activities moving out of SH would in practice mean recognition for 'stopping breaking the law'. This is clearly not the same as recognising investments aimed at achieving a higher level of environmental ambition than is actually required by law. Nevertheless, the Taxonomy is a tool to describe environmental performance in terms of a substantial contribution to, or an undermining of, six environmental goals. The Platform's view is that the issue of whether some transitions out of an SH performance space are moving from an illegal to a legal status cannot be addressed in the Taxonomy and would need to be addressed elsewhere in a legal framework. From a purely taxonomic perspective, the environmental impact is the same, and the Platform believes these transitions should be included in the extended Taxonomy, since finance may be needed for them.

Concern has also been registered that simply getting out of an SH space should not be rewarded as it is not a sufficient transition. Three points may mitigate these concerns:

i) A requirement on continued improvement to lower the risk of 'falling back' into an SH space that might occur without further improvements as the DNSH/SH criteria tighten. This is defined in Table 5-3 above and would need to be adjusted to the characteristics of different activities' nature of improvement (e.g. some are stepwise while others are more linear in nature).

ii) However, for some objectives, the change from SH to intermediate performance is a substantial shift not represented by a smooth 'falling negative impact curve'. One example of this kind is avoiding SH to the biodiversity objective where DNSH is to avoid doing irreversible harm to biodiversity and ecosystems. Another example is avoiding SH to the climate change adaptation objective where DNSH means analysing climate vulnerabilities and taking action to address all material risks. Making the transition away from SH in both these cases is a critical step towards a more sustainable operation. It therefore should be made transparent even if the activity cannot reach a green performance.

iii) The market should continue to prioritise and make transparent green transitions whenever possible, encouraging activity-based transition plans which aim to move on to SC performance as soon as that is technically and economically feasible. They also aim to provide arguments as to why the activity cannot reach SC performance in activity-specific intermediate transition investments.

Reporting

Reporting by companies or other entities on activities that do not comply with DNSH will potentially create a form of SH reporting by companies using DNSH criteria, and this may help enterprises develop clear activity-specific transition plans and make those transitions transparent to the market in a very clear way, less subject to the individual views of shareholders or stakeholders. It may

have the same use in enterprise-level strategies to address these SH performance issues. The Platform's outreach found that some enterprises support this clarity, and some financial market participants are already using DNSH criteria to engage with investee companies. However, since no compulsory reporting of activities doing significant harm under the Taxonomy is required of companies or public entities, it is clear that guidance on how to use concepts and performance criteria in the existing green Taxonomy could be useful. It would provide de facto ways of describing transition finance other than green, thereby supporting transparency and the development of robust activity-based transition plans and entity-level strategies.

The Platform highlights that it will continue to work on whether this approach needs to be adjusted when looking at DNSH/SH to adaptation, whilst being very aware that many regulators across Europe and globally are already moving to more detailed reporting on climate risks, including physical climate change risks, for example through a TCFD[46]-like approach. The Platform highlights that a performance level of SH to climate change adaptation should not be seen as less serious than the others, but it may need to be addressed slightly differently.

5.9 Financial instruments to provide financing of intermediate transition capex

The proposed extended Taxonomy builds on the current logic and set up of the existing Taxonomy (i.e. using the DNSH threshold to create two more performance levels). Therefore, any debt or equity instruments developed for the financing of expenditures to improve performance into the SC space can easily be adjusted to the financing of expenditures (including capex and relevant opex),[47] improving performance into the intermediate performance space. As an example, the structure of a green bond can be applied on assets where the improvement leads to intermediate performance and as a result be called an intermediate transition bond or amber transition bond using the same governance structure and transparency requirements as for a green bond, including the grandfathering of financial instruments. This will be particularly relevant for industries where relevant but incremental improvements can be done in between large-scale technology updates, such as the steel industry.

In addition, with a revised set of applicable DNSH criteria that can be used to assess intermediate performance, the market will have an important additional tool to define improvements that do not lead all the way to an SC during the financing period. This is particularly relevant for financial instruments and products with more flexibility, such as sustainability-linked bonds and sustainability-linked loans. For such products, the DNSH threshold, if revised as proposed in this report, will serve as a benchmark for adequate/ambitious-enough improvements for a specific activity. Currently, such guidance is not available in the market for many of the activities covered in the Taxonomy.

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[46] Task Force on Climate-Related Financial Disclosures | TCFD) (fsb-tcfd.org)

[47] 'Expenditures may not be related to those of companies as there are much wider uses of the Taxonomy, however for corporate Article 8 reporting, the OpEx KPI represents the proportion of the operating expenditure associated with taxonomy-aligned activities or to the CapEx plan. The operating expenditure covers direct non-capitalised costs relating to research and development, renovation measures, short-term lease, maintenance and other direct expenditures relating to the day-to-day servicing of assets of property, plant and equipment that are necessary to ensure the continued and effective use of such assets. The plan that accompanies both the CapEx and OpEx KPIs shall be disclosed at the economic activity aggregated level' (from EC FAQ: What is the EU Taxonomy Article 8 delegated act and how will it work in practice?

An example of a potential approach for an ‘amber transition’ bond is given below, and more detailed examples are given in Annex 7.

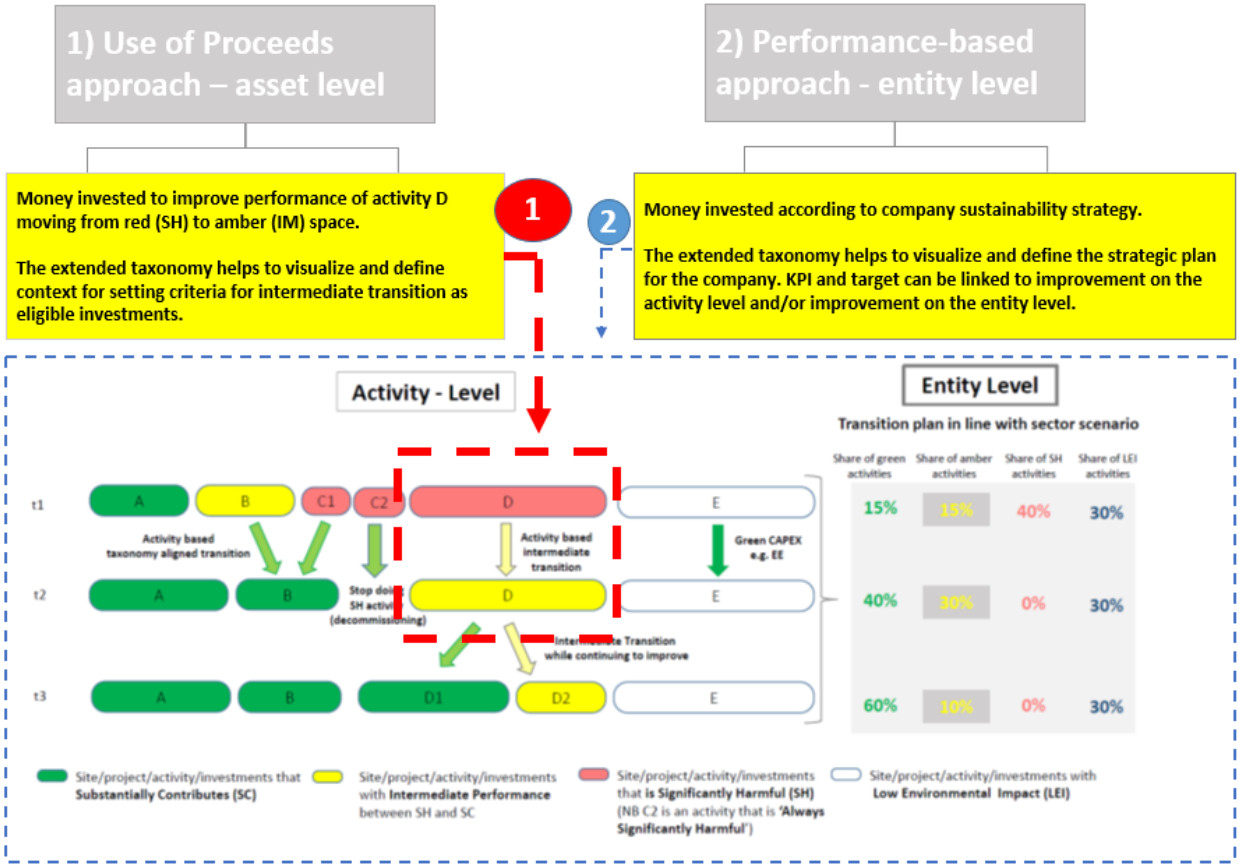


Figure 5-5. Example of a practical application of the extended Taxonomy concept to an ‘amber’ or ‘intermediate transition’ instrument.

Activity-level (sectoral) examples

This report makes the case for a category of ‘intermediate transitions’ or ‘amber transitions’ to improve performance away from the significant harm space without reaching green performance for a given activity. Four potential cases for an **intermediate transition** are shown on the following pages. The first case, that of steel manufacturing, is considered of high importance as an indication of how an amber transition might work in practice in a high-emitting industry, demonstrating the usefulness of the concept of the extended Taxonomy, which could then be developed further in other high-emitting industries with reference to each industry’s decarbonisation pathway and with consideration of Just Transition aspects in such transition plans.

Potential case for an intermediate/amber transition:
Manufacture of steel

According to the latest industry decarbonisation roadmap for carbon-neutral steel making in Europe[48] and an analysis by the EC,[49] no one technology will be able to deliver the required 80–95% sector GHG reduction targets by 2050. This transformation will require some €52 billion in investment. Several of the investments required will not immediately allow for reaching the SC criteria for a transitional activity as set out in the Climate Delegated Act[50] because this is based on the average value of the top 10% of performers in the EU under the EU Emission Trading System (ETS).

Meeting the targets will involve at an intermediate stage implementing combinations of *smart carbon* with existing assets that allow partial (15–20%) CO_2 emission reductions. When existing assets come up for renewal, their replacement by *carbon avoidance* (see CDA) technologies will allow deep decarbonisation (i.e. by using green hydrogen). The technological pathways may vary according to the local availability of resources, the technology readiness level (see table 5-4 below) and the right legal framework to prevent carbon leakage.

An intermediate transition, as described in this report, that moves steel production at a specific site out of SH performance for climate change mitigation using *smart carbon* or similar technologies could potentially be a valid transition on the pathway for the overall sector, provided that a robust activity-specific investment plan is combined with an overall entity-level transition strategy.

The current Taxonomy DNSH criteria are based on the logic of the ETS system, where GHG emissions do not exceed the values applied to the different manufacturing process steps of hot metal, sintered ore, coke (excluding lignite coke), iron casting, electric arc furnace (EAF) high alloy steel and EAF carbon steel. The DNSH criteria also offer the possibility of complying with DNSH through the ratio of steel scrap input relative to the product output for high alloy steel and carbon steel using EAF. A discussion of the some limitations of the current ETS-based DNSH metric is found at the end of this case. This case focuses on the total emissions from primary steel production and secondary (scrap metal) steel production and the activities and technologies that can reduce CO_2 emissions.

Table 5-4. Overview of CO_2 reduction strategies for iron and steel production

[48] Eurofer (2019). Low carbon roadmap - Pathways to a CO_2-neutral European steel industry.
[49] European Commission (2021). Towards competitive and clean European steel. Commission Staff Working Document SWD (2021) 353 final Brussels, 5.5.2021.
[50] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

CO_2 reduction

	Strategy	Examples	Current outlook
Blast furnace efficiency (BOF)	Make efficiency improvements to optimize BF/BOF operations	Optimized BOF inputs (DRI, scrap), increased fuel injection in BF (e.g., hydrogen, PCI)	Technology readily available at competitive cost
Biomass reductants	Use biomass as an alternative reductant or fuel	Tecnored process	Process possible in South America and Russia, due to biomass availability
Carbon capture and usage	Capture fossil fuels and emissions and create new products	Bioethanol production from CO_2 emissions	Not available on an industrial scale

Full decarbonization possible

	Strategy	Examples	Current outlook
Electric arc furnace (EAF)	Maximize secondary flows and recycling by melting more scrap in EAF	EAF – usage to melt scrap	Technology readily available at competitive cost
DRI plus EAF using natural gas	Increase usage of DRI in the EAF	Current DRI plus EAF plants using natural gas (NG)	Technology readily available
DRI plus EAF using H_2	Replace fossil fuels in DRI process with renewable energy or H_2	MIDREX DRI process running on H_2 HYL DRI process running on H_2	Technology available at high cost

Source: McKinsey analysis.

Intermediate transition in practice

Product type

The technology of production assets in existing steel plants is highly correlated with the type of steel products they manufacture.

Flat steel products are generally produced from primary ore through an integrated blast furnace/basic oxygen furnace (BF/BOF) route that is limited in the amount of additional secondary scrap input. Long products — generally with a higher tolerance for scrap impurities — can be fully produced from scrap that is melted in an EAF.

Timing: BF relining cycle

BF are capital-intensive assets that must be relined after 15–20 years of operation. This brings the opportunity to decide whether to invest in another ironmaking technology.

Before the point of relining, operating BFs can already reduce CO_2 emissions by making efficiency gains through the use of biomass reductants and carbon capture and use (CCU) projects. At the end of the BF operating cycle, they can be replaced by direct-reduced iron (DRI) technology in combination with an EAF that allows for deep decarbonisation achieved (primarily) by DRI

produced with natural gas and eventually — in line with availabilities — green hydrogen (H_2). The EAF also allows for adding higher ratios of secondary scrap.

The figure below illustrates how different steel plants move to different technologies at different times based on their context and technology. The example also illustrates a situation where the DNSH criteria are tightened over time.

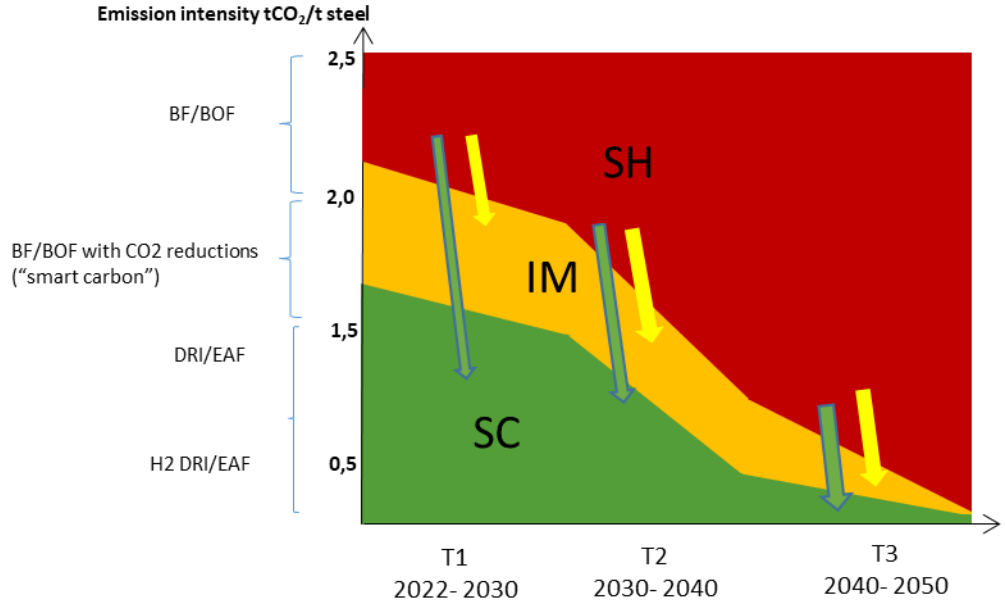


Figure 5-6. Schematic view of how the SC and DNSH thresholds could develop over time given the expected technological development in the steel industry combined with arrows indicating green transition and intermediate transition at the three different points in time. Please note that emission intensity numbers are illustrative.

As simulated below, the improvements in the BF-route that can be labelled an intermediate transition involve, for example, the introduction of biomass, the injection of natural gas (substituting coal), increasing the scrap ratio, CCU etc. These can be implemented during a BF's existing operation cycle (15–20 years) but still require substantial capex. Over time, the improvements relate to the introduction of hybrid technologies such as DRI/EAF. Over the period 2025–2035, most BFs in Europe will have ended their operation cycle, with the opportunity to replace them with DRI/EAF technology. Natural gas facilitates DRI production today, but it can gradually switch to green hydrogen, in line with its availability. Scrap ratios can increase with EAF melting. Electrical power consumption for melting DRI/scrap evolves to become more renewable with the grid. This would imply that the plants undergo gradual improvements over time that could be considered an intermediate transition as the DNSH threshold is also expected to tighten over time. For plants where the improvements cross the threshold for an SC, the investment/capex is Taxonomy aligned. This process goes on until a final technology shift is introduced to achieve near-zero carbon steel making.

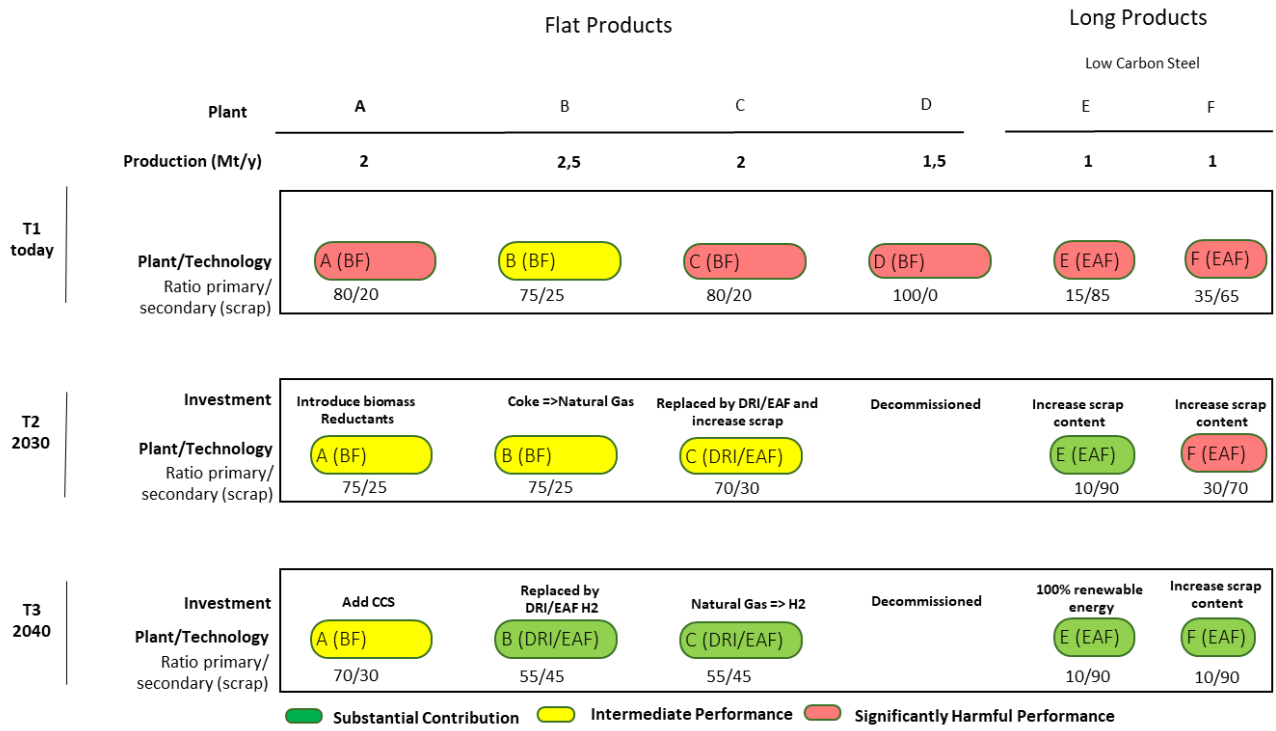


Figure 5-7. Example of different steel plants improving over time and applying the intermediate transition investment concept in this report.

Discussion on the DNSH criteria

Scrap: The TSC/DNSH (90% for carbon steel) might lead to a situation where a manufacturer allocates scrap to meet the threshold on specific lines without increasing its overall consumption. That is an illustration of potential side effects from defining scrap thresholds. Another possible approach to be considered in a future review of DNSH criteria might be pro rata qualifying all scrap input on an equal basis, whatever the type of process.

It is difficult to capture all CO_2 improvement technologies within ETS benchmarks, in particular when processes become more hybrid or with CO_2 savings from synergies with other activities (e.g. circular carbon: waste plastics are used as a coal substitute and CO_2 is captured/transformed into methanol feedstock for plastics). Therefore, a review of this DNSH criteria is recommended (ref Recommendation 8) to create clarity around intermediate transition in the steel sector.

Potential case for an intermediate/amber transition:
Production of electricity from gas (not exclusive to natural gas)[51]

According to Article 19 of the Taxonomy Regulation, technical screening criteria should be technologically neutral, and therefore any electricity-generation technology can be foreseen to be included in the Taxonomy. The existing DA criteria for power generation state that when using an ISO 14067 or a GHG Protocol Product Lifecycle Standard-compliant product carbon footprint (PCF) assessment, the lifecycle impacts from producing 1 kWh of electricity should be below the threshold given by the SC technical screening criteria for climate change mitigation (**technologically neutral TSC included in the Climate Delegated Act[52]** in force since January 2022), which is 100 g CO_2e/kWh[53] (lifecycle GHG emissions), and meet other Taxonomy requirements. The long-term GHG emissions development strategy of the EU and its member states, submitted to the UNFCCC[54] in March 2020 as per Article 4, para. 19 of the Paris Agreement, sets the objective of achieving a climate-neutral EU by 2050, and this is cross-referenced in the TR.

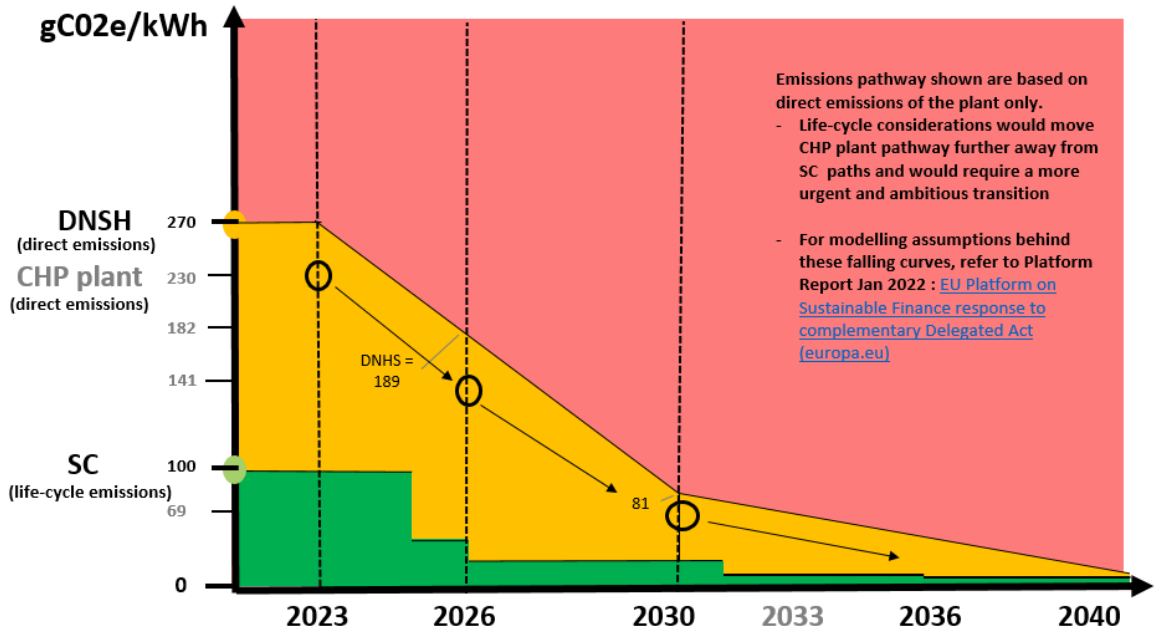
In parallel, the International Energy Agency (IEA) published in May 2021 its Special Report: Net Zero by 2050, A Roadmap for the Global Energy Sector, showing that electricity generation globally must reach net zero by 2040 as one of the earliest sectors to decarbonise (see Section 2.3 and Figure 2.3 of the IEA report). In line with Article 19 of the TR, a technology-neutral technical screening criteria for DNSH to climate change mitigation objective has also been set in the Climate DA as 270 g CO_2e/kWh (direct GHG emissions), based on the average EU grid emissions (see TEG Final Report March 2020 and Commission Climate Delegated Act Impact Assessment[55]). This creates a middle (intermediate) space of environmental performance for electricity production between 100 g CO_2e/kWh (lifecycle GHG emissions) and 270 g CO_2e/kWh (direct GHG emissions). Natural gas-fired plants operating at higher than 270 g CO_2e/kWh would be doing SH to the climate change mitigation objective and a clear transition pathway can be supported by access to finance for investments that bring emissions below that SH threshold (one example would be high efficiency CHP plants). The definition of the middle space in this case is somewhat complicated by the use of direct GHG emissions for the DNSH criteria instead of lifecycle, but as these are the technical screening criteria laid down in law by the Climate Delegated Act, these have to be referred to together and the complication overcome.

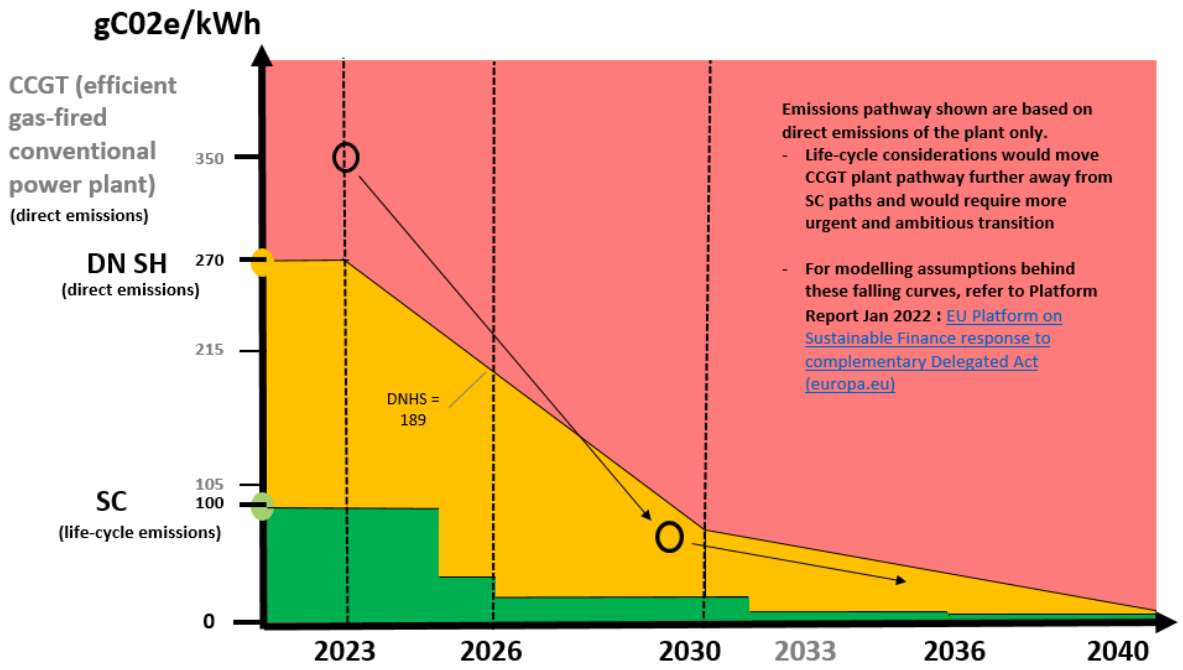
Technological possibilities for transition may be foreseen through blending natural gas with renewable and low-carbon gases (such as renewable or low-carbon hydrogen, biogas, bio-methane or other synthetic methane produced using electricity generated from renewable energy sources), which may require adaptation of plant components and gas supply infrastructure and/or installing Carbon Capture and Storage (CCS) technology.

[51] This example of an intermediate/amber transition makes reference to an economic activity/activities) (fossil gas-fired power) that was covered by TEG recommendations in March 2020: Technical annex to the TEG final report on the EU taxonomy (europa.eu) and has now been included in a Complementary Climate Delegated Act (which has, at the time of publication of this report, been adopted by the European Commission and is currently under four or six months of parliamentary and Member State scrutiny).
[52] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.
[53] Note that these criteria will fall over time in line with sector pathways.
[54] United Nations Framework Convention on Climate Change: https://unfccc.int
[55] taxonomy-regulation-delegated-act-2021-2800-impact-assessment_en.pdf (europa.eu)

In the case of an existing natural gas facility, the following transition pathway could potentially be seen as an **intermediate transition**: increasing efficiency, or upgrading the plant for natural gas-renewable and low-carbon gases blending up to operationally/legally/financially feasible levels and/or possibly installing CCS technology to reduce emissions from say 350 g to below 270 g CO_2e/kWh or to continue to improve efficiency if already below 270 g CO_2e/kWh. This could be categorised as an **intermediate transition**. Key power plant components would need to be ready for blending with renewable and low-carbon gases but could still run mainly on natural gas for a certain time, until renewable and low-carbon gases are supplied. Whilst the blending of methane from renewable and low-carbon sources typically does not require technical modifications at the gas power plant, the technical capability to handle hydrogen is typically limited and requires the replacement or retrofitting of key components above certain blending shares. To this end, hydrogen-ready equipment is being developed and becoming increasingly available.

Sources: (1) Fraunhofer, I. S. E. (2015). What will the energy transformation cost? Pathways for transforming the German energy system by 2050.
(2) Bartholdsen, H. K., Eidens, A., Löffler, K.,, ... & Hirschhausen, C. V. (2019). Pathways for Germany's low-carbon energy transformation towards 2050. Energies, 12(15), 2988.
(3) International Energy Agency. Net zero by 2050 – A roadmap for the global energy sector (windows.net)





Modelling assumptions for both graphics above:

Assumption on DNSH: DNSH curve is drawn using the logic of the TEG recommendations of March 2020 Technical annex to the TEG final report on the EU taxonomy (europa.eu) and of the Commission's Impact Assessment for the Climate Delegated Act DA taxonomy-regulation-delegated-act-2021-2800-impact-assessment_en.pdf (europa.eu), which stated that 'in light of the systemic importance of decarbonising the energy sector, it is considered that an approach…is warranted, setting the threshold for significantly harming climate mitigation at the current average emissions'. Additionally, the impact assessment states that 'the TEG recommendations are supported to use the IEA regional average as the reference (262 g)'. This leads to the starting point of 270 g CO_2e/kWh (the finally adopted technical screening criteria for DNSH to mitigation).

The reduction of DNSH is shown in the graphic according to a 70% reduction of emissions in the power sector by 2030 (base year 2015) and decarbonisation of the EU power sector by 2040 (capped at 10 g) in line with EU 2030 Climate Targets and EC Impact Assessment. Alternative calculations based on an IEA WEO21 assumed pledges scenario or an IEA net-zero scenario would have led to an even steeper reduction of the DNSH curve as well as a steeper drop in the period to 2025 than to 2030. This leaves the DNSH line as shown in the graphic as a conservative model. (Noting that in reality this line will not only need to be more of a 'falling curve', as indicated in Section 4.2 of this Report, but will in fact become a series of falling steps similar to those shown for the SC line).

Assumption on SC: Reduction of SC criteria in line with TEG analysis for EU Commission on required climate action emissions factors in EU power sector with gCO_2e/kWh of 42 g 2023 until 2026, 26 g until 2031, 15 g until 2036, 7 g until 2041 and 2 g from 2042. Provided by the Commission to the Platform as part of the Commission data for their own Taxonomy work. The first step-wise reduction of SC threshold is shown in 2025, rather than 2023, which is the earliest estimated date that such revision could come into force after TWG periodic review. It is important to highlight that development of the SC criteria shown here do not pre-empt the future evolution of the technical screening criteria of the Taxonomy Regulation as may be recommended by the Platform.

Potential case for an intermediate/amber transition:

Forestry: Identification of forest to set aside for conservation

One part of the forestry DNSH to biodiversity is written as follows: 'There is no conversion of habitats specifically sensitive to biodiversity loss or with high conservation value, or of areas set aside for the restoration of such habitats in accordance with national law'.

Although we note that this DNSH is qualitative, we can imagine that a forest owner develops a forestry survey to identify any areas that might need to be set aside for conservation due to their high biodiversity value. The expenditure to conduct such a survey, as part of developing the overall forest management plan for the local context, could be considered an intermediate transition expenditure it leads to areas being set aside for biodiversity conservation in line with the DNSH criteria. This situation assumes that all other DNSH criteria are already fulfilled.

Potential case for an <u>intermediate/amber transition</u>:

Electricity generation from wind power (onshore)

The generation of electricity from wind power is a clear case for an SC to the environmental objective (1) of the Taxonomy: climate change mitigation. However, as set out in Article 3 (b) in combination with Articles 9 and 17 of the TR, wind projects can only qualify as environmentally sustainable where that activity DNSH to any of the other five environmental objectives. Avoiding causing SH to objective (6), which is the **protection and restoration of biodiversity and ecosystems**, is of particular relevance to wind power generation as wind farms are often built on greenfield sites and can endanger birds, bats or other species in the living environment.

New onshore wind developments shall be in conformity with the DNSH criteria on biodiversity. The Climate Delegated Act[56] specifies the technical DNSH criteria for the biodiversity objective for onshore wind generation in Section 4.3 and Appendix D. An environmental impact assessment (EIA) or screening in accordance with Directive 2011/92/EU[57] shall be completed *in advance* of the investment. Requested mitigation and compensation measures for protecting the environment are to be implemented. Particular attention and assessments are requested for sites/operations located in or near biodiversity-sensitive areas including the NATURA 2000, UNESCO World Heritage sites and Key Biodiversity Areas. Inside the EU, it is also normal that compliance with an EIA requires an operating licence taking account of any responses that might be needed should a biodiversity impact be identified during operations. It is therefore most likely that compliance with the DNSH criteria for biodiversity is built into the construction and operation licence if happening in the EU.

In the case of a project under the design phase or an installed and operational onshore wind project outside of the EU[58] in a country that either does not impose a process similar to the one set forth in the Directive 2011/92/EU or where the regulatory enforcement is not effective enough to assure impact avoidance, mitigation and compensation, and consequently fails to meet the DNSH criteria for the biodiversity objective, the onshore wind development projects could be non-aligned with the Taxonomy criteria by posing SH to the biodiversity objective (i.e. irreversible harm to the environment).

An **<u>intermediate transition</u>** could consist of a wind development project moving out of a space of doing significant harm to biodiversity by conducting appropriate mitigation measures before and/or after the project's onset. In addition, such an **<u>intermediate transition</u>** to IP (amber space) on the biodiversity criteria could bring the wind development project into Taxonomy alignment on the climate change mitigation objective (1) if DNSH criteria on all other environmental objectives are met.

[56] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

[57] Directive 2011/92/EU on the assessment of the effects of certain public and private projects on the environment.

[59] Commission notice C (2020) 7730 Final guidance document on wind energy developments and EU nature legislation, (version [adoption date]:wind_farms_en.pdf (europa.eu).

The following activities could be seen as components of an intermediate transition in order to mitigate detrimental significant effects.

The first is the retroactive implementation of the required environmental impact assessment and screening for wind power projects from the biodiversity aspect if these were not conducted prior to the start of the project or the update of the existing ones if failed in its analysis or objectives. As outlined in the practical guidance document on wind energy developments and EU nature legislation,[1] wind power projects comply with best practices on biodiversity conservation when they undertake comprehensive screening and assessment processes (favoured by public stakeholder participation) and conduct strategic planning to measure the sensitivity of protected habitats and species. The general criterion is the implementation of an environmental monitoring plan (EMP) for the wind farms in operation, usually for the entire useful life of the plant. Such a plan includes:

- Monitoring of the possible effect on flying fauna (birds and bats) regarding the use of the space and control of incidents/collision;
- Control of the restoration actions carried out on the land where the facility is located;
- The state of roads and drainage;
- Waste management;
- Detection of other incidents and general appearance of the environment;
- Additionally, and depending on the location, noise measurement campaigns.

Based on the results of monitoring activities, corrective actions can be proposed.

The relevant economic cost range (opex) for an EMP as a general environmental monitoring tool is quantified as 200–800€/MW/year by industry stakeholders.

Second, if an ongoing wind power project has been determined to do significant harm to biodiversity protection (a situation that should be assessed by a public authority/agency responsible for environmental protection), a new environmental assessment may be conducted with additional mitigation measures that significantly reduce the harmful impact, even if it cannot be relocated. Such measures include, amongst others[59]: curtailment and staggering turbine operation during ecologically sensitive periods, modifying turbine design or visual and acoustic measures to protect birds, bats and other species. Studies on bat activities, use and management of ornithological radar, as well as focus programmes for innovation in biodiversity, are further long-term remedial activities for biodiversity protection. A comprehensive approach is repowering. It involves the removal of existing turbines and the construction of new turbines, often of a larger size and capacity leading to larger and more modern, but fewer, turbines that can reduce the environmental impact (thanks to the use of better technologies or just fewer installations).

Further possible mitigation measures concern adverse effects related to construction, such as habitat degradation (storage of soils and equipment). Habitats shall usually be restored right after construction is completed. Access roads could be closed to unauthorised vehicles or even be reduced in size. A successful outcome is to be proven by a recalculation of the no net loss (NNL) principle that should indicate a positive net gain for biodiversity of the wind project as a whole after restoration activities take place.

[59] Commission notice C (2020) 7730 Final guidance document on wind energy developments and EU nature legislation, (version [adoption date]:wind_farms_en.pdf (europa.eu).

External verification and compliance with remedial measures and the EMP are verified by at least one of the following:

(1) the submission of periodical reports to the local administration that has required these EMPs;

(2) the ISO 14001 compliance audits that are carried out by a third party; and

(3) through the company sustainability report verification process.

Additionally, a specific audit could be done by an accredited body to verify the investments that are committed or required by the responsible body.

A final point on this example is to note that if addressing this DNSH to biodiversity objective should then result in the entire activity being green (wind power being listed as making a substantial contribution to climate change mitigation objective under Section 4.3 of the Climate Delegated Act Annex 1), then the amber transition noted above, avoiding significant harm to biodiversity, would be a green transition. If that was the case, then capex and opex to make that improvement/transition could potentially be reported as green capex and opex.

Potential case for an intermediate/amber transition:

Building renovation

The renovation of existing buildings (activity 7.2 in the Climate DA) is an important activity in that it addresses improvements in existing building stock of all types and sizes, public and private.

The DNSH criteria on climate change adaptation state that the physical climate risks that are material to the activity should be identified from those listed in Table 5-5 below by performing a robust climate risk and vulnerability assessment. The DNSH criteria indicate that the climate risk and vulnerability assessment should be **proportionate** to the **scale** of the activity and its **expected lifespan**. This is important when renovating buildings because they can be of very different types, such as individual homes that need to be made more energy efficient, a large industrial complex or even a university campus. The steps that are defined for the assessment must therefore be seen in the context of the type of building and the scale and timescale of the refurbishment. This example attempts to cover an amber transition (urgently building climate resilience by moving away from significant harm to the climate change adaptation objective) for small-scale building renovation.

In this case – the three steps are as follows:

(a) **screening** of the activity to identify which physical climate risks may affect the performance of the building during its expected lifetime;

(b) where the activity is assessed to be at risk from physical climate risks, **a climate risk and vulnerability assessment to assess the materiality of the physical climate risks**;

(c) **an assessment of adaptation solutions** that can reduce the identified physical climate risk.

In the context of a very small-scale activity with the assumption that the expected lifespan of the building *renovation* activity is less than 10 years, the assessment can be performed by using climate projections at the smallest appropriate scale.

The criteria also state that for activities using **existing** physical assets, the economic operator implements physical and non-physical adaptation solutions over a period of time of up to five years that reduce the most important identified physical climate risks that are material to that activity. An adaptation plan for the implementation of those solutions is drawn up accordingly.

For individual building renovations, the professional advisers or designers of the renovation activity would need to conduct such screening and assessment as part of the design work for the project. Thus, the architect or construction company would not only have to do the assessment but also propose solutions for the renovation project and integrate the chosen solution into the renovation. These could include design modifications, such as raising electrical outlets and specifying flooring to withstand standing water during floods, as well as sizing the roof for additional snow loads, ensuring adequate ventilation and cooling for extreme heat etc. At the end of the process, provision could be made for the professional adviser or designer to issue a certificate of compliance with the DNSH criteria as part of, or even independent of, the energy efficiency or other renovation work on the building. In cases of small buildings, although at the current time the SC criteria for adaptation are not likely to be fully implemented (requiring ongoing monitoring and the regular reassessment of climate risks), it is still the case that avoiding significant harm by identifying risks and vulnerability as part of the building renovation project can be of vital importance in terms of making the buildings more climate resilient. The 'amber transition' (in this case, taking place as part of the renovation) to prevent significant harm to the climate change adaptation objective would provide a strong element of climate resilience for the building owner, and this approach clearly shows how that could be integrated into renovation work undertaken for other purposes and certified by the professionals involved in the building project. This can be an extremely useful and important step for green mortgages and other financing for small buildings.

Table 5-5. Climate hazards

	Temperature-related	**Wind-related**	**Water-related**	**Solid mass-related**
Chronic	Changing temperature (air, freshwater and marine water)	Changing wind patterns	Changing precipitation patterns and types (rain, hail and snow/ice)	Coastal erosion
	Heat stress		Precipitation or hydrological variability	Soil degradation
	Temperature variability		Ocean acidification	Soil erosion
	Permafrost thawing		Saline intrusion	Solifluction
			Sea level rise	
			Water stress	
Acute	Heat wave	Cyclone, hurricane and typhoon	Drought	Avalanche
	Cold wave/frost	Storm (including blizzards, dust and sandstorms)	Heavy precipitation (rain, hail and snow/ice)	Landslide
	Wildfire	Tornado	Flood (coastal, fluvial, pluvial and ground water)	Subsidence

5.10 Implementation

Although in principle, the Taxonomy Regulation incorporates building blocks for a future extended Taxonomy of both an SH and an intermediate space through the three performance levels that have been described above, the current Taxonomy regulation does not allow for creating any other category of activities than 'environmentally sustainable economic activities', as per Articles 1 and 3. Additionally, reporting under Article 8 of the Taxonomy Regulation only allows for reporting on 'environmentally sustainable economic activities'. The type of reporting required in the future to accommodate the concepts of the extended Taxonomy will depend on how reporting develops for financial products and instruments and for companies and other entities as the Taxonomy starts to be used.

The Platform considers that the EU Taxonomy was developed to constitute a common point of reference for the whole range of legislative initiatives contained in the Action Plan of 2018, aimed at supporting the financing of activities that best contribute to the environmental objectives. In order to fully realise the potential contribution that an SH Taxonomy can make to environmental objectives and to the 2021 Strategy for financing the transition to a sustainable economy, it needs to be presented in a way that highlights and favours the orderly and managed exit of economic activities from harmful levels of performance.

Due to the urgency of this result, all possible ways in which an extended Taxonomy encouraging an urgent transition or exit from significantly harmful performance levels or activities can be implemented should be evaluated considering the effectiveness, timing and possible side effects of the different alternatives.

For this reason, the Platform considers that careful reflection is possible and necessary as to how and to what extent its recommendations on SH can be articulated formally. Nevertheless, it believes that urgent action will be key, starting with voluntary reporting in the first of two phases. Noting that such non-Article 8 voluntary reporting by entities in their transition plans and voluntary use of proceeds instruments will provide very useful inputs to future analysis and discussions on formal reporting as the Taxonomy develops. Another urgent early step will be the identification of activities that cannot transition to mobilise green finance for their decommissioning investments.

- Phase 1: Build on the current framework (i.e. what may be possible to develop in the context of the current Taxonomy Regulation without reopening Level-1 legislation), primarily through a guidance document on voluntary reporting, with examples of amber use of proceeds instruments and debt, and through appropriate activities being included in Taxonomy-related DAs, starting with examples based on Article 19 (3) activities. In each case, be mindful of the possible unexpected consequences of any guidance;
- Throughout Phase 1: Gather experience and consult with users of the voluntary approach to feed into an assessment and analysis of formal reporting options, as well as impact assessments;
- Phase 2: Consider what may be possible under the hypothesis that the TR can be revised to include new categories of economic activities causing significant harm and performing at an intermediate level, plus the reporting on those categories of activities.

According to the Platform, when comparing timing options for these phases, it must also be considered that any announcement (either within guidance issued by the Commission or an initiative to change Level-1 legislation) that the DNSH criteria in the Delegated Acts **technically** define the significant harm performance level carries the risk of having unintended consequences

if not accompanied by an appropriate framework for supporting the decommissioning of harmful activities which cannot qualify as environmentally sustainable economic activities by nature (Article 19 (3)-type activities) and the transition of those activities which do not comply with DNSH.

An indicative timeline for implementation is shown in Section 8.4.

Such a supporting framework should be based on existing measures and financial incentives but will probably also require other appropriate measures and incentives, as well as additions to initiatives undertaken by the EU as part of the Strategy for Financing the Transition to a Sustainable Economy. The supporting framework, which would need to have a strong Just Transition approach incorporated into it, needs to be announced as soon as possible and implemented in parallel with an SH Taxonomy extension to ensure that the advantages are embraced while the potential unintended consequences are minimised.

Frameworks should provide companies and other entities with a range of options for accessing finance for their transition plans in the context of an extended Taxonomy.

6 LEnvI activities (NSI on environmental sustainability)

6.1 Conceptualising the extension of the green Taxonomy by a low environmental impact Taxonomy

The Platform was asked to support the Commission through its report[60] describing the provisions that would be required to extend the scope of the current Taxonomy and — for this chapter — what would be required to cover economic activities that *do not have a significant impact on environmental sustainability*.

By proposing the term *low environmental impact* (LEnvI[61]) for the above-mentioned economic activities, the Platform will apply a slightly different terminology; however, it will be used synonymously with the original term. This is to avoid misunderstandings due to the widespread use of the abridged form (i.e., *no significant impact*, without the emphasis on *environmental sustainability*) that risks being perceived as applying beyond the environmental perspective. This ensures it will not be confused with a social Taxonomy, which is independent of the LEnvI Taxonomy. With this slight change in emphasis on environmental impact, rather than an impact on sustainability, there may be a need for a more proactive consideration of the adaptation objective that might otherwise be thought to fall outside the range of LEnvI considerations.

The Platform wishes to stress that a potential category of economic activities with LEnvI in relation to the six environmental objectives defined in the Taxonomy Regulation is **NOT** the same as the category of intermediate environmental performance between SC and SH in the current Taxonomy. The intermediate category is marked in amber, while the LEnvI category is marked in grey/white. The faded red/amber/green section represents economic activities that are currently expected to be included in the green Taxonomy but for which no technical screening criteria have been developed yet. The grey section marks economic activities that might be included in the green Taxonomy as it will be updated over time. This is depicted in Figure 6-1.

[60] According to Article 26 para. 2 lit a (Regulation (EU) 2019/2088).
[61] The Platform notes the use of LEI as abbreviation for legal entity identifier and has therefore decided to use the acronym LEnvI.

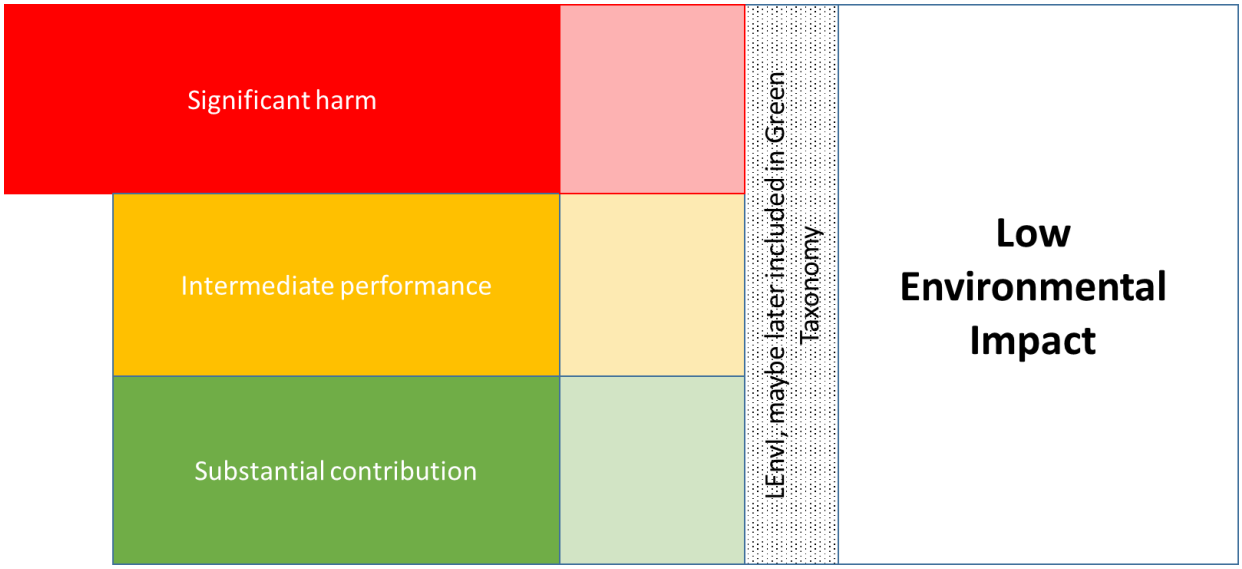


Figure 6-1. Relation of a LEnvI extension to the existing Green Taxonomy.

As with the green Taxonomy, a LEnvI Taxonomy refers to the level of economic activities, not the sector in which an enterprise is active. Examples are professional, scientific and technical activities (NACE M69–M75), education (NACE P85) and residential care activities (NACE Q87).

The Platform proposes a working definition of LEnvI activities as follows:

LEnvI activities are those economic activities that:

a. do not have the potential to make a substantial contribution to any one of the six EU environmental objectives, with the exception of climate adaptation;

   AND

b. are not at risk of causing significant harm to any one of the six EU environmental objectives;

   AND

c. meet minimum safeguards.

The aim is to qualify the turnover, capex and opex of all economic activities with LEnvI that are not otherwise included in the green Taxonomy (See Table 6-1, Example 1 below). While these activities cannot claim green revenues, they can classify as green the expenditures (capex and opex) related to objective (2) (climate change adaptation, see Table 6-1, Example 2 below) and as category c capex following Article 8 Delegated Act (see Annex 1) related to the purchase of output from Taxonomy-aligned economic activities and to individual measures enabling the target activities to become low carbon or to lead to GHG reductions, such as individual building renovation measures, as identified in the Delegated Acts adopted pursuant to Article 10 (3), Article 11 (3), Article 12 (2), Article 13 (2), Article 14 (2) or Article 15 (2) of Regulation (EU) 2020/852, provided that such measures are implemented and operational within 18 months.

- If an economic activity is covered by the green Taxonomy for environmental objectives (1) and/or (3–6) (see Table 6-1, Example 3 below), or the economic activity would cause significant harm, it would not qualify as having a LEnvI.
- In case the capex and expenditures (but not the turnover) of Taxonomy-eligible activities regarding the climate change adaptation objective are covered by the green Taxonomy, the turnover, capex and opex from the core business can still qualify as LEnvI-related economic activities (Table 6-1, Example 2) unless:
    - the economic activity concerns an enabling one, or
    - the economic activity would potentially do significant harm (Table 6-1, Example 4).

Table 6-1 pictures the logic as follows:

Table 6-1. Picturing the LEnvI logic

	Taxonomy eligible economic activities							
	Example 1		Example 2		Example 3		Example 4	
	SC	SH	SC	SH	SC	SH	SC	SH
Env.Obj.1	N	N	N	N	Y	N	N	Y
Env.Obj.2	N	N	Y	N	Y/N	N	Y/N	N
Env.Obj.3	N	N	N	N	N	N	N	N
Env.Obj.4	N	N	N	N	N	N	N	N
Env.Obj.5	N	N	N	N	N	N	N	N
Env.Obj.6	N	N	N	N	N	N	N	N
LEI?	Y		Y		N		N	

The Climate Delegated Act[62] Annex II for climate change adaptation economic activities[63] includes several service sector-related economic activities that might have been expected to be part of a LEnvI Taxonomy, such as education and libraries, archives, museums and cultural activities. In the Delegated Act, the DNSH criteria for environmental objectives other than adaptation are set to N/A for those economic activities. The fact that the capex for such LEnvI economic activities are already included in the climate adaptation Taxonomy thus needs to be acknowledged when developing a definition of LEnvI activities (see litera c above).[64]

[62] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

[63] https://ec.europa.eu/finance/docs/level-2-measures/taxonomy-regulation-delegated-act-2021-2800-annex-2_en.pdf

[64] This precedent set by the Commission suggests that one approach to introducing a LEnvI taxonomy could be to develop LEnvI generic criteria for a substantial contribution to climate change adaptation (or other objectives such as the circular economy and mitigation), and hence include such low-impact activities into the existing green Taxonomy. This approach will not be further explored with the aim of distinguishing as clearly as possible between environmentally sustainable/harmful economic activities and LEnvI economic activities.

Those low environmental impact economic activities that provide *green services*, for example, professional services, architectural and engineering services, advertising and publishing activities conducted in relation to green economic activities should be considered for inclusion in the green Taxonomy (see the grey section in Figure 6-1).

Table 6-2. Examples of LEnvI activities

	Residential Care Activities (Healthcare)	Professional Services	Education
Definition	Provision of residential care combined with either nursing, supervisory or other types of care as required by the residents	Conducting professional services as auditor, architect, technical consultant, lawyer, …	Providing education services in a broad sense (training of all trades: sports, music, universities, schools, …)
Mentioned in Climate DA Annex II	Yes (chapter 12.1)	--	Yes (chapter 11)
Areas to observe	Waste + pollution Location of the healthcare facility	Boundary of activity Critical activities in value chain with positive / detrimental impacts	Boundary of activity
Double materiality	Low on (i) env impact materiality and (ii) financial materiality related to transition risks	Low on (i) env impact materiality and (ii) financial materiality related to transition risks	Low on (i) env impact materiality and (ii) financial materiality related to transition risks
Other		Services with a positive value chain impact could be deemed *green services*	Education targeted at supporting green transition / activities could be deemed *green education*

Might be included into green taxonomy in the future

It is important to note that enterprises with their dominant economic activities in the field of LEnvI that do or wish to conduct green economic activities can and should of course do so. Those should qualify for the green Taxonomy as provided by its rules (e.g. the operation of solar photovoltaic panels[65] and energy-efficient renovation).[66] To this extent, these enterprises should also be eligible for green financing and for adaptation financing to build climate resilience. The difficulty here is that other less well-defined green investments and adaptation investments may not be accessible as green finance for LEnvI entities as there may not be a NACE code/Taxonomy-eligible activity for them. However, it should also be clearly understood that a LEnvI category is not a way to avoid passing necessary and essential ESG standards; rather, it is a way to further support them.

6.2 Relation to other EU Sustainable Finance policies

This section aims at identifying relationships between a potential LEnvI Taxonomy and other existing or planned legislative initiatives as part of the Sustainable Finance Action Plan,

[65] Annex 1 to Commission Delegated Regulation 2021-2800 supplementing Regulation (EU) 2020/852 (Climate Delegated Act): 4.1 Electricity generation using solar photovoltaic technology. https://ec.europa.eu/finance/docs/level-2-measures/taxonomy-regulation-delegated-act-2021-2800-annex-1_en.pdf

[66] Ibid: 7.2. Renovation of existing buildings.

including the 2021 renewed EU Sustainable Finance Strategy (**Strategy for Financing the Transition to a Sustainable Economy)** (a more detailed analysis is presented in Annex 5). The Platform believes that the potential LEnvI Taxonomy would complement the other regulatory initiatives and would act as a potential amplifier of their beneficial effects.

Together, these activities have or will have an impact on all parts of the investment chain, from investors through to distributors, asset managers and investee companies. The LEnvI Taxonomy would, in particular:

- allow companies to show their low environmental impact to investors (e.g. through a recognition of LEnvI activities).

- allow companies to identify activities which imply a low environmental financial materiality for transition risks and consequently require less management attention in this sense. Efforts can be focused on red, amber and green activities.

- provide investors and lenders with transparency on capital flows that have a low environmental impact; hence, have low transition risks in a large segment of the economy not covered by the green Taxonomy, thereby facilitating companies' access to financing in pursuit of such activities.

- increase transparency on the non-green part of a financial portfolio/basket/product, also for the benefit of end-investors, which would also allow:

    - product providers to identify the parts of a financial portfolio/basket/product that do not need to undergo a DNSH assessment or which do not imply a principal adverse impact on the environment.

    - for an identification of the non-green parts of such portfolios/baskets/products that are not associated with harmful economic activities. This would also be useful for labels such as the Ecolabel, the EU GBS or benchmarks.

    - more (e.g. reputational) risk-averse investors to include, also under its *diversification* (i.e. not its *environmentally sustainable* or *green*) pocket, only activities which have been categorised as LEnvI economic activities.

6.3 Use cases and arguments regarding an extension of the green Taxonomy to LEnvI economic activities

To assess whether a LEnvI Taxonomy is useful, the use cases and arguments should be considered. Those mentioned below have been collected by SG3 from (i) internal discussions, (ii) outreach events with a broad variety of public and private stakeholders in February and

March 2021 and (iii) feedback received on the Public Consultation Report on Taxonomy Extension Options Linked to Environmental Objectives.[67]

6.3.1 Rationale and potential use cases for a LEnvI extension

The rationale, or use cases, behind the potential extension of the Taxonomy is first and foremost to enhance the efficiency of capital allocation by means of improved and more comprehensive Taxonomy-related information with the aim of enhancing transparency and addressing concerns in relation to any perceived future challenges about access to finance for LEnvI economic activities. In addition, the extension supports lower transaction costs and improved nuance at the enterprise level in communicating about its economic activities.

A LEnvI Taxonomy may **provide comfort** to non-financial and financial enterprises by explicitly **defining and tagging** low environmental impact economic activities. The availability of an additional (i.e. a LEnvI) classification would provide the means to tag those economic activities that are not aligned with the green EU Taxonomy but that are LEnvI — *not environmentally unsustainable*. This would enhance transparency around the environmental performance/impact of such economic activities with classifications that could thus be changed from *Taxonomy ineligible* with unknown environmental impacts under the current Taxonomy framework to LEnvI, a known category with low environmental impacts.[68]

As a side effect, a LEnvI Taxonomy could reduce the desire of some industries to have their economic activities defined as eligible under the green Taxonomy because they fear that financing conditions would otherwise deteriorate.

6.3.1.1 Use case 1: Supporting access to green finance

By employing a LEnvI taxonomy approach, concerns in relation to any perceived challenge about future access to green finance might be addressed for those economic activities, and similarly, any perceived risk of increased financing cost avoided.[69] In particular, for financial enterprises that do not want to prioritise the financing of economic activities that urgently need to transition, a LEnvI Taxonomy could provide clarity about available financing opportunities.

6.3.1.2 Use case 2: Procurement decisions

The same may be true for procurement decisions (e.g. by Tier 1 companies) if it is demonstrated that an economic activity has a low impact on environmental objectives.

6.3.1.3 Use case 3: Lower transaction cost

Easy access to a low environment impact economic activities' inventory may help their quick and cost-efficient assessment, in particular by financial market participants. This includes

[67] See: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-platform-report-taxonomy-extension-july2021_en.pdf

[68] This was already mentioned in the Transition Finance Report by the Platform on Sustainable Finance (March 2021), p. 23.

[69] Financing costs are, amongst others, influenced by information asymmetry and environmental performance. More useful (i.e. standardised by means of a Taxonomy) information about environmental impact, and in particular, low environmental impact (and the associated lower financial transition risk from environmental regulation and/or shifts in consumer behaviour and demand) do, ceteris paribus, translate into relatively lower financing costs.

delineating low environmental impact economic activities from Taxonomy-eligible, intermediate-performance economic activities.

In the absence of a LEnvI Taxonomy, financial market participants would either have to carry out their own analyses or find out whether an economic activity would already be eligible under the Taxonomy Regulation in its current form or under a potential Taxonomy catering for economic activities with an urgent need to transition.

This is particularly relevant because the lack of public access to aggregated data on economic activities at the enterprise level can be a significant obstacle for those financial market participants without direct access to or leverage on their investee/financed enterprises.

Thus, a standardised definition of LEnvI economic activities may support comparability and ease of understanding by financial market participants and reduce their transaction costs, as well as uncertainty. Risk related to financing decisions would be lower, and hence so would be the financing costs. This could also be useful information for supervisory authorities to give them guidance on where a particular focus on environmental risks is not required.

6.3.1.4 Use case 4: Simplify communication and enhance transparency

A LEnvI Taxonomy would add nuance to the Taxonomy and enable simpler communication between Taxonomy users regarding the mix of different activities an enterprise may undertake (and by extension, the mix of different activities financed by financial market participants). In particular, a combined insight into the share of economic activities contributing to the EU's environmental objectives and the portfolio share that has low environmental impact provides additional information to investors seeking to reduce their investment in activities which may pose a high environmental risk. It would reduce the amount of unknown and potentially high-risk activities in the portfolio.

Example of the impact on reporting of a potential LEnvI (NSI) extended Taxonomy

O Portfolio A with a 15% significant contribution and a 5% LEnvI share

o Portfolio B with a 10% significant contribution and a 25% LEnvI share

Without an extended Taxonomy, portfolio manager A will show a 15% green share and portfolio manager B will show a 10% green share (A > B).

With an extended Taxonomy, portfolio manager A will show a combined share (= green + low environmental impact) of 20%, while portfolio manager B will show 35% (A < B).

6.3.1.5 Use case 5: Benefits for financial regulators

A better understanding of portfolio transition risk is an important focus for financial regulators. Gaining insight into the share of economic activities that do not have significant environmental impacts in loan and investment portfolios will add nuance to risk assessment as greater transparency in the environmental performance of financial products plays an increasingly important role in assessing market stability.

The average risk–return profile of investment portfolios will likely require diversification beyond economic activities that contribute significantly to EU environmental goals. Therefore, a LEnvI Taxonomy would increase the transparency of the overall environmental performance of financial instruments by classifying the full range of underlying assets.

This additional nuance may also assist Member States in implementing measures under Article 2.1 (c) of the Paris Agreement, which is about aligning financial flows with the objectives of the Agreement.

6.3.2 Arguments against LEnvI extension

6.3.2.1 Low priority

Other than outlined in use case 3 above, as soon as a Taxonomy for economic activities with an urgent need to transition, as well as economic activities that are likely to be included in the (substantial contribution and/or urgent need to transition) Taxonomy are defined alongside the current environmentally sustainable green Taxonomy activities, low environmental impact economic activities could be assumed as residual activities, which could be derived simply by means of exclusion.

From the perspective of supporting transition, developing a Taxonomy for economic activities with an urgent need to transition will likely have a higher transformation potential by highlighting economic activities that are still significantly harmful and need to transition. A low environmental impact Taxonomy could thus be of lower priority for stakeholders connected to economic activities with an urgent need to transition while still being a high priority for other stakeholders that benefit from a LEnvI classification.

6.3.2.2 Low environmental impact already part of financial sector due diligence activities

The benefit of a low environmental impact Taxonomy compared to market-led ESG labelling may be limited as some financial market participants might already identify investments that they consider to have low environmental risk. However, is it unlikely that a standardised process and harmonised definition of low environmental impact across financial market participants exists: as part of their due diligence process, banks, insurers and financial investors are expected to make their own judgments regarding environmental risks. There might also be a risk of some overlap and a multiplication of indicators with the CSRD.

6.3.2.3 Taxonomy already too much to absorb

The current green Taxonomy is still being implemented. Adding further categorisations may lead to parallel workstreams and may be too much to absorb. A LEnvI Taxonomy could overload an already fast-moving sustainable finance architecture, suggesting additional reporting when current Taxonomy reporting is not yet in force. There could also be difficulty identifying and maintaining the list of activities without activities being penalised as the Taxonomy itself expands into new activities. Identifying activities that are not included in the Taxonomy currently and distinguishing those that may be included in the future represents a considerable challenge.

As a result, the cost–benefit ratio of a LEnvI extension may not be favourable in the short term, particularly when considering the impacts for some financial institutions.

6.4 How material are LEnvI activities?

Applying the definition for LEnvI above, the Platform's preliminary analysis of economic activities defined at the NACE-2 level[70] found that the scope of activities likely to qualify as LEnvI represents a significant portion of the EU economy. It includes most NACE-2 level activities in macro-sectors J to U, predominantly in the service sectors. The economic relevance only for those sectors where data were (easily) available at the NACE-2 level is significant.

Based on the latest Eurostat Structural Business Statistics, the limited number of service sectors[71] (and hence potential LEnvI activities) for which data are available already represents approximately 25% of value added and employment and 35% of the number of enterprises in the EU economy. If we consider the missing data for such sectors as leisure, health and education and other missing services, we can take the above figures as conservative and can reasonably assume that 30-40% of the EU economy (depending on how it is evaluated) may potentially be included in LEnvI.

Further, potential LEnvI economic activities account for a very large portion (> 90%) of SME and micro-enterprises,[72] a factor which needs to be considered when designing appropriate disclosure/reporting mechanisms and any work related to the treatment of SMEs under the scope of other sustainable finance measures and policies, including the CSRD.

This confirms the materiality of LEnvI activities in terms of the aggregated size of the economy while having a low total environmental impact. It deserves further analysis at the NACE-4 level by the Commission to identify all activities not yet covered or not planned to be covered by the green Taxonomy or an extension of the Taxonomy that covers the intermediate space and those economic activities with an urgent need to transition.

[70] It should be noted that there is no direct relationship between NACE code activities and the definitions of activities in the Taxonomy.
[71] Data available from Eurostat SBS for NACE sectors J, L, M and N.
[72] Microenterprises are enterprises with fewer than 10 employees.

6.5 Implementation options

6.5.1 Regulatory options for LEnvI Taxonomy extension

The Platform considered three options for a LEnvI Taxonomy extension:

Option 1 – Establish a low environmental impact Taxonomy.

To establish a LEnvI Taxonomy, basically two main avenues are available:

a) Level 1: amending the TR, or
b) Introducing voluntary, non-binding guidelines.

- **Option 1(a) – Amend the TR** (e.g. by analogy to Article 17). An additional article or subsection could define low environmental impact economic activities.

Pros	Cons
Standard regulatory process Involvement of relevant stakeholders Impact assessment	Time-consuming Resources required Regulation fatigue

- **Option 1(b) – Introduce non-binding Level 3 guidelines.** The Platform could prepare non-binding guidelines on LEnvI activities that could be used by the Commission. Those would be for voluntary use by Taxonomy users and other interested parties. Such guidelines would set out the types of activities that could be considered as potentially having a low environmental impact and how to assure basic levels of environmental performance.

Pros	Cons
Work can commence immediately and experience can be gained without delay Platform on Sustainable Finance could be tasked to develop recommendations for non-binding guidelines Building on expertise gained on the Platform and by outreach Voluntary and more flexible to adjust over time (learning phase)	Voluntary: may not be applied to the extent expected (acceptance) Reporting fatigue Inflicting comparability, quality and thus trust Slower process compared to Option 1(a)

Option 2 – Deprioritise the establishment of a low environmental impact Taxonomy until the current and the significant harm Taxonomies have been established and used in practice.

Pros	Cons
Taking one thing at a time Wait and see would strengthen the negative screening if the Taxonomy were expanded to significantly harm economic activities in urgent need to transition	No experience gained Lack of guidance for economic activities that have low environmental materiality, which also accounts for a large proportion of all activities More uncoordinated requests for detailed information when accessing funding

Option 3 – Reject the establishment of a Low environmental impact Taxonomy. The pros and cons of Option 3 are similar to those of Option 2, only no further exploration of low environmental impact will take place.

Conclusion and recommendation

On the basis of the work of the Platform's internal discussions and outreach, the Platform sees merit in Option 1(b) to extend the Taxonomy to include LEnvI activities using non-binding guidance and reassessing after three years of experience and practice.

To avoid confusion between SC and LEnvI, it will be important to clearly differentiate SC and LEnvI in any reporting, disclosure or other use cases of an extended Taxonomy.

The counterfactual is that if a LEnvI Taxonomy classification were not established, an important part of the EU economy having a low environmental impact to the environment would be unable to distinguish itself from green, transition and those significantly harmful activities with an urgent need to transition. For financial market participants, a LEnvI activity category would have several benefits at the portfolio and product level. It is important to note that the Platform has not yet performed a usability assessment for a Taxonomy that incorporates all possible dimensions flagged in this report.

The Platform recommends gaining experience with the expansion to a low environmental impact Taxonomy by issuing non-binding guidelines. The Platform could be tasked to make a recommendation to the Commission.

6.5.2 Positive screening vs negative screening

There are two approaches how low environmental economic activities could be identified:

a. By means of negative screening (e.g. residual illustrated in Figure 6-2 by the grey area at the right-hand side).
b. By means of positive inclusion, leaving some economic activities unclassified (e.g. illustrated in Figure 6-2 by the light grey area at the top right-hand side).

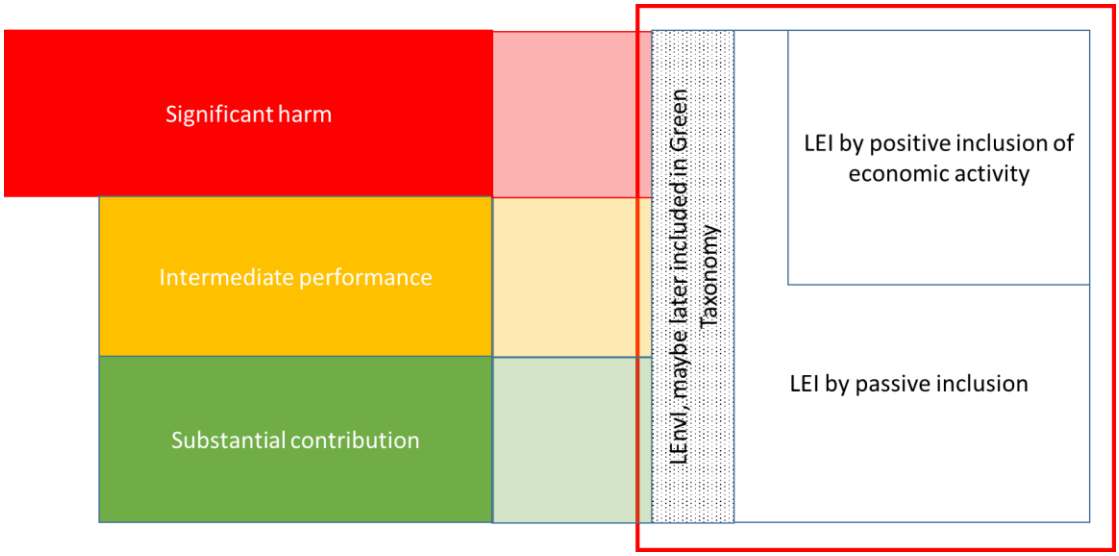


Figure 6-2. Relation of a LEnvI extension to the existing green Taxonomy highlighting the part on the right.

The Platform suggests considering the above-mentioned approaches as part of the development of the non-binding guidelines.

6.5.3 Potential issues related to indirect environmental impacts

LEnvI economic activities could be linked to upstream or downstream economic activities that themselves might have different environmental performance profiles. Identifying those profiles will be needed to avoid indirectly causing significant harm.

However, this assessment should be based on global best practices, as set out in the UN Guiding Principles on Business and Human Rights, and align with the targets of the sustainable development goals. This would mean that LEnvI economic activities cannot cause, contribute to or be directly linked to significant harm activities over which there is a direct or indirect influence.

Three different approaches could be used:

1. Approach A: All economic activities that are not eligible for the green Taxonomy automatically qualify without any further testing steps.
2. Approach B: A risk-based consideration is made in relation to the probability of economic activities indirectly causing significant harm. Only those with a medium or high likelihood will be tested.
3. Approach C: All LEnvI economic activities will be tested.

Table 6-3 shows the three approaches, including assumptions about the credibility of the respective approach, transparency and administrative burden. In the view of the Platform, Approach B offers a good balance of both.

Table 6-3. Three approaches, including assumptions about the credibility of the respective approach and the administrative burden

Value chain	A Elementary	B Balanced	C Selective
Approach	LEnvI economic activities' indirect impacts are always deemed as not environmentally significant	Two classes depending on the probability of indirect damage; also in light of the size of the enterprise a) Low probability and an SME: always LEnvI b) Low probability and a large enterprise: LEnvI in connection with some assurance c) Medium/high probability: test for activities connected to indirect DNSH-classified activities	No automatism, all LEnvI economic activities have a probability to be exposed to indirect DNSH-classified economic activities. All LEnvI activities to be tested for exposure to indirect DNSH-classified economic activities
Administrative burden	Low	Medium	High
Transparency	Low	Medium	High
Credibility	Low	Medium	High

Examples where indirect impacts should be considered for their overall environmental impact:

- Advising a coal power station owner (consultant services) can either contribute positively (e.g. by providing advice to transition to a greener world), be neutral (e.g. by providing advice for enhancing internal communication) or be significantly harmful (e.g. by providing advice to expand the lifetime of the power plant).

- A travel agency can either contribute positively (e.g. by advising and selling green vacations), be neutral (e.g. by advising and selling vacation trips) or be significantly harmful (e.g. by advising and selling trips aimed at hunting rare animals).

The graph below depicts the structure of adding safeguards to low environmental impact economic activities.

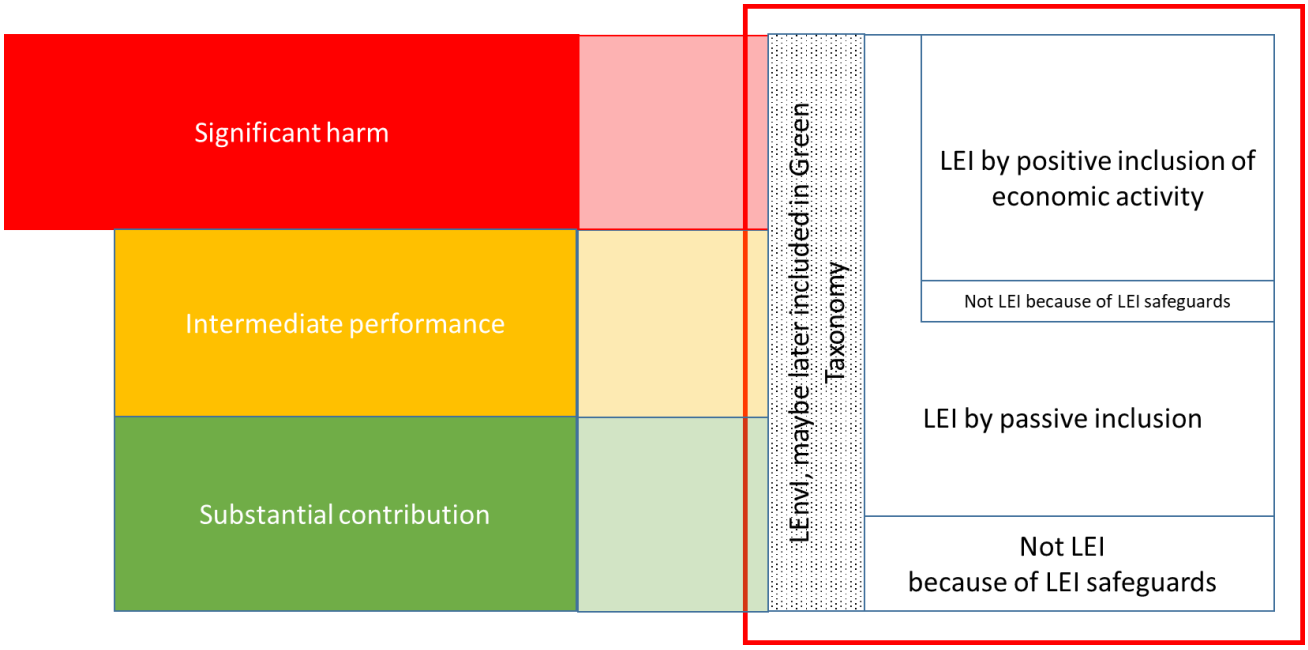


Figure 6-3. Structure of adding safeguards to low environmental impact economic activities.

The Platform suggests:

- reviewing the above-mentioned alternative approaches as part of the development of the non-binding guidelines, and
- considering a differentiated approach for microenterprises and small businesses.

An **indicative timeline** for implementation is shown in Section 8.4.

7 Further work

This report presents the Platform's thinking on the issues and options related to extending the EU environmental Taxonomy beyond green activities. The Platform has already identified several topics that will require further investigation:

i) Further consideration on how SH to climate change adaptation might be addressed differently from the other five objectives in entity transition plans.

ii) The development of non-binding guidelines to precede any changes to the Taxonomy Regulation in order to prepare the expansion of the Taxonomy framework to LEnvI activities and start to identify LEnvI activities in a robust way.

iii) As part of such a guidance document, LEnvI-related sectoral DNSH checklists should be established to avoid significant harm by otherwise low environmental impact activities.

iv) Considerations on how indicators/metrics relevant to the DNSH criteria could be made coherent with other indicators/metrics within the overall sustainable finance framework for improved usability.

v) Clarification about how to capture indirect and/or supply chain-related environmental (and social) impacts across existing and all emerging parts (i.e. the work on all environmental objectives, social, SH and LEnvI) of the Taxonomy, including the consideration of the indirect SH effects of SC and LEnvI activities.

vi) Considerations on the essential parts of a legislative framework, including reporting options, for supporting the decommissioning of harmful activities which cannot qualify as environmentally sustainable economic activities by their nature (Art. 19 (3)-type activities) and the transition of activities away from SH performance. Identification of gaps in current provisions and advice on further measures necessary to support these urgent transition activities.

vii) Technical assessment of the DNSH criteria to identify those that work well already for use in an extended Taxonomy to support the transition and those that may need revision, rewording or addition. This can build upon the voluntary use of criteria set out in the Climate Delegated Act[73] and experience gathered during voluntary and legally required Taxonomy reporting.

[73] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

8 Platform recommendations

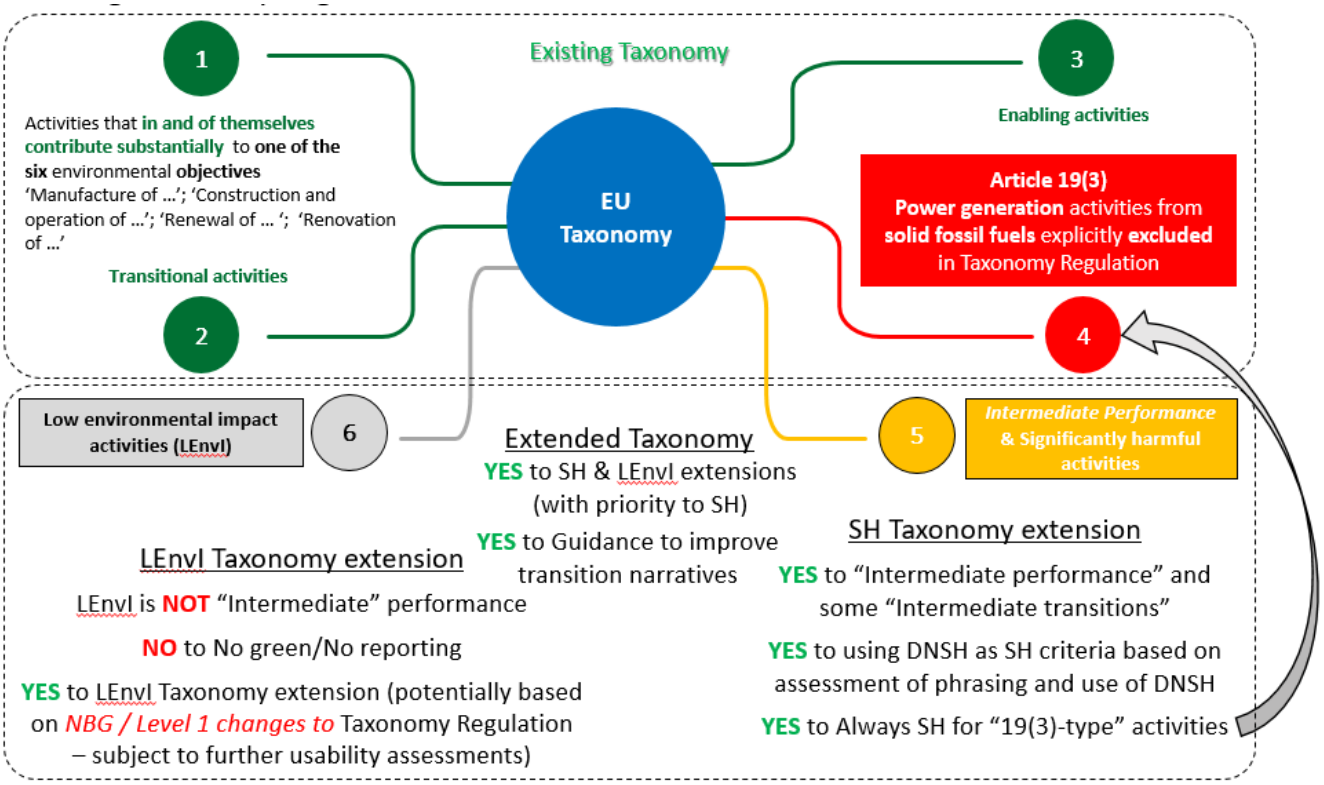


Figure 8-1. Overview of Platform recommendations

8.1 General recommendations

This section includes the recommendations on the key concepts and terms that can be used for an extended Taxonomy, including those for use in a voluntary manner and through future legislative changes. Figure 8-1 shows the overall approach.

Extend the environmental ('green and sustainable') Taxonomy with a priority on activities supporting urgent environmental transition

Recommendation 1. In response to the mandate given to the Platform in relation to Article 26 of the TR, the Platform recommends that the EU Taxonomy be extended, with priority given to an extension towards activities that require urgent transition to avoid causing significant harm. A fully extended Taxonomy will allow a complete coverage and recognition of activities with different performance levels: Green and sustainable performance, intermediate or amber performance, performance requiring urgent transition to avoid significant harm to environmental objectives and to recognise low-environmental impact (LEnvI activities. Further, it would help to provide a positive label for investments aiming at improving the environmental performance of economic activities, definitively putting an end to significantly harmful effects.

Define key parts of an extended Taxonomy

Recommendation 2. The Platform stresses that the current Taxonomy framework already defines three levels of environmental performance and that where criteria for these are specified in laws now in force, and that environmental performance that does not meet the Do No Significant Harm (DNSH criteria, then that performance level is technically equivalent to causing significant harm to environmental objectives. As a consequence, the current Taxonomy framework already technically defines three levels of environmental performance for each environmental objective: Green and sustainable, significantly harmful and the resulting intermediate level, which is dependent on the existence of both technical screening criteria for a particular objective and a particular economic activity. However, the current regulation is not intended to define any category of activity other than 'environmentally sustainable economic activities', as per Articles 1 and 3 and leading to the reporting of green activities under Articles 5, 6 and 8.

The Platform therefore proposes that any future extended Taxonomy incorporates definitions and associated disclosures of the following activities (whilst further noting that a technical assessment of some DNSH will be required – see Recommendation 8):

- Intermediate performing economic activities:
  An economic activity shall qualify as having an intermediate environmental performance level where that economic activity:

  (a) does not significantly harm any of the environmental objectives set out in Article 9 in accordance with Article 17;
  (b) does comply with technical screening criteria that have been established by the Commission in accordance with Articles 10 (3b), 11 (3b), 12 (2b), 13 (2b), 14 (2b) or 15 (2b);
  (c) complies with minimum safeguards.

- SH economic activities in need of urgent transition:
  An economic activity shall qualify as requiring urgent action to transition away from the level of performance that is significantly harmful to environmental objectives where that economic activity:
  (a) does significant harm to any of the environmental objectives set out in Article 9 in accordance with Article 17;
  (b) does not comply with technical screening criteria that have been established by the Commission in accordance with Articles 10 (3b), 11 (3b), 12 (2b), 13 (2b), 14 (2b) or 15 (2b).

Identify further economic activities with no technological possibility of improving their environmental performance

Recommendation 3. The Platform recommends that further economic activities for which no technological possibility of improving their environmental performance to avoid significant harm exists are identified with respect to all six environmental objectives, as is the case for the power-generation activity using solid fossil fuels already identified in Article 19 (3) of the

current Taxonomy, in order to support financing (green financing) of the urgent decommissioning investments needed of these activities.

Clarify that significant harm is the same concept whether it requires urgent transition and urgent exit

Recommendation 4. The Platform recommends that economic activities failing DNSH criteria and those for which no technological possibility of improving their environmental performance exists are jointly considered as significantly harming the relevant environmental objective and equally in need of an urgent transition away from these activities or these performance levels (noting also the Platform's recommendation for a review of DNSH criteria in Recommendation 8).

Extend the Taxonomy with a transition focus and with coherent supporting policies

Recommendation 5. Noting the urgency and substantial investment needs over the present decade for meeting EU climate and environment objectives, and noting that markets and investors are already taking action based on criteria and exclusions in the Taxonomy, the Platform recommends to the European Commission that the extended Taxonomy must be part of a wider set of coherent EU policy and legislative initiatives. These policies and initiatives need to be implemented in order to incentivise financing for urgent transitions away from environmentally significantly harmful activities, along with building climate resilience and supporting a greening of the whole economy, and also to address the consequences that may arise, affecting companies and jobs. The Platform stresses that any new set of policies must undergo a full impact assessment that, in the case of an extended Taxonomy, should take into consideration benefits and drawback from the concepts and additional requirements established (and should additionally include an assessment on reporting and usability). Such policies and initiatives should also take into account any effects on a level playing field for EU companies to attract funding for transition but must also be sufficiently ambitious for climate and environmental aspects to allow for green and sustainable performance; intermediate and sustainable performance; and unsustainable performance causing significant harm to environmental objectives to be clearly identified.

8.2 Recommendations regarding the implementation of an extended Taxonomy

This section includes recommendations on how an extended Taxonomy can be phased in and expanded in areas not yet covered by the technical screening criteria included in the Taxonomy DA(s).

Name the Intermediate (or 'Amber') Performance space — Acknowledging ''Intermediate'' or "Amber" transitions

Recommendation 6. The Platform recommends that the middle level of environmental performance (between DNSH and SC technical screening criteria) of economic activities is referred to as 'amber performance' or "intermediate performance" in line with the 2021 EU Strategy for Financing the Transition to a Sustainable Economy. The Platform is against creating any further subdivisions of performance levels.

The Platform underlines that, as a consequence of the extended Taxonomy, two transition opportunities materialise.

- Transitioning out of significant harmful performance levels into intermediate performance levels
- Transitioning within the intermediate performance space through improving environmental performance

The Platform proposes that both of these transitions be called Intermediate or "Amber" transitions. The Platform also proposes that these transitions are recognised under conditions of continuing to improve in order to help mobilise finance (see Recommendation 9). First of all, a robust activity-based transition plan is needed to ensure continuous improvement in environmental performance to be disclosed, including justification for why the activity cannot reach an substantial contribution directly (for further information on the requirements for such plans, see Section 5.7).

Aim for the rapid phasing in of an extended Taxonomy

Recommendation 7. Given the urgency to encourage intermediate transitions (in parallel with a transition to substantial contribution performance levels), the Platform recommends that after a decision on an extended SH Taxonomy is made, phasing in should be as rapid as possible, especially for those entities that find the concept useful to tell their own transition stories. Such voluntary reporting can be based on the first legally in-force Climate Delegated Act[74] criteria and build upon that in a phased way as more DNSH criteria are set out in Delegated Acts. This voluntary use should provide experience that can feed into a review of potential standardised reporting and necessary impact assessment prior to any legally required reporting, which would require legislative changes.

At the same time, the Platform recommends that the necessary work to identify activities for which no technological possibility of improving their environmental performance to avoid significant harm exists, referencing all six objectives, is initiated as soon as possible.

The Platform stresses the opportunity to encourage, in the absence of a formal Taxonomy extension, the voluntary use in corporate disclosure of the already existing significant harmful and intermediate performance levels for activities covered by agreed Delegated Acts, benefiting from a standardised reporting framework and allowing access to transition finance by the use of such a robust framework.

Technically assess DNSH criteria for clarifying environmental performance levels requiring urgent transition and intermediate performance levels

Recommendation 8. The Platform recommends that a technical assessment should be made regarding the formulation of DNSH criteria in Delegated Acts for supporting the interpretation of the three performance levels embedded in the current Taxonomy framework. This includes the identification of significantly harmful activities that need robust transition plans and support towards better performance — either intermediate or substantial contribution performance levels. The assessment should include a stock-take of current market practices and a review of the formulation of criteria where needed for enhanced usability through (preferably)

[74] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

quantitative metrics (i.e. the existence and adequacy of the wording of DNSH criteria for avoiding significant harm and clarity on the definition of the resulting intermediate performance space), with such a review being coordinated within overall reviews of TSC usability and robustness.

The Platform emphasises that this technical assessment is not needed for the first voluntary use of those DNSH criteria that work well for the extended Taxonomy concept, nor is it proposed that all activities should have DNSH criteria introduced for all objectives. The timing of any review should be planned to support the data and usability review as well as other DNSH criteria reviews and future impact assessments. Nevertheless, the Platform highlights that the success of the extended Taxonomy, as with the Green Taxonomy, depends in large part on its usability.

Define intermediate transition, corresponding investments and plans

Recommendation 9. To qualify as an intermediate transition, investment decisions have to be incorporated in robust, monitored corporate-level or entity-level transition strategies and activity-specific intermediate expenditure plans with 'intermediate transition investments' (in particular, capex) as reported KPIs for companies and financial products. The Platform recommends that the European Commission, as a first step, issue non-binding guidelines to corporates, financial market participants and other Taxonomy users on the use of DNSH and intermediate performance levels for informing activity-specific investment plans and transition narratives. This should provide a framework for voluntary use and a solid implementation of DNSH, which can be further enhanced by accelerated work on clear activity pathways for transition predictability on TSC development, enabling more robust transition planning informed by an understanding on how DNSH criteria are likely to develop.

The Platform considers that the extended Taxonomy would also contribute to accelerating the transition from harmful to significantly better environmental performance through the synergies that could be established with the legislative reforms launched as part of the 2018 Action Plan. The Platform recommends that any effective and legally sound way of exploiting the links of the extended Taxonomy with these legislative reforms, both already in force or in the process of being enacted, should be carefully evaluated for a rapid implementation.

Technically identify and develop criteria for activities that have no technological possibility of transitioning away from a significantly harmful performance level

Recommendation 10. The Platform recommends developing technical screening criteria for potential 'decommissioning/closure of…' Article 19 (3)-type activities, as well as for other activities for which no technological possibility of improving their environmental performance to avoid significant harm exists. It should be noted that whilst respecting The Polluter Pays Principle, it may be possible to add 'decommissioning of…' in the next Delegated Act, similar to activities such as 'renovation of…' or 'Renewal of…'. This would provide technical clarity on this topic, albeit indirectly, and could incentivise access to green finance for these activities without changing the Taxonomy Regulation.

8.3 Recommendations concerning a Low Environmental impact (No Significant Impact) Taxonomy extension

This section includes recommendations on how a LEnvI Taxonomy could potentially be established in a series of steps.

Concerning a LEnvI Taxonomy extension

Recommendation 11. The Platform recommends that the low environmental impact Taxonomy should be established as non-binding guidance that could eventually be further incorporated into a full Taxonomy after experience has been gained.

This could help to create a category of low environmental impact economic activities to support enterprises and other entities to proactively show that they are not active or invested in an economic activity with a material environmental impact. Such activities could be readily identified and would mostly fall under the NACE codes in macro-sectors J–U.

The Platform notes the advantages of establishing a non-significant environmental impact Taxonomy independent from a social Taxonomy, at least to start with, and irrespective of the intention or actual development of a significant harm Taxonomy.

Identify potential LEnvI activities based on a NACE-4 analysis

Recommendation 12. To achieve a better understanding of the size of the included economic activities that may be suitable for the low environmental impact the Platform recommends that the Commission carry out an in-depth materiality analysis at the NACE-4 economic activity level to identify all activities not yet covered or not planned to be covered by Delegated Acts as a basis for developing a list of no significant impact activities.

Ensure minimum standards and reporting for LEnvI activities

Recommendation 13. The Platform notes that to enable the reporting of no significant impact activities, it recommends considering simple approaches, building on well-established tools in the market — amongst others — and striving for coherence with other disclosure frameworks (e.g. the Corporate Sustainability Reporting Directive) to exclude indirect significant harm caused by otherwise low environmental impact economic activities and to support market confidence. The principle of proportionality should be taken into account. It is important to highlight that the classification of economic activities as low-environmental impact does not exempt the economic actors conducting those activities from their responsibilities to minimise and properly manage their impacts, even if low. Further, many of these activities carry significant social or governance externalities that should be addressed accordingly and regarded carefully by investors and financiers when investing in them.

Develop guidance to clarify how LEnvI activities can access green finance

Recommendation 14. Enhance understanding of how the green Taxonomy can also be used by enterprises with their predominant activity in the low environmental impact economic activities through their capital and operational expenditures. In order to ensure that low environmental impact economic activities can benefit from the adaptation Taxonomy, we recommend prioritising the development of a common set of DNSH criteria.

LEnvI green services should be dealt with by the green Taxonomy

Recommendation 15. Those low environmental impact economic activities that provide green services (e.g. professional services, architectural and engineering services, advertising and publishing activities conducted in relation to green economic activities) should be considered for inclusion in the green Taxonomy.

8.4 Potential timelines for extending the Taxonomy and developing non-binding/voluntary guidance for low environmental impact activities

The table below provides an indicative timeline of the development of an extended Taxonomy. It should be noted that for any EU legislative issue, the Commission is the institution deciding the final formal timeline, noting nevertheless that the extension of the Taxonomy to cover wider transition options and offer clarity on reporting on activities that cannot transition is deemed a priority by the Platform and that preparatory steps should therefore be taken as soon as feasible, such as a review of DNSH criteria and an examination of the reporting options.

Timeline	Milestones
March 2022	Platform Report published with recommendations to the Commission on an extended Taxonomy: on that basis, the Commission produces a report, as per Taxonomy Regulation Article 26 (originally foreseen by the end 2021; new timing will therefore be defined by the Commission over the course of 2022).
Autumn 2022	The Commission is expected to adopt a new Delegated Act on the four other environmental objectives. This would be an important moment for the review of some DNSH criteria, and as well as usability issues, this can also include the Platform's technical recommendations to partly help to clarify the use of DNSH criteria for the extended Taxonomy. Any improvements proposed should therefore, where relevant, ensure the DNSH criteria have similar levels of ambition in order to ensure their use for supporting urgent green and amber transitions.
	Technical recommendations for activities that cannot technically or economically transition out of the category of significantly harmful activities should be developed to allow for green finance to be accessed for the decommissioning or closing of these activities. Earlier examples may be useful for certain activities, such as Article 19 (3) activities, prior to a longer assessment being carried out.
	As the DNSH criteria are already enshrined in the Climate Delegated Act[75], and therefore the intermediate space is already technically in existence, it would be important to develop and publish non-binding

[75] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, OJ L 442, 9.12.2021.

Timeline	Milestones
	guidelines to encourage stakeholders to test the extended Taxonomy and to be able to voluntarily tell their transition stories and access finance for these important amber transitions. Building on existing DNSH criteria from the green Taxonomy, voluntary guidelines could be produced based on the first Delegated Act and together with a technical assessment of DNSH criteria, bring in the following Delegated Acts after they pass into law, including the publication of examples for guidance on voluntary reporting.
	Using the non-binding guidelines from the Commission, feedback could then be requested from stakeholders. Stakeholders can start reporting on their 'learning period' on a voluntary basis.
	The concepts in the extended Taxonomy as voluntarily tested through the amber use-of-proceeds instruments could be linked to the work on developing frameworks for other use-of-proceeds instruments, for example, those based on the EU GBS.
	The Commission should prepare a legislative proposal as needed for the extended Taxonomy following outcomes of their public consultation and a review of reporting options based on the market experience of green Taxonomy reporting, SFDR reporting, CSRD reporting and related voluntary reporting, impact assessment, regulatory scrutiny board and inter-service consultation.
	The Commission should table amendments of the Level-1 TR, extending the Level-1 TR to several categories with co-legislators' negotiations for Level-1 amendments, plus Article 8 DA[76].
	An updated Level-1 Taxonomy Regulation could enter into application, plus an updated Article 8 DA.

The table below provides an idea for an indicative timeline of the development, application and review of non-binding guidelines for the LEnvI concept.

Timeline	Milestones
March 2022	Report published
	Draft voluntary guidelines about disclosure according to the LEnvI concept could be developed and tested with stakeholders to be ready for implementation of the CSRD, allowing LEnvI activities to report, as such, using a robust yet simple framework to do so, thereby avoiding a wide variation of potential arguments about environmental 'low impacts'.

[76] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021

Timeline	Milestones
	Voluntary guidelines could be published by the European Commission in a timely way to support CSRD reporting.
From FY 2023	The CSRD applies to large companies, both listed and non-listed.
	Non-financial enterprises are encouraged to apply the LEnvI concept voluntarily based on the guidelines.
	A review of the LEnvI non-binding guidelines' voluntary application would be useful, leading to adjustment based on learnings. This would be needed for the option to assess a regulatory extension of the Taxonomy.
From FY 2026	The CSRD should start being applied additionally to SMEs (except microenterprises). At this point, the LEnvI concept may be being applied more widely, and its usefulness and effectiveness — as well as practical experience on its reporting — can be reviewed again at this stage, taking account of the more formalised state and use of the green Taxonomy and potentially the developments of a social Taxonomy, where a clear overlap with many LEnvI activities is expected. Assessment could then be made on the need for a formal LEnvI category or not.

Annex 1. Outreach and consultation

Outreach events

Despite representing a broad range of stakeholders, the Platform considered outreach to those interested in the development of the Taxonomy an important part of the process for developing its recommendations. This report incorporates feedback from discussions during five outreach events with different user groups, discussing use cases, pros/cons, and practical implementation issues (see Table below). All meetings were held online due to Covid restrictions.

SG3 online outreach events in 2021:

Date	Format	Participants/Audience	Numbers
24th Feb	Panel discussion + Q&A	Panellists from all 4 actor groups + general public via twitter livestream	5 panellists 1200 online
22nd Mar	Workshop	Wider society: consumer organisations, pension funds	8 participants
22nd Mar	Workshop	Non-financial corporates: large private, public, municipal, SME	13 participants
24th Mar	Workshop	Financial system regulators: banking, insurance, central banks	22 participants
24th Mar	Workshop	Finance market participants: investment funds, banks, asset managers	9 participants

Concerns and expectations

Following an explanation of the latest conceptual thinking of SG3, participants at outreach events were able to express their opinions on the need for, and potential risks of, extending the Taxonomy and how this might be done in practice.

The strongest opinions related to:

- Non-financial corporates concerned that an SH taxonomy might 'blacklist' companies with such activities, making it more difficult for them to raise finance for transition.
- Financial market participants concerned that an extension would add another level of complexity to reporting before there is any market experience from applying the current 'green' taxonomy.
- Non-financial corporates in favour of an SH + LEnvI extension applying consistent criteria to their entire portfolio of activities in order to get a 'whole business' view of their transition needs.
- SMEs concerned that it would place a higher reporting burden on them indirectly from banks, their main source of finance, and requesting simplified reporting rules for smaller entities.
- Financial market regulators are in favour of a more granular SH + LEnvI taxonomy that could provide better metrics for understanding and eventually quantifying transition risks.

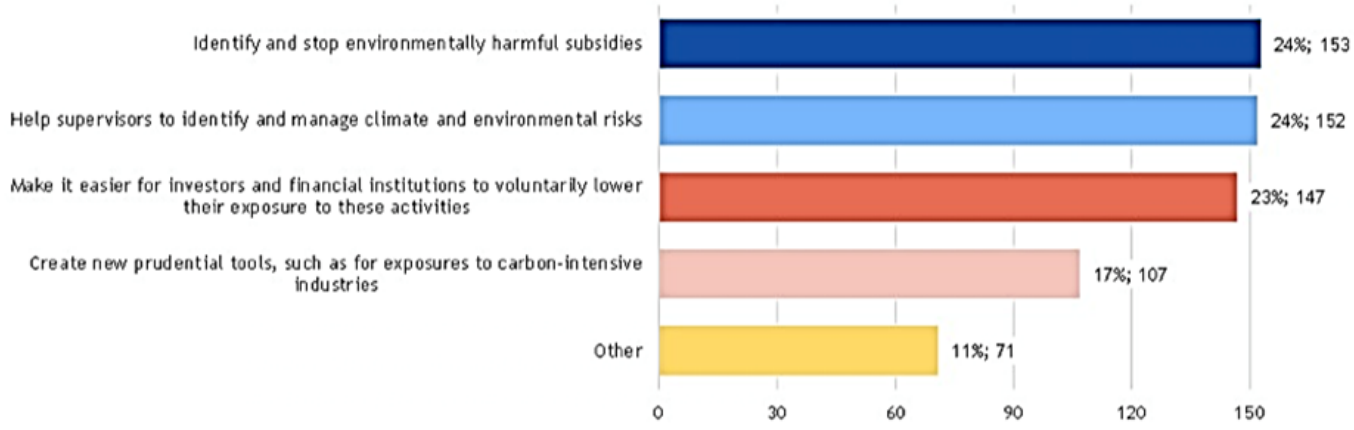
- Retail investors and consumers in favour of more transparency about harmful investments in order to be able to avoid financial products invested in environmentally harmful activities.
- Civil society organisations concerned that *de facto* more finance was channelled towards investments in new fossil fuels compared to renewables, and therefore an SH taxonomy was essential in order to clearly identify unsustainable activities and investments and avoid financial support/subsidies to harmful activities.
- Full disclosure of pension funds for green, neutral and harmful activities would show long-term and transitional risks and help to develop adequate emission/transition pathways also for less prominent sectors.
- Institutional Investors/Labels are in favour of an extended taxonomy, as higher transparency increase efficiency of capital markets by supporting retail investors decision making according to investment preferences.

Public consultation on the renewed EU Sustainable Finance Strategy in relation to extending the EU Taxonomy

The public consultation on the renewed EU Sustainable Finance Strategy in 2020 included two questions (Q82-83) related to extending the EU taxonomy. The main findings were:

- The majority (48%) of respondents *supported an SH extension* to include activities that have a negative impact on environmental objectives, whilst 39% were against such an extension.
- The majority (44%) of respondents were *against a LEnvI extension* to include activities that have a low impact on environmental objectives, whilst 29% were in favour of such an extension.

The reasons given why respondents were in favour of an SH taxonomy were:



Public consultation on Platform's draft recommendations on the extension of the Taxonomy (July-Sep 2021)

Feedback from **194 respondents** was received. This feedback was mainly provided by businesses (with a majority of businesses involved in non-financial activities). Civil society organisations and public authorities represent the two largest following stakeholder groups.

Business (finance)	Business (non-finance)	Civil society organization	Public Authorities	Rest (private, academia)	**Total**
49	84	36	15	10	194

Among non-financial businesses, a well-balanced representation of organization size could be remarked:

Large (250 +)	Medium (50-249)	Small & micro (1 –49)	Total
29	15	40	84

A geographical split reveals that a disproportionately large number of respondents originated from Western and Northern Europe, as well as Belgium (headquarters of many organisations representing different stakeholder groups).

Western& Northern Europe (excl. BEL)	Eastern & Southern Europe	Belgium	Other country	Total
115	31	43	5	194

Substantially, the questionnaire largely confirmed the above listed advantages and disadvantages of an extension of the taxonomy in Section 3.4.

Some findings that inform and support the Platforms recommendations in this report were outlined:

- **Preference for a completion/extension of the taxonomy** beyond green activities: in Q2 the simple majority of the responses indicated that policies should 'distinguish different levels of environmental performance clearly throughout the taxonomy and in other instruments' (83 stakeholders, 43%).
    - A slight majority indicated that it would be important to name the significant harm performance level (44%), compared to 41% no answers
- **Transition Focus and intermediate Performance**: Incentivising intermediate transition away from environmentally harmful activities and recognising intermediate performance levels was regarded largely positive by the respondents
    - The majority of respondents (46%) was favourable to recognising or naming the intermediate performance level to encourage mitigating significant harm (vs. 31% no answers)
    - 53% percent of respondents agree with the statement 'Always significantly harmful activities should be distinguished from those activities that have a potential to transition out of significant harm' (102 stakeholders, 53%).

- Conditions for intermediate transition and Performance: 56% of respondents favour the condition for recognizing intermediate transition that the activity does not do significant harm to that particular environmental objective' (109 stakeholders, 56%). In addition, 30% are favourable to the condition that the activity continues to improve its environmental performance in order to stay in the intermediate performance level. The same number of respondents favours a formulation that preconditions on *continuing to improve* "in order reach an substantial contribution (green) in the future".

- A **low environmental impact (LEnvI) taxonomy was regarded cautiously** by the respondents. When support was found, it pointed towards a possible extension in the future, with low priority for immediate legislative change.
  - Only 3 % of respondents stated that recognition of LEnvI as a generic category was a priority. 19% were generally in favour of a LEnvI inclusion, "but it should be done in the future only".
- A qualitative analysis of answers performed by external consultants produced two main findings:

  - **most respondents propose a phased approach**. They suggest to implement the current proposed taxonomy first, and to subsequently evaluate it before any extension.

  - The overarching rationale for an increased transition focus towards environmentally sustainable activities is supported by most stakeholders. Remarks related to the urgent mitigation of significantly harmful activities and observations relative to the concrete transition of non-significantly impactful activities mostly question the implementation side of the taxonomy, while confirming the relevance of a taxonomy to reach the goals of the Paris Agreement. **Clarity, guidance, transparency and rewarding features** (e.g., support to activities in the course of their transition) are regularly advocated for.

Further public outreach:

Public consultation webinars were held on 13th July 2021 and 17th August 2021. A Webinar presenting the main findings of this Report was held on 28th March 2022.
Webinar recordings can be found at:

EU Platform presentation on proposed "Significantly Harmful" & "No Significant Impact" Taxonomies - YouTube

EU Platform presentation on proposed "Significantly Harmful" & "No Significant Impact" Taxonomies - YouTube

EU Platform on Sustainable Finance launches: Extended Environmental Taxonomy (SG3) - YouTube

Annex 2. Concepts defined within the Taxonomy and associated Regulations

Activities damaging the environment are often subject to legal requirements under EU environmental laws. The provisions of such laws usually aim to prevent or limit many of the adverse effects on nature, water and land that come within the scope of the term 'environmental damage'. DNSH can be understood in this context as a very specific method developed in line with the six established environmental objectives (climate change mitigation and adaptation, protection of ecosystem and water resource, building the circular economy and pollution prevention). The concept of DNSH is embedded in EU Law and guidance.

Taxonomy Regulation[77]

Article 17 of the TR defines 'significant harm' for the six environmental objectives covered by the Taxonomy Regulation:

Significant Harm (SH)

1. An activity is considered to do significant harm to ***climate change mitigation*** if it leads to significant greenhouse gas (GHG) emissions;
2. An activity is considered to do significant harm to ***climate change adaptation*** if it leads to an increased **adverse impact** of the current climate and the expected future climate, on the activity itself or on people, nature or assets;
3. An activity is considered to do significant harm to the ***sustainable use and protection of water and marine resources*** if it is detrimental to the good status or the good ecological potential of bodies of water, including surface water and groundwater, or to the good environmental status of marine waters;
4. An activity is considered to do significant harm to the ***circular economy***, including waste prevention and recycling, if it leads to significant inefficiencies in the use of materials or in the direct or indirect use of natural resources, or if it significantly increases the generation, incineration or disposal of waste, or if the long-term disposal of waste may cause significant and long-term environmental harm;
5. An activity is considered to do significant harm to ***pollution prevention and control*** if it leads to a significant increase in emissions of pollutants into air, water or land;
6. An activity is considered to do significant harm to the ***protection and restoration of biodiversity and ecosystems*** if it is significantly detrimental to the good condition and resilience of ecosystems, or detrimental to the conservation status of habitats and species, including those of EU interest.

Within the current TR, the concept of SH is used as a screening out tool to ensure that an activity that is making a Substantial Contribution to one environmental objective cannot be counted as environmentally sustainable if the same activity is causing significant harm to another. This applies the precautionary principle of DNSH referred to in Article 2.17 of the SFDR (EU) 2019/2088.

[77] REGULATION (EU) 2020/852 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

The Technical Annexes to the Taxonomy Regulation Delegated Acts for each environmental objective establish:

- A list of economic activities that can potentially substantially contribute to meeting that environmental objective.
- Whether each economic activity is a considered transitional or enabling for that objective.
- For each economic activity, quantitative or qualitative criteria for deciding whether the performance can be counted as SC for that environmental objective.
- For the same economic activity listed under one objective, DNSH performance criteria for the other 5 environmental objectives to decide whether the activity causes SH and hence cannot be treated as environmentally sustainable (screening-out criteria) (TR Articles 10-15).

Based on the DNSH criteria in the Taxonomy Regulation Delegated Act Annexes[78] for climate change mitigation and adaptation, in some cases the draft criteria draws heavily on existing EU environmental legislation, but in other cases they are more ambitious, based on latest scientific evidence, e.g. 270gCO_2e/kWh emissions from the activity "**4.7 Electricity generation from gaseous and liquid fuels**" to comply with the Paris Agreement.

The TR Article 25 amends the SFDR by inserting ***Article 2a Principle of do no significant harm***, such that the SFDR relies on taxonomy criteria to identify and report on activities causing significant harm. The Article further requires the European Supervisory Authorities (ESAs) to define regulatory technical standards (RTS) defining the information requirements in relation to DNSH.

The principle of DNSH in the Taxonomy Regulation is referenced in other EU Regulations, e.g. Recovery and Resilience Facility (RRF) Regulation 2020/0104. Per technical guidance on the application of "do no significant harm" under the Recovery and Resilience Facility Regulation[79] (C(2021) 1054 final), DNSH is to be interpreted within the meaning of Article 17 of the Taxonomy Regulation.

No Significant Impact (LEnvI)

The concept of LEnvI does not appear in the Taxonomy Regulation nor in the SFDR or NFRD. The concept is mentioned only in the context of Article 26 on the review of the TR, which states:

> ***Article 26 Review****. 2. By 31 December 2021, the Commission shall publish a report describing the provisions that would be required to extend the scope of this Regulation beyond environmentally sustainable economic activities and describing the provisions that would be required to cover:*
>
> *(a)* ***economic activities that do not have a significant impact on environmental sustainability*** *and economic activities that significantly harm environmental sustainability, as well as a review of the appropriateness of specific disclosure requirements related to transitional and enabling activities; and*
>
> *(b) other sustainability objectives, such as social objectives.*

[78] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R2139&qid=1639037016630
[79] C(2021) 1054 final

Although not defined, the concept of LEnvI implies that there are some activities that in and of themselves do not place high pressure on the environment. Whilst this concept is intuitive for activities potentially causing damage through emissions to, or direct damage of, the natural environment, for climate change adaptation and the circular economy objectives there is a different logic.

Excluded activities

TR Article 19.3 acts as an exclusion clause for certain economic activities that are incompatible with meeting the EU climate objectives set out in the Paris Agreement for a clean energy transition consistent with a pathway to limit the temperature increase to 1.5°C above pre-industrial levels. The exclusion is currently limited to power generation activities using solid fossil fuels, i.e. coal-fired power stations.

> ***Article 19 Requirements for technical screening criteria*** *- 3. The technical screening criteria referred to in paragraph 1 shall ensure that power generation activities that use solid fossil fuels do not qualify as environmentally sustainable economic activities.*

Sustainable Finance Disclosure Regulation and Corporate Sustainability Reporting Directive

SFDR and Principal Adverse Impacts (PAIs)

The Disclosure Regulation[80] (SFDR) recognises the 'do no significant harm' (DNSH) principle as an element of sustainable investments. Sustainable investments are investments in economic activities that contribute to an environmental or social objective[81]. In addition, the SFDR recognises principal adverse impacts as those impacts of investment decisions that result in negative effects on sustainability factors. When identifying principal adverse impacts, market participants need to disclose how they adhere to international codes for responsible business conduct. The three European supervisory authorities EBA, EIOPA and ESMA[82] were mandated to develop draft regulatory technical standards to further specify the content and methodologies of information in relation to sustainability indicators with regard to environment-related adverse impacts. According to their draft advice, the DNSH principle is linked to the disclosures of principal adverse impacts of investment decisions on sustainability factors. For this reason, according to the European supervisory authorities, financial product disclosures relating to the 'do no significant harm' principle should explain how the indicators for adverse impacts have been taken into account.

The draft Regulatory Technical Standards for the SFDR recognises that Principal Adverse Impacts are looking at negative impact comparable to failing DNSH criteria from the Taxonomy Regulation. The Principal Adverse Impact are identified at asset level (e.g. share in a company), whereas the DNSH criteria are looked at from an activity level.

[80] REGULATION (EU) 2019/2088 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 27 November 2019 on sustainability-related disclosures in the financial services sector
[81] Art. 2 (17) SFDR
[82] Final Report on draft Regulatory Technical Standards, with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088, JC 2021 03, 2 February 2021

An extended taxonomy, in particular a “significant harm” extension, may further broaden the connection to SFDR products, mainly in two ways. First activities which cannot transition and could then be classified as “always causing significant harm”, should likely be considered for the strategy of products investing in sustainable investments (for instance through exclusions or dedicated engagement to propose decommissioning), i.e. Article 9 (products with objectives) and the relevant Article 8 (products with characteristics) of the SFDR. The reasoning would be that the PAI would be significant – and remain – significant, which contradicts the precautionary principle relevant for sustainable investments under the SFDR. Secondly, the SH criteria could provide guidance, acting as supportive boundaries or upper caps, to the levels of the various PAI disclosures. It is the Platform’s understanding, awaiting adoption of the SFDR RTS, that the PAI does not currently require any cap(s), such as thresholds for significant harm, on the adverse impact on sustainability factors. Nevertheless, given that PAIs are identified on an asset level whereas DNSH are identified on an activity level further work on the correlation needs to be done.

How the Taxonomy Regulation can facilitate SFDR disclosures

Next to the connection points on the precautionary principle, the Taxonomy Regulation, including an extension to Significant Harm and LEnvI, can offer an assortment of objectives to use for SFDR Article 9 products. Article 9 of the SFDR covers financial products with sustainable investment as an objective and shall include information on how the objective is to be attained. Here, the Taxonomy Regulation offers six environmental objectives, the first two being adopted, and the Platform is developing recommendations for social objectives.

With an SH extended taxonomy, products with objectives related to transition would obtain better guidance than without further specification on SH performance (see Fig 1 and 4). In general, the Platform expects authentic creativity, not misused, on how to use provided guidance, e.g. when designing Article 9 products. As a starting point, products could in theory have the objective of transitioning out of the SH space, which would encourage investments and capital flows not only to activities meeting TSCs for substantial contribution but activities moving out of SH. An extension to LEnvI would, in a similar way, offer more combinations of both objectives and characteristics as it would be possible to provide the full picture (classification) of the product. To explain more clearly, it may well be that an Article 9 product, entirely focused on a sustainability objective, might still not have 100% Green investments within it (one could think of a Climate resilience Fund where investments will not be 100% adaptation). In these cases, far from watering down such an Article 9 product, the LEnvI information might provide a clearer picture of the remaining, non-Green fund investments, clarifying that these actually support the Fund overall objective or to other sustainability objectives.

For SFDR Article 8 products promoting environmental and social characteristics, there could be even more options with the help of the Taxonomy. As characteristics are seen as less stringent than objectives, more combinations would be allowed. These could include, but are not limited to, any kind of transitional activities despite the starting and end point (illustrated in fig 4).

The Taxonomy Regulation and the Corporate Sustainability Reporting Directive

Article 19a of the Corporate Sustainability Reporting Directive states that companies subject to the CSRD: “shall include in the management report information necessary to understand the undertaking’s impacts on sustainability matters, and information necessary to understand how sustainability matters affect the undertaking’s development, performance and position”. These two perspectives are called the Double Materiality. To disclose on the double materiality

for environmental factors, the Taxonomy works as a “practical translation” of EU’s environmental objectives (which are framed by the Paris agreement) into granular levels of market activities, e.g. economic activities.

With the Taxonomy Regulation disclosure obligations - % of turnover - capex and opex - the Taxonomy alignment can serve as a basis for both the “impact in” and “impact out” perspectives. Seen from the CSRD reporting perspective, an extension to an SH taxonomy and associated disclosures may be very important. This enables companies to disclose information to the extent necessary for the full understanding of the undertaking’s impact on sustainability matters, as well as how these matters affect the undertaking, as stated in Article 19a of the CSRD. The Platform believes an extension to both an SH and a LEnvI taxonomy to be useful in this regard, as a LEnvI taxonomy can help rule out significant impacts in both directions. The interlinkages continue throughout the Corporate Sustainability Reporting Directive, and Article 19a, with disclosures on resilience of the undertakings business model and strategy, as well as if and how these are compatible with the Paris agreement.

Other EU Environmental Legislation

Environmental Damage

The terms “harm” and “damage” are used in a similar way. The EU Environmental Liability Directive[83] provides a framework to prevent and remedy **“environmental damage”**. It deals with "pure ecological damage" and defines it as damage to protected species and natural habitats, damage to water and damage to soil.[84] In March 2021, the Commission adopted guidelines that clarify the scope of the term 'environmental damage' in the Directive. These guidelines clarify whether damage to water, land and protected species and natural habitats must be prevented or restored by explaining the scope of each of these categories in detail. The Liability Directive links the idea of environmental damage to the environmental objectives of the Union. It states that preventing and remedying environmental damage contributes to implementing the objectives and principles of the Community's environment policy, as set out in the Treaty.

The idea of preventing and remedying of damage is also underlying the non-binding guidelines on non-financial reporting. According to this guidance, failing to avoid or minimise adverse impact on the climate[85] as well as investments that are more damaging to the climate, are assumed to be riskier.

Do No Harm Principle

[83] DIRECTIVE 2004/35/CE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 21 April 2004 on environmental liability with regard to the prevention and remedying of environmental damage.

[84] The definition of ‘environmental damage’ expressly refers to different important Directives such as:

- Council Directive 79/409/EEC of 2 April 1979 on the conservation of wild birds(13) *[now Directive 2009/147/EC on the conservation of wild birds*(14)] (‘the Birds Directive’);
- Council Directive 92/43/EEC of 21 May 1992 habitats and of wild fauna and flora (‘the Habitats Directive’);
- Directive 2000/60/EC of the European Parliament and the Council of 23 October 2000 establishing a framework for Community action in the field of water policy (‘the Water Framework Directive’);
- and Directive 2008/56/EC of the European Parliament and the Council of 17 June 2008 establishing a framework for Community action in the field of marine environmental policy (‘the Marine Strategy Framework Directive’).

[85] COMMUNICATION FROM THE COMMISSION, Guidelines on non-financial reporting: Supplement on reporting climate-related information, (2019/C 209/01)

The Green Deal identifies a "green imperative" in chapter 2.2.5, which expands and strengthens the DNSH principle of doing no harm: "The aim is to ensure that all Green Deal initiatives achieve their objectives as effectively as possible and with the least effort, and that all other EU initiatives are compatible with the green imperative "Do no harm". To this end, the Explanatory Memorandum to all legislative proposals and Delegated Acts will include a separate section explaining how each initiative meets this principle." The three-paragraph brief chapter on the green imperative is thus a statement of intent for future legislation: Transparent and efficient legislation (e.g. via impact assessments and evaluations) should enable the "transition to a sustainable future."

Other definitions

The literature also lists overlaps and direct references to the already established precautionary principle. In fact, the European Environmental Agency equates the precautionary principle in its glossary with the DNSH principle:

"- (= do-no-harm principle) a proactive method of dealing with the environment that places the burden of proof on those whose activities could harm the environment. (Opposite: wait-and-see principle) - if the costs of current activities are uncertain, but are potentially both high and irreversible, the precautionary principle holds that society should take action before the uncertainty is resolved."[86]

[86] https://www.eea.europa.eu/help/glossary/chm-biodiversity/precautionary-principle

Annex 3. Review of other Transition Finance Initiatives and Taxonomies

Beyond the EU Sustainable Finance Taxonomy, other external initiatives and fora exist that have started to develop granular concepts for financing transition efforts across levels of environmental performance. Initiatives reviewed originate from the public, private and civil-society sector covering both the international and national level.

PRIVATE SECTOR AND CIVIL-SOCIETY

ORGANISATION	Sector	*Publication*	Regional Scope	Content	Financial Products
ICMA (INTERNATIONAL CAPITAL MARKETS ASSOCIATION)	Financial Industry Association	*Transition Finance Handbook*	International	Definition of Transition principles & eligibility requirements	Yes (Use of Proceeds (UoP) and entity level)
CBI (CLIMATE BONDS INITIATIVE)	NGO	*Transition Finance for Transforming Companies*	International	Standards for Transition Finance Label: i) Green Transition ii) Interim Transition	Yes (UoP and entity level)
NATIXIS	Bank	*Brown Industries: The transition tightrope*	International	Brown Industry Transition Financing	Yes (UoP and focus on entity level instruments)
DBS	Bank	*Sustainable and Transition Finance Framework and Taxonomy*	International	Definition of Transition eligibility requirements and sectoral scope	Yes (UoP and entity level)
CICERO	ESG service provider	*CICERO Shades of Green*	International	3-step label for green bonds	Green & Sustainability Bonds
AXA IM	Insurance / Institutional Investor	*Financing brown to green: Guidelines for Transition Bonds*	International	Guidelines for Transition Bonds	UoP (Transition Bonds embedded in entity-level strategy
CSA (CANADA)	Industry-led Initiative/ Standard Setting Body	*Transition Finance Taxonomy*	National	Development of tailored taxonomy beyond green to reflect composition of CAN economy	tbd

PUBLIC SECTOR

ORGANISATION	Sector	*Publication*	Scope	Content	Financial Products
GOV. JAPAN	Consortium of Ministries	*Basic Guidelines on Climate Transition Finance*	National	Modelled on ICMA Handbook principles	Yes (UoP and entity level)
GFIT (SINGAPORE)	Transition Finance Taskforce	*Fostering Green Finance Solutions Whitepaper*	National	Taxonomy with Transition finance component	Yes (equity, debt, trade finance, retail products, public sector interventions)
ASEAN	Regional IO	*ASEAN Taxonomy for Sustainable Finance*	National /International	Taxonomy including a traffic light system (green-amber-red) with 3 characteristics for transition (amber) activities	No
BANK FOR INTERNATIONAL SETTLEMENTS	Int. Financial Institution	*A taxonomy of sustainable finance taxonomies*	National /International	Review of taxonomies & Principles for climate transition taxonomy	No

BANK NEGARA MALAYSIA / GOVERNMENT OF MALAYSIA	Central Bank / Government	*Climate Change and Principle Based Taxonomy*	National	Classification system with economic activities i) Climate supporting ii) Transitioning and iii) Watchlist	Yes (UoP and entity level)
VEB.RF / GOVERNMENT OF THE RUSSIAN FEDERATION	State development bank / Government	*Russian Green Taxonomy*	National	Classification system for i) green economic activities and ii) adaptation Both encompass transitioning activities for high-emitting sectors	Yes (focus on CAPEX and OPEX for activity level financing)
OECD	IO	*Transition finance: Investigating the state of play: A stocktake of emerging approaches and financial instruments*	National / International	Review of 12 transition relevant taxonomies / guidelines and 39 relevant financial instruments	Yes (UoP and entity level)
G20	Group of Countries	*G20 Sustainable Finance Roadmap*	National /International	Addressing transition considerations in existing and future sustainable finance alignment frameworks	Reference to development and expansion of transition financing tools

Commonalities and divergences of transition finance approaches are evident across dimensions of reasoning & motivation, transition concepts and labels, transition criteria, scope (both sector coverage and focus on entity or activity level), as well as financial instruments & products.

Reasoning and Motivation: **Recognizing a need to support financing of activities as they transition towards environmental sustainability over time** emerges as the consensus of reviewed transition finance initiatives and publications. The aim is to transcend the green / non-green dichotomies of 'first generation' Sustainable Finance initiatives by introducing a greater granularity of classification systems. With a 'whole of the economy approach'[87] it shall enable the inclusion of activities from all parts of the economy and from all starting points of environmental performance to engage in incremental improvements in climate performance over time, to outline transition pathways and eventually, to access financial instruments and products. The G20 Sustainable Finance Roadmap summarizes that *"The existing sustainable finance landscape has gaps in terms of enabling the transition, and more broadly there is a lack of common principles, strategies, or definitions of transition finance, pathways, disclosure requirements, and policy incentives."*[88] Many transition finance initiatives acknowledge the need to take into account national and regional-specific contexts to encompass varying economic and industrial profiles. This is an explicitly stated goal for example in the ASEAN, GFIT (Singapore) or expected in the yet to be published Canadian taxonomy from the standard-setting body CSA.

Transition concepts & labels: Varying differentiation and granularity of transition concepts and labels are proposed. The recently published proposed ASEAN taxonomy from November 2021 contains a **'traffic light concept'** of red (significant harm), amber (making a substantial contribution to transition) and green activities. Amber activities can be one of three types: i) Activities following a decarbonisation pathway aligned with the trajectory required by the Paris Agreement, ii) activities facing significant barriers to decarbonisation, and iii) interim solutions to significantly reduce emissions compared to available alternatives and which are carried out for a limited period of time. The Malaysian taxonomy introduces a system of transition

[87] OECD. 2021. *Transition Finance: Investigating the state of play*. p. 4.
[88] G20. 2021. *G20 Sustainable Finance Roadmap*. p.14.

categories with decreasing environmental performance levels from 'Climate supporting', to 'Transitioning' and 'Watchlist'. Under 'Transitioning', economic activities are included that at present do not fulfil the DNSH principle to other environmental objectives, but that are willing to undertake remedial efforts to promote the transition. CBI subdivides transitional finance labels into 'green transition' – on a common sectorial transition pathway that aligns with net zero (alignment or outperforming sector), and 'interim transition' - working towards the common sectoral pathway. CICERO develops three 'shades' of green labels for bonds, of which two, 'medium green' and 'light green' fall into a transition category. Medium green refers to projects or activities that represent a step towards long-term science-based transition (e.g. plug-in hybrid busses). Light green refers to projects or activities that contribute to environmental sustainability but that cannot be part of a long-term trajectory, such as energy efficiency in fossil fuel infrastructures. On the other hand, the well-established ICMA Transition Handbook, on which the Japanese Government Guidelines on transition finance are modelled, NATIXIS, DBS and GFIT do only recognize one general transition pathway.

Transition criteria: The applied criteria for assessing credible transitions vary considerably across frameworks and granularity of transition concepts. The OECD distils three core eligibility criteria for transition finance in its review of existing approaches: (i) substitutability (absence of a zero or near zero alternative); (ii) a commitment by the borrower/issuer to a low-emissions transition trajectory; and (iii) avoiding lock-in, i.e. investments that prevent the implementation of green alternatives available in the future. DBS considers an activity 'transitional', if it can meet the two conditions of displacing more carbon intensive options and facilitating graduation along Paris-Agreement aligned trajectories, as well as enabling the wider application or integration of less carbon intensive options. AXA IM's guidelines for transition bonds specify that eligible entities must not currently or for the near future have green assets to finance. NATIXIS' publication summarizes three options of defining credible transition output/result indicators benchmarked through (i) own historical performance, (ii) peer performance or (iii) science-based targets such as Paris-aligned net-zero pathways, performance thresholds, or best-available technologies (BATs). Science-based target setting, which the current EU Taxonomy has already adopted, represents a particular focus of the ICMA handbook's transition principles as well as CICERO and the CBI's transition finance framework.

Both the ASEAN and Malaysia taxonomy have adopted the **principle of do-no-significant harm** (DNSH) to other environmental objectives as well as the concept of **'remedial measures to transition'**. The remedial concept is designed to incentivize transition efforts that minimize or reduce environmental impacts, even when overall business or economic activities have been identified with significant harm. *'The recognition of remedial measures aims to support an orderly transition by avoiding any outright exclusion of economic activities that are currently not contributing to climate change objectives and/or not sustainable.*'[89] The Malayan taxonomy incorporates the remedial principle into its classification system with the category of 'Transitioning' that is applicable when remedial efforts to address significant harm are undertaken at entity level (overall business) or economic activity level.

Scope – Sector coverage: The scope of applicable economic sectors and activities varies widely from whole- or most-of the economy approaches (ASEAN taxonomy Foundation Framework) to a more specific selection of high-emission intensive sectors and activities, for example in the case of Singapore (both GFIT and DBS), AXA IM Transition Bond guidelines

[89] Government of Malaysia. 2021. *Climate Change and Principle-based Taxonomy*. p.18.

or the Plus Standard of the ASEAN taxonomy with threshold-based screening criteria for six focus sectors and three enabling sectors. Common sectors identified for transition finance are fossil fuels and power generation, aviation, shipping, construction, manufacturing, steel, cement, paper, chemicals as well as metals & mining.

Scope – Activity and entity level: Similarly, the emphasis between entity- and activity-level scope of transition finance varies. The Japanese guidelines, NATIXIS and the BIS working paper on transition finance promote an entity-level perspective on the transition of emission-intensive economic activities according to specified transition pathways. An approach that is facilitated as well through ICMA, CICERO and CBI frameworks, or the DBS formulation of corporate-level transition. In the Malayan taxonomy that includes both activity- and entity-level, corporate wide general-purpose finance qualifies only if the borrower has demonstrated a willingness and commitment to the transition, for instance by putting in place a policy or an action plan. Materiality to core business transformation is a key criterion even for activity-level transition finance in most reviewed approaches. A granular activity-level classification system, similar to the EU taxonomy, is provided with the ASEAN taxonomy Plus Standard for initially six economic sectors or in the Malayan taxonomy that provides sectoral guides with activity-based criteria for in-scope sectors. AXA IM transition bonds are use-of-proceed type finance on the activity-level. However, projects financed must sit within the corporate transition strategy and be essential to advance its objectives. From a financial sector and macro-economic perspective, transition finance (independent of its scope) essentially serves as a risk management tool on the entity-level for reducing transition risks through enhanced environmental performance, as the OECD underlines.

Transition finance instruments and products: As a result of transition finance frameworks, a general bifurcation of two types of financial products and instruments becomes evident. First, Use-of-proceeds types of green bonds, loans and equity for ring-fenced transition activities and second, general purpose corporate bonds, loans or thematic equities on the entity that is transitioning towards more sustainable levels of environmental performance. While most publications remain agnostic on the type of financial product derived from underlying transition financing frameworks, NATIXIS explicitly states its preference for entity-level holistic KPI-linked financial products and instruments along the General corporate purpose model. The comprehensive OECD review of 39 financial instruments and products observes three types of penalty mechanisms in KPI-linked bonds and loans that incentivize compliance with transition efforts: i) coupon step-ups, ii) premium payment and iii) obligation to purchase offsets. The GFIT Singapore lays out further debt and equity applications of transition finance, including green retail and consumer loans, venture capital and guarantees to provide risk-coverage. It also includes other transition financing measures, such as industry industry-wide programs structured as a guarantee framework for green projects, transition trade finance products, or financial advisory grants and capital tax allowances.

Annex 4. Detailed analysis of the links with the legislative reforms of the Action Plan on Sustainable Finance

Taxonomy is the cornerstone of the legislative initiatives launched as part of the 2018 Action Plan on Sustainable Finance which aim to enrich the endowment of financial markets in terms of corporate disclosure, services and products for boosting the role of private finance in supporting the transition to an eco-sustainable European economy. An Extended Taxonomy would act as a potential amplifier of the effects of the legislative reforms, with the result of increasing opportunities of financing the environmental transition in Europe. In evaluating the pros and cons of the Extended taxonomy, this effect could be considered a significant benefit.

Some tentative examples concerning both European legislations that are already in force and others that are in the process to be enacted can be offered in order to promote more in-depth reflections on the legal profiles and impact analyses.

Changes to the regulations on corporate disclosure are aimed at widening the range of information available to credit institutions and financial market participants on the environmental performance of the economic activities financed or to be financed. Referring to Art. 8 of Regulation (EU) 2020/852, the Extended Taxonomy, requiring companies to provide information on the composition of their activities and their capex also with reference to those in the amber space and on amber transition plans would be complementary to the extension of the scope of application of the reporting obligations to be achieved with the proposed CSDR.

The Extended Taxonomy could also be usefully integrated into the information disclosed by financial market participants (FMPs) under the Regulation (EU) 2019/2088 (SFDR): for financial products investing in an economic activity that contributes to an environmental objective, FMPs could be required to provide a description of how and to what extent the investment underlying the financial product can qualify as financing an amber transition plan.

The concepts of amber environmental performance and transition capex could be taken into consideration in the works for the development of the EU Ecolabel criteria for environment friendly financial products. This use would not be entirely new, since the Technical Report 4.0 produced by the JRC already considers that fund managers must have a documented engagement policy describing at least: a) how the environmental objectives of Regulation (EU) 2020/852 will be used as the basis on which to engage with companies; b) how they plan to target and engage with companies to grow their green turnover, to grow their market share for environmentally sustainable economic activities in order to contribute to the medium to long-term performance of their assets, to decrease the share of their activities that do not meet the Do Not Significant Harm criteria under the EU Taxonomy and, where relevant, to reduce/phase out the share of some specifically identified activities[90] provided certain conditions are not met.

[90] The supply and use of solid, liquid and gaseous fossil fuels for fuel, energy generation in the form of electricity and/or heat, heating and cooling using these fuels; waste management facilities and services without any form of material segregation of non-hazardous waste, including waste handling, landfill and incineration; production, distribution and sale of new passenger cars and light commercial vehicles with engine technology based on combustion of fossil fuels.

Alongside the threshold now envisaged for the assignment of the green ecolabel, an additional ecolabel could be introduced for the case in which the retail financial product respects specific thresholds defined considering the proportion of the underlying investments (securities or loans) invested in amber transition plans. The set of investment opportunities for retail investors would be broadened and synergies would be established with the changes made in the Mifid II and IDD delegated regulations to ensure that investment firms that provide investment advice and portfolio management recommend financial instruments to their clients (and potential clients) that are consistent with the sustainability preferences they have expressed.

Inserting the financing of amber transition plans in a framework similar to the EU Green Bond Standard (EUGBS) would make it possible to mobilize resources useful for putting an end to harmful environmental performance and starting the adoption of technologies that are likely to evolve, at a later stage, in trajectories towards sustainable levels. The proposal for a regulation on European Green Bonds published on 6 July 2021 could be integrated by extending the use-of-proceeds approach to bonds issued to finance amber transition plans that have the necessary requirements, thus amplifying the effects of the discipline on corporate communication in terms of environmental objectives. As a matter of fact, this might be the only difference from the standard proposed by the European Commission. All the other features of the EU GBS would remain unaltered: the reporting requirements on how the bond proceeds are allocated; the external review regime to ensure compliance with the Regulation and with respect to the Taxonomy; the system of registration and supervision of the external reviewers entrusted to the ESMA.

The way in which the links between the various legislative reforms functional to the Action Plan, on the one hand, and the Extended Taxonomy, on the other, could be exploited deserves careful consideration.

From a logical point of view, a modification of Art. 1(1) of the Regulation broadening the scope of application seems to be the most direct and clean way of giving legal value to the already technically defined three levels of environmental performance. However, the need to initiate the transition towards significantly better environmental performance than those currently harmful is so urgent that different but equally effective and legally sound ways should be explored.

For some legislative proposals that have not yet reached the final steps, it is possible to make direct reference to the (technical) conditions for the definition of harmful and low-impact activities, as already argued for the Ecolabel and the EU GBS. In other cases, the possibility of modifying the delegated regulations (without reopening L1) should be evaluated: for example, in that relating to Art. 8 of the Taxonomy Regulation, the KPIs could also refer to the share of turnover deriving from activities with amber environmental performance and to the capex associated with amber transition projects. Furthermore, it is possible to formulate recommendations to the market for the development of specific forms of sustainability linked bonds and loans for which the financial characteristics can vary depending on the realization of an amber transition plan complying with the required qualifications

Annex 5. Detailed analysis on the relation to other EU Sustainable Finance policies

EU Strategy to Financing the Transition to a Sustainable Economy

The Strategy's scope is very broad. It ranges from central banks and supervisors to member states, citizens, local authorities and financial and non-financial enterprises, with a part looking specifically at SMEs.

Though there is no explicit reference made to LEnvI, the concept could be relevant across the four building blocks of the strategy: i) enabling economic actors to finance their transition, ii) providing greater access to finance to individuals and SMEs, iii) improving the financial sector's resilience and contribution to sustainability, iv) fostering global ambition. By labelling activities as LEnvI, economic actors could address a potential risk of facing financing constraints and investors will better understand risks (and opportunities) in a large segment of the economy not covered by the "green taxonomy"; even if the "LEnvI activities are, by definition, less relevant from an environmental sustainability perspective but can be very attractive from a social or governance perspective.

The Strategy makes reference to a number of specific initiatives e.g. CSRD, SFDR, voluntary pledges by financial institutions, etc. While the LEnvI-concept is not explicitly referenced, it is potentially interesting for some of the above-mentioned initiatives. This potential relevance will be elaborated in more detail in the following sections.

Corporate Sustainability Reporting Directive (CSRD)

This section captures linkages between the Corporate Sustainability Reporting Directive and LEnvI. The CSRD is currently in proposal stage but once adopted by the co-legislators, it will replace the Non-financial Reporting Directive (NFRD). Compared to the NFRD, the CSRD is having an extended scope and depth. Yet many elements remain and are being highlighted. This includes for example the double materiality (development, performance, position and impact) which was stemming from the NFRD but got structured in the EC's 2019 Non-binding Guidelines, accompanying the NFRD. Lastly, the Taxonomy Regulation obliges financial and non-financial companies under the NFRD to report Taxonomy-related information. Article 8 in the Taxonomy Regulation governs how these companies shall disclose. This section therefore elaborates on Article 8 and LEnvI.

Double materiality

From a double materiality perspective, the environmental impact materiality of LEnvI-related economic activities, complying with the LEnvI criteria, is low. LEnvI activities could therefore be said to be resilient to environment-related transition risks due to their low-impact nature. Having a low environmental impact materiality also implies a low environmental financial materiality for transition risks, as the various inherent risks – from the environmental impact materiality – are low. Financial materiality caused by physical or dependency risks would have to be assessed separately given their location-specific risk profile and the impact focus of the Taxonomy regulation.

LEnvI activities	Impact materiality	Financial materiality
Transition risks (five environmental objectives)	Low	Low
Physical and dependency risks (for all six environmental objectives)	Low	Needs to be assessed

With regard to the CSRD legislative proposal, a LEnvI taxonomy may offer improved guidance to supervisory boards and management teams of in scope companies when managing and disclosing on the aspect of double materiality relating to impact of the activity on the environment. Economic activities classified as having low environmental impact would require reasonably less oversight, controls and follow-up, with respect to impact of the activity on the environment, than other activities, and in particular less than activities with significant impact and in need of transition. This does not exempt companies conducting only or mainly LEnvI from their responsibilities to manage and minimise their environmental impacts such as their carbon footprint or their sourcing practices.

In addition, a LEnvI taxonomy could be useful to auditors when assessing board and management accountability for double materiality perspectives. This is because a LEnvI taxonomy would list activities that neither contribute substantially to nor can significantly harm the environmental objectives of the taxonomy.

Consequentially, from a materiality perspective, such activities would likely not be seen as material related to environmental matters covered by the taxonomy.

Interlinkages between the Corporate Sustainability Reporting Directive and LEnvI

While the CSRD regulatory proposal covers double materiality for the wider spectrum of sustainability aspects, the LEnvI criteria offer a classification for economic activities with low environmental impact. This results in certain interlinkages that have both similarities and differences.

The Platform has noted EFRAG's Working Papers Batch 1[91] from January 18, 2022. The direction and content did not significantly impact the recommendations for the low environmental impact classification. On the contrary, the Platform believes a LEnvI expansion could facilitate disclosures for enterprises with a high portion of low environmental impact economic activities. It is important to highlight that the classification of economic activities as low-environmental impact does not exempt the economic actors conducting those activities from their responsibilities to minimise and properly manage their environmental impacts even if low. Further, many of these activities carry significant social or governance externalities that should be addressed accordingly and regarded carefully by investors and financiers when investing in them.

[91]https://www.efrag.org/Assets/Download?assetUrl=/sites/webpublishing/SiteAssets/Cover%20note%20for%20Batch%201%20WPs.pdf

Aspects	CSRD	LEnvI
Topic	Wide range of sustainability aspects	Activities with low environmental impact
Coverage / scope	Entity level disclosures	Activity level disclosures
Providing	Disclosures	Classification with disclosures
Thresholds	Transparency but not thresholds	Criteria with indirect thresholds (from the environmental taxonomy)
Materiality	Double materiality	Double materiality
Cross-references	Disclosures (potential references to the EU Taxonomy)	DNSH and MSS have been considered
Basis	Reporting standards developed under CSRD are building on developing EU legislation, existing global standards and best practice	Scientific evidence-based and technology neutral
Risks	Disclosures on risks	Low environmental transition risks
Opportunities	Disclosures on opportunities	Low opportunity to significantly contribute to environmental objectives but opportunity for reducing financial instability due to previous unknown classification

If the CSRD proposal by the European Commission is adopted by the co-legislators with the proposed time line, enterprises falling under its scope will publish the first set of disclosures for FY2023, and the second set of disclosures a year later. Listed SMEs will fall under scope of the CSRD and would have three years longer until they have to report, i.e. for FY2026. Depending on how sustainability reporting standards will be defined, a LEnvI classification could either facilitate or complement CSRD-related disclosures. Without prejudice to the work on the reporting standard and final CSRD, two reasonable scenarios are to be considered:

a. If a LEnvI taxonomy extension were introduced on a voluntary basis it could help listed SMEs prepare for mandatory reporting from 2026 onwards (and SMEs more generally for voluntary reporting) while also providing comfort to lenders and other stakeholders about the proportion of economic activities with low environmental impact and low transition risks.

   With respect to all enterprises, increasing interest is expected as a LEnvI classification could reduce uncertainty in how the non-taxonomy-aligned share of economic activities is classified.

Delegated Act on Taxonomy Regulation Article 8 and Low Environmental Impact

The Delegated Act on Article 8 specifies how non-financial and financial companies shall disclose on the EU Taxonomy Regulation. Disclosures include turnover, capex and opex of taxonomy eligible and aligned activities. For activities with low environmental impact, the same principle already applies to some capex and opex (e.g. renovation of their installations). The

same principle could apply, e.g. disclosures on “neural or LEnvI” turnover, capex and opex, where relevant.

The rationale would be to provide transparency on capital flows that have a low environmental impact, hence with low transition risks regarding environmental objectives. Such transparency would offer one common set of guidance for banks’ lending[92] to LEnvI economic activities or to companies with a significant portion of LEnvI activities with regards their environmental impacts.

Aspects	DA on Taxonomy Regulation Article 8	LEnvI
Topic	How companies shall disclose on the environmental EU Taxonomy	Economic activities with low environmental impact
Coverage	Activity level disclosures	Economic activity level disclosures
Providing	Disclosures and some templates	Classification with disclosures
Thresholds	Transparency for what is environmentally sustainable, e.g. economic activities that can substantially contribute to the environmental objectives	Criteria with minimum qualifications
Materiality	Double materiality (tool for both perspectives)	Double materiality
Cross-references	DA for TR Article 8 in the Taxonomy Regulation	DNSH and Minimum Social Safeguards have been considered
Basis	Scientific evidence-based and technology neutral	Scientific evidence-based and technology neutral
Risks	Not a direct risk tool but a definition of what is environmentally sustainable	Low environmental transition risks
Opportunities	The EC Action Plan intends to reorient capital flows from unclassified towards green activities. Being taxonomy aligned or transitioning to alignment would be seen as opportunities	Low opportunity to significantly contribute to environmental objectives but opportunity for reducing ambiguity due to previously unknown classification

[92] A similar case as for banks could be made for insurance provision and portfolio investors.

EU Ecolabel

In the context of equity funds and other financial products[93], for which the European Commission services currently work on developing a proposal for an EU Ecolabel, combining assets with different environmental performance levels plays a central role, not least in terms of diversification and risk-return-preferences and requirements.

Eligible Assets for Ecolabelled financial products

To define *eligible* assets for ecolabelled financial products, the current thinking about the EU Ecolabel in principle is about defining a set of criteria that any investment fund (and indirectly its underlying assets) needs to comply with to qualify for the EU Ecolabel:

a. A minimum portfolio share of a financial product needs to be *environmentally sustainable*, or, in other words, comply with the *substantial contribution* criteria of the EU Taxonomy[94].
b. Other criteria apply to the entire portfolio, i.e. both the *green* and the *other* share:
    - DNSH compliance;
    - Minimum Social Safeguards compliance; and
    - Environmental Exclusions that are broader in scope than stipulated in the Taxonomy Regulation.

Every enterprise considered in an *ecolabelled* fund needs to proof that no more than 5% of its revenues are from harmful / excluded activities: “Investment funds and insurance products shall not contain equities or bonds issued by companies that derive more than 5% of their revenue from the excluded activities listed below” (p.77).

As long as those criteria are met, there is no provision to differentiate between the intermediate taxonomy space, activities not yet covered by the EU Taxonomy and what could be defined as LEnvI economic activities. Equally harmful /excluded activities do not follow the same definitions and criteria than in the Taxonomy.

From this quick assessment, two key observations with a focus on coherency between Subgroup 3’s recommendations on LEnvI and the emerging Ecolabel can be derived.

1. A future LEnvI definition could provide a framework:
    a. for guaranteeing that ecolabelled funds are not associated with harmful (and some “significantly harmful”) economic activities in the absence of an extended Taxonomy;
    b. for more (e.g. reputational) risk averse investors to include, also under its *diversification* (i.e. not its *environmentally sustainable* or *green*) pocket, only activities which have been categorised as LEnvI economic activities;
2. The EU Ecolabel criteria that go beyond the EU Taxonomy Regulation could inform the conditions that could apply to enterprises (or at least large enterprises) that aspire to demonstrate that (parts of) their economic activities are LEnvI.

[93] Currently the proposed scope for the Ecolabel comprises in principle, subject to a number of specifications, UCITS funds and alternative investment funds (AIF), and fixed-term deposit or savings deposit products.

[94] “environmentally sustainable economic activity’ means an economic activity that complies with the relevant criteria set out in Delegated Regulation (EU) xxxx/xxx supplementing Article 3 of Regulation (EU) 2020/852, hereafter the ‘EU’ Taxonomy, including transitional activities as defined in Article 10(2) and enabling activities as defined in Article 16 of Regulation (EU) 2020/852;”

3.

Key features	EU Ecolabel	LEnvI
Topic	Green financial products (see scope)	Activities with low environmental impact
Coverage / scope	Subject to a number of specifications, UCITS funds and alternative investment funds (AIF), and fixed-term deposit or savings deposit products.	Activity level definitions
Principal use cases	Providing a transparent framework for (labelling) “green” financial products (see scope)	Providing a classification for LEnvI disclosures
Thresholds	Explicit reference to the Taxonomy Regulation	Criteria with minimum qualifications
Materiality	n/a	Double materiality
Cross-references	none	none
Basis	Taxonomy Regulation plus additional criteria	Scientific evidence-based and technology neutral
Impacts/Risks	Impact focused and hence also implying lower environmental transition risks	Low environmental transition risks
Exclusions	Taxonomy Regulation plus additional criteria	In line with Taxonomy Regulation

SFDR / MiFID II / IDD

SFDR on the one hand and MiFID II and IDD on the other overlap only to some extent in their scope. While SFDR mainly applies to a certain type of product providers (fund managers, pension fund providers, insurers and credit institutions / MiFID firms providing individual portfolio management), the forthcoming changes in

(i) MiFID II apply to the distribution of all financial instruments and
(ii) IDD apply to the distribution of insurance-based investment products.

While there are differences in scope, some core terms are relevant for all three frameworks:

a. Taxonomy-alignment: Term is used in line with the Taxonomy Regulation
b. Sustainable Investments: Investments in economic activities that positively contribute to an environmental and / or social objective provided that (i) such investments do not significantly harm any of those objectives and (ii) the investee companies follow good governance practices. The term is broader than taxonomy alignment, but all taxonomy-aligned investments are sustainable investments.

c. Principal adverse impact: Certain impact of investment decisions on sustainability factors.

These terms are relevant under SFDR for product providers since they need to disclose commitments to sustainability including

(i) *taxonomy-aligned investments* in products that promote environmental or social characteristics*;*
(ii) with respect to products that have *sustainable investments* as objective; and
(iii) with respect to *principal adverse impacts*.

The terms are relevant for product sales, as distributors of financial products are required by MiFID II and IDD to inquire about clients' sustainability preferences with regard to the three dimensions mentioned above.

A LEnvI extended taxonomy could have an impact on all three dimensions. LEnvI-related information is therefore of relevance for both the disclosure under SFDR as well as the requirement to ask clients about their sustainability preferences under MiFID II / IDD, thereby providing a more complete picture to investors. Indeed, increased clarity from an extended Taxonomy may well avoid misunderstandings (which are already developing) in the market on SFDR Article 8 and 9 funds. The Table below provides an overview of the impact of the LEnvI extended taxonomy for the three terms:

Term	SFDR, MiFID II / IDD
Taxonomy-alignment	In addition to providing a green taxonomy share, a LEnvI taxonomy share would give investors a more complete picture of the investments of the portfolio / product sold particularly in the absence of an extended Taxonomy
Sustainable Investment	For sustainable investments, the DNSH assessment can be done by PAI screening. An extended LEnvI Taxonomy would help ruling out DNSH without the need of a full PAI screening
Principal adverse impact	Consideration of PAI on a product level comprises identification and action, e.g., engagement or exclusion. An extended LEnvI Taxonomy would help identifying for which part of the portfolio not a complete PAI consideration is required.

Aspects	SFDR	LEnvI
Topic	Wide range of sustainability aspects	Activities with low environmental impact
Coverage	Entity and product level disclosures	Activity level disclosures
Providing	Disclosures	Classification with disclosures
Thresholds	Transparency but not thresholds	Criteria with minimum qualifications

Aspects	SFDR	LEnvI
Materiality	Double materiality	Double materiality
Cross-references	Disclosures (references to the EU Taxonomy)	DNSH and MSS have been considered
Basis		Scientific evidence-based and technology neutral
Risks	Disclosures on risks	Low environmental transition risks
PAI		

EU Green Bond Standard

The EU Green Bond Standards is currently in proposal stage, but once adopted by the co-legislators it will provide for a voluntary standard for bonds financing projects where proceeds are to be used in full to financing of taxonomy-aligned activities. There are several ways in which the expansion of the Taxonomy concept to include LEnvI economic activities could broaden the scope of the EU Green Bonds Standard:

a. The scope could be broadened to include green bonds whose proceeds are not fully used for taxonomy-aligned activities but also for LEnvI activities. This would be particularly important for projects that include green economic activities as well as environmentally non-relevant ones.
b. Should the EP's proposal to expand the scope of the EU Green Bond Standard include transparency requirements for all sustainable bonds marketed in the EU, including green, social or sustainability bonds, LEnvI would increase transparency about what is being financed with the proceeds, apart from Taxonomy-aligned economic activities.

ESG Benchmarking

The European Commission services are currently assessing the case for setting criteria for ESG benchmarks (going beyond the already existing climate related benchmarks), acting on a so-called *empowerment* for the Commission included in the Climate Benchmark Regulation. In addition the Climate Benchmark includes an empowerment whereby Commission services are required to assess the potential coherence of EU Climate Transition and EU Paris-aligned benchmarks with the EU taxonomy by the end of 2022.

However, the work on the ESG benchmark is still at a very early stage, so that no draft for a corresponding regulatory proposal is yet available. This makes a detailed assessment of cross-linkages between a LEnvI taxonomy and an ESG benchmark regulation challenging. The overview in the table below summarises potential options and SG3's current assessment under limited information.

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Key features	ESG Benchmarking	LEnvI
Topic	Market Benchmarks with a broader “ESG” scope	Activities with low environmental impact
Coverage/scope	Publicly traded companies	Activity level definitions
Principal use cases	Not clear yet: Could be a lowest common denominator type ESG benchmark, defining minimum standards for all sustainability or similarly labelled benchmarks Could also be a taxonomy aligned benchmark similar to the Ecolabel for financial products	Providing a classification for LEnvI environmental disclosures
Thresholds	Taxonomy alignment is currently assessed	Criteria with minimum environmental qualifications
Materiality	n/a	Double materiality
Cross-references	SFDR and TR likely	none
Basis	Through TR reference indirectly science based, but likely with stronger empirical basis for market applicability / penetration potential	Scientific evidence-based and technology neutral
Impacts/Risks	Impact focused, hence also considering transition risks	Low environmental transition risks
Exclusions	Likely to be aligned with existing benchmarks regulation, which exclude companies that do significant harm to the TR objectives; and are linked to UN Global Compact and includes social criteria, OECD principles for multi-national companies and some exclusions (such as tobacco)	In line with TR

To the knowledge of Subgroup 3, so far, no category similar to LEnvI has been considered. However, similar to the potential applicability of the LEnvI taxonomy in the context of the EU Ecolabel for financial products, it could become relevant

- for further defining any *non-green* or *non-taxonomy compliant* share of ESG benchmarks;
- by helping to define the lowest common denominator that applies to all sustainability or similarly labelled benchmarks.

Regarding *Significant Harm*, currently, Articles 10(2) and 12(2) of the Commission Delegated Regulation (EU) 2020/1818 include exclusions for EU CTB (starting 31 December 2022) and EU PAB related to significantly harmful companies. This provision does not directly build on the DNSH criteria developed in the EU Taxonomy, but rather on an estimate made by administrators of benchmarks or data providers. It should be considered whether an extended taxonomy could provide a useful new reference point for the definition of these exclusions to ensure harmonisation of the estimate of the significant harmful companies that would be based on objective criteria.

Proposal for a Directive on corporate sustainability due diligence

The European Commission services are currently assessing the case for setting criteria for Sustainable Corporate Governance in light of the European Green Deal and the Recovery Plan. The work on the topic is at an early stage, so that no draft regulatory proposal is yet available. A public consultation on the topic was conducted early 2021.[95]

Sustainability in corporate governance encompasses encouraging businesses to consider environmental (including climate, biodiversity), social, human and economic impact in their business decisions, and to focus on long-term sustainable value creation rather than short-term financial value.

To the extent that LEnvI economic activities are present in a company's portfolio, these activities are neutral from an environmental impact and (transition) risk perspective. LEnvI economic activities require less management attention in this sense. Efforts can be focused on red, yellow and green activities.

The overview in the table below compares key features with respect to sustainable corporate governance and a LEnvI taxonomy.

Key features	Sustainable Corporate Governance	LEnvI
Topic	Directors' duties of care and due diligence duties	Activities with low environmental impact but whose main impact may be caused through their supply chains.
Coverage/scope	Not yet clear	Activity level definitions
Principal use cases	Corporate governance attention related to environmental issues, including risks, would be freed up to focus on other economic	Providing a classification for LEnvI disclosures

[95] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/public-consultation_en

Key features	Sustainable Corporate Governance	LEnvI
	activities than the one with LEnvI	
Thresholds	N/a	Criteria with minimum environmental qualifications
Materiality	N/a	Double materiality
Cross-references	N/a	none
Basis	N/a	Scientific evidence-based and technology neutral
Impacts/Risks	Impact and risk focus by management	Low environmental transition risks
Exclusions	N/a	In line with TR

Annex 6. Further data supporting need for extended Taxonomy

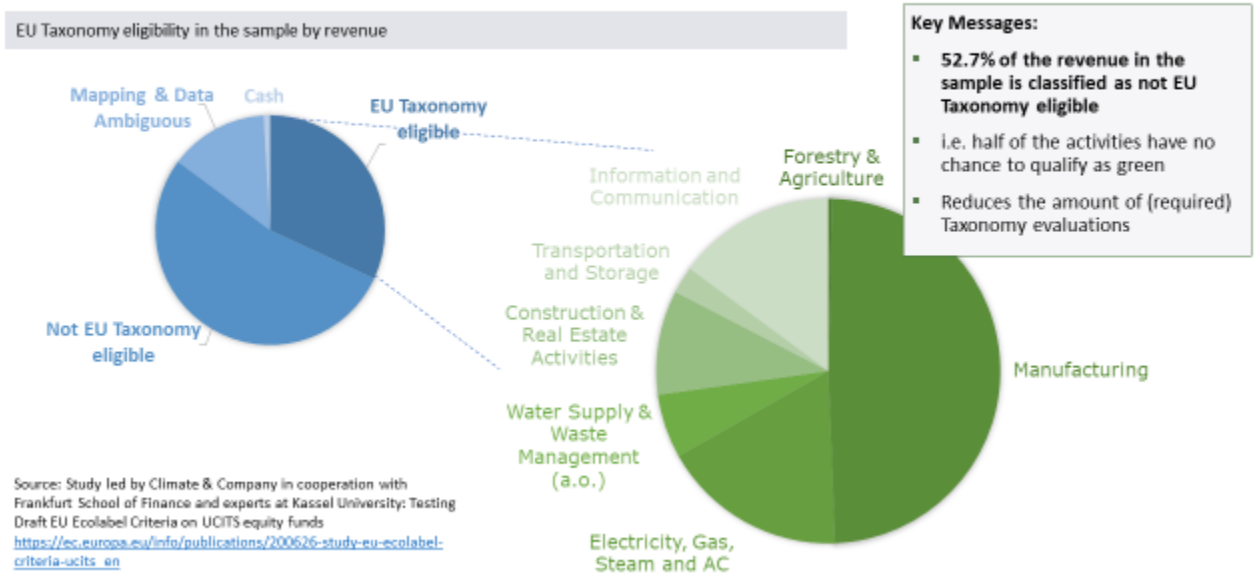
Ecolabel Study I: Sample of 101 „green" funds: sectoral split

NACE-Sector	Description	No. of Companies	% of Companies	Avg. TNA (%)[17]	Labelled (#51)	Non-Labelled (#50)
A	Agriculture, Forestry and Fishing	8	0.44	0.17	0.16	0.18
C	Manufacturing	795	43.42	52.31	48.13	56.58
D	Electricity, Gas, Steam and Air Conditioning	92	5.02	6.98	3.70	10.32
E	Water Supply, Sewerage, Waste Management and Remediation Activities	39	2.13	4.23	2.98	5.51
F	Construction	67	3.66	2.52	1.97	3.08
H	Transportation and Storage	49	2.68	1.86	2.12	1.60
J	Information and Communication	147	8.03	8.44	11.05	5.78
L	Real Estate Activities	116	6.34	3.72	4.84	2.58
Rest	Not yet covered by the Taxonomy	518	28.29	18.83	24.42	13.12

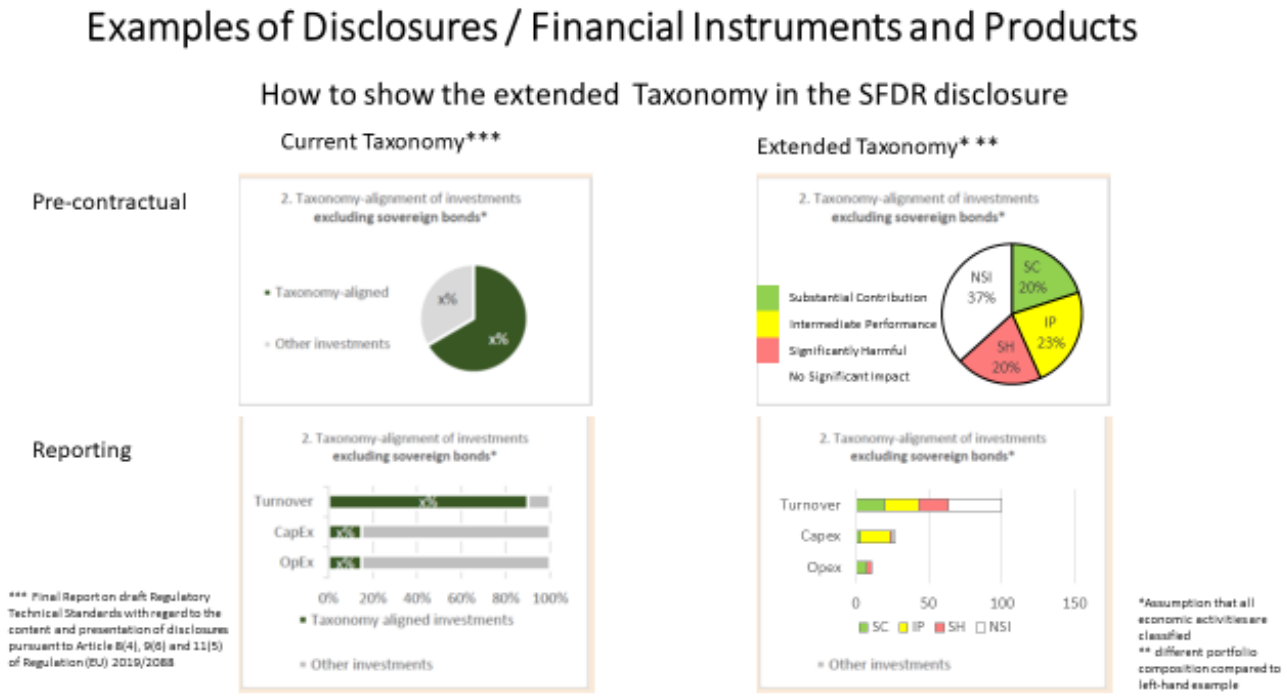
Source: Study led by Climate & Company in cooperation with Frankfurt School of Finance and experts at Kassel University: Testing Draft EU Ecolabel Criteria on UCITS equity funds https://ec.europa.eu/info/publications/200626-study-eu-ecolabel-criteria-ucits_en

Note: The "not yet covered by the Taxonomy" includes activities that will be included during the development of criteria for the four environmental objectives, activities not yet analysed for the climate objectives, activities excluded as well as activities that do not contribute significantly nor do they impact significantly any environmental objective.

Mapping to the taxonomy shows significant share of non-EU taxonomy eligible even in "green funds"



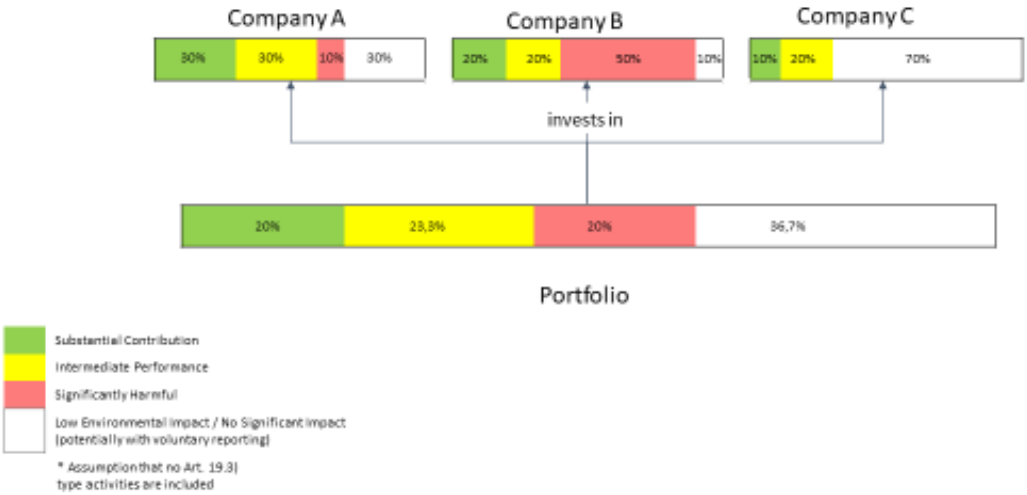
Annex 7. Financial Examples showing potential use of extended Taxonomy



Note: The examples above only show a part of the disclosures related to the Taxonomy at product-level for the purposes of portraying how it would work. For a complete picture of product-level disclosures please see:

https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

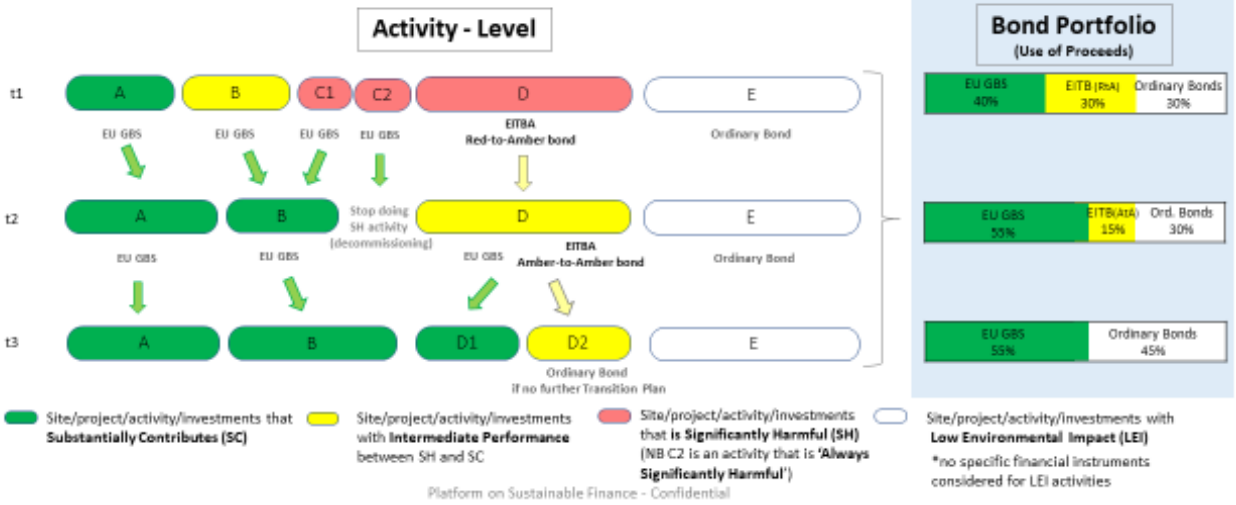
How to apply the extended Taxonomy to an equity portfolio



How to apply the extended Taxonomy to a bond portfolio

Based on potential **'European intermediate transition bond (EITB) standard'** to finance investments in activities that improve their environmental performance without reaching Substantial Contribution (green space) – supplementing the EU Green Bond Standard (EU GBS)
2 types of European Intermediate Transition Bonds (EITB) are conceivable with an extended Taxonomy:

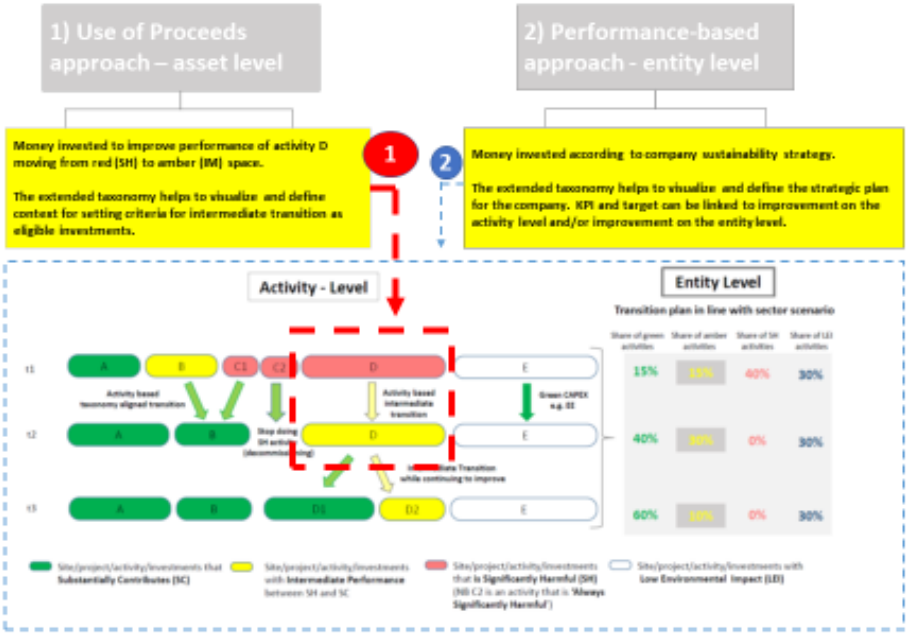
- **EITB(RtA):** transition from significantly harmful environmental performance (red space) to intermediate performance (amber space)
- **EITB(AtA):** for amber-to-amber transitions within intermediate performance space (pursuant to additional requirements set out in Intermediate Transition Annex).



Examples of two potential intermediate "Amber" transition financing instruments

Note: These examples have been developed using the governance framework of a **Use of Proceeds** debt instrument and a **KPI –linked** debt instrument

1) Applicability of an extended EU Taxonomy in sustainable debt approaches



1) Use of Proceeds approach

Applying typical Use of Proceeds governance to an Intermediate Transition "Amber" investments

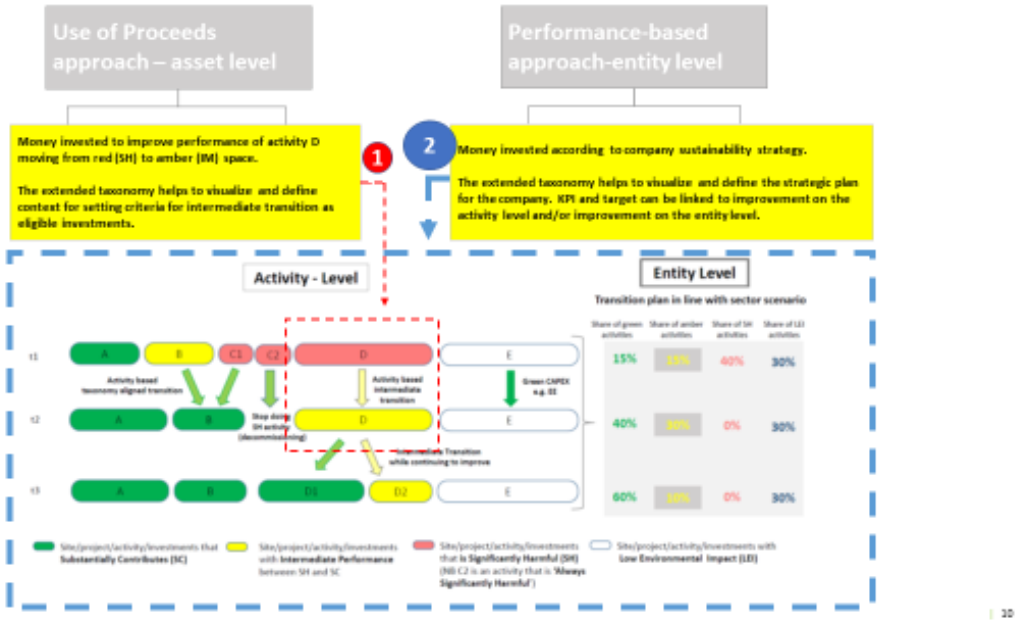
Use of proceeds	Process for project evaluation and selection	Management of proceeds	Reporting
Identification and definition of investment areas / assets which are eligible	The selection process ensures the right assets in line with the amber bond framework are evaluated and selected Establish procedures and secure ongoing monitoring	The proceeds raised via the Amber Bond should be earmarked to support financing of the established criteria	To uphold credibility it is essential to be transparent towards investors and the market Annual publically available investor letter/report. Reporting of the expected / achieved environmental impact through performance indicators (qualitative and quantitative if possible) should be provided in a transparent manner.

- Taxonomy as a definition of eligible investment areas
- Taxonomy based DNSH criteria for assessment of improvement level
- Ex of KPI: tCO_2/t steel
- Report annually on progress against Taxonomy

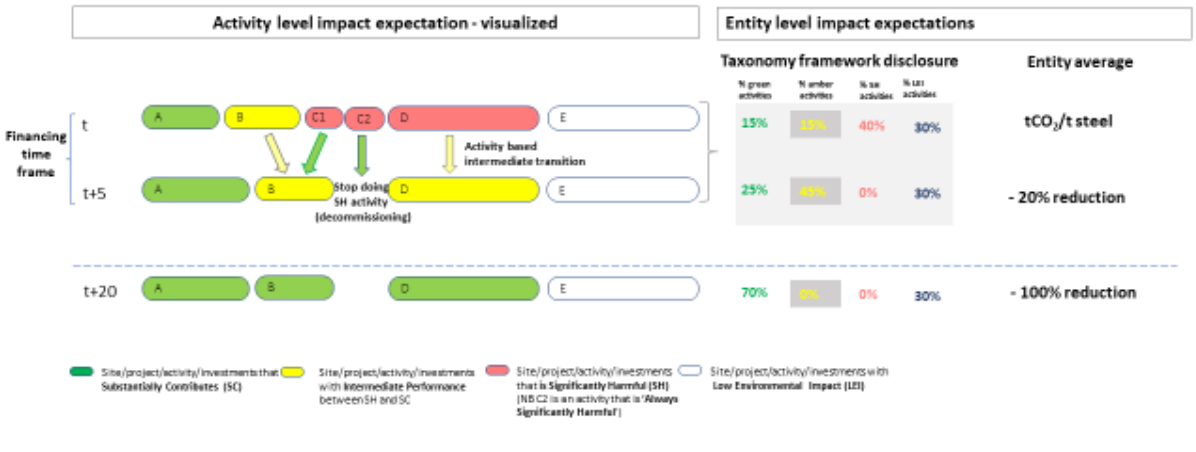
Amber Bond Framework

External review- second party opinion

2) Applicability of extended taxonomy in Amber KPI-linked debt approaches



2) Activity level improvement during financing period for this entity is at least intermediate transition (moving out of SH in all cases)



2) Performance based approach

Applying an "Amber" KPI-Linked Bond approach for Intermediate Transition

1 Selection KPIs	2 Amber performance targets	3 Bond Characteristics	4 Reporting	5 Verification
The KPIs should be: • Relevant, core and material • Measurable or Quantifiable • Able to be benchmarked	Targets should be ambitious, i.e.: • A material improvement • Be determined on a predefined timeline	An economic outcome is linked to whether the selected predefined Amber targets are met or not	Issuer to be encouraged but not obliged to report publicly on progress	Issuer must obtain independent and external verification
•Taxonomy based DNSH criteria set for entity and/or activity •Ex: tCO_2/t steel	•Cross DNSH threshold for individual activities •In line with ambitious entity level transition plan		• Report annually on progress against Taxonomy	• Verification as part of the annual reporting or separately
External review – Second Party Opinion				

Conclusions on intermediate transition financing instruments

1. An extended Taxonomy would work well with use of proceeds financing. It could potentially be called **Intermediate Transition** or **Amber Transition** bonds/loans.

2. The Taxonomy creates clarity around setting of ambition levels for improvement when substantial contribution cannot be reached during the financing period, but the entity plan is in line with generally accepted 1,5 degrees transition scenarios.

3. An extended Taxonomy can illustrate the stepwise, not always linear, improvements that signify many industrial investments.

Annex 8. Members and Observers of the EU Platform and composition of Sub-group 3 of the Platform

All Members, Observers and sherpas in this group have worked in their personal capacity for this report which does not necessarily reflect the position of their organisations.

Members and Observers of the Platform on Sustainable Finance are listed below. **Members of Subgroup 3 on the Extended Environmental Taxonomy (previously Significantly Harmful activities and No Significant Impact activities sub-group) are shown in bold.**

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Organisation	Name
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b. Rapporteur

Organisation	Name
European Investment Bank (EIB)	**Nancy Saich**

c. Members

Organisation	Name
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European Recycling Industries' Confederation (EuRIC)	Emmanuel Katrakis
OMV Aktiengesellschaft	Brigitte Bichler
Confederation of European Forest Owners (CEFP)	Maria Pohjala
Eurometaux	Mukund Bhagwat
European Water Association (EWA)	Károly Kovács
Cefic	Jelena Macura
European Construction Industry Federation (FIEC)	Jari Pekka Vuorinen
Eurofer	Jan Bollen
European Dredging Association (EuDA)	Lara Muller
Iberdrola	Roberto Fernández Albendea
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Organisation	Name
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EIT Climate KIC	**Sandrine Dixson- Declève**
International Union for Conservation of Nature (IUCN)	James Dalton
European Environmental Citizen's Organisation for Standardisation (ECOS)	Mathilde Crêpy
World Wildlife Fund (WWF)	**Sebastien Godinot**
Transport and Environment	Luca Bonaccorsi
Agent Green	Theodor F. Cojoianu
Birdlife	Ariel Brunner
Chemsec	Sonja Haider
World Green Building Council, Europe	Stephen Richardson
Ellen MacArthur Foundation	Michiel De Smet
The Institute for European Environmental Policy (IEEP)	Ben Allen
RTO Lithuania (Association of Research and Technology Organisations)	Steigvilė Byčenkienė
Basque Research and Technology Alliance (BRTA)	Garbiñe Manterola
Type A	Linda Romanovska
Type A	Marzia Traverso
Type A	Bernabé Alonso Fariñas
BNP Paribas	Patrick Bader
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Allianz SE	**Jörg Ladwein**
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European Trade Union Confederation (ETUC)	Marco Cilento
SEB	**Karl-Oskar Olming**
Global Reporting Initiative (GRI)	Bastian Buck
Type B	Antje Schneeweiß
Type B	Signe Andreasen Lysgaard
Type A	Helena Vines Fiestas

d. Directly appointed members

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European Investment Bank (EIB)	Eila Krevi
European Investment Fund (EIF)	Peter Coveliers
European Banking Authority (EBA)	Fabien Le Tennier
European Insurance and Occupational Pensions Authority (EIOPA)	Pamela Schuermans
European Securities and Markets Authority (ESMA)	Evert van Walsum
EU Agency for Fundamental Rights (FRA)	Jonas Grimheden

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Organisation	Name
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European Central Bank (ECB)	**Fabio Tamburrini**
European Financial Reporting Advisory Group (EFRAG)	Saskia Slomp

Organisation	Name
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European Stability Mechanism (ESM)	Carlos Martins
Network of Central Banks and Supervisors for Greening the Financial System (NGFS)	**Erlan Le Calvar**
Organisation for Economic Co-operation and Development (OECD)	Raphael Jachnik
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Julia Backmann	**Allianz**
Ingmar Juergens	**Green and Sustainable Finance Cluster Germany (Frankfurt School and Climate & Company)**
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