Principles for Responsible Investment

IMPLEMENTING THE EU TAXONOMY

AN UPDATE TO THE PRI'S 'TESTING THE TAXONOMY' REPORT

UN environment programme | finance initiative

United Nations Global Compact

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

PREAMBLE TO THE PRINCIPLES

As institutional investors, we have a duty to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that environmental, social, and governance (ESG) issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society. Therefore, where consistent with our fiduciary responsibilities, we commit to the following:

1 We will incorporate ESG issues into investment analysis and decision-making processes.

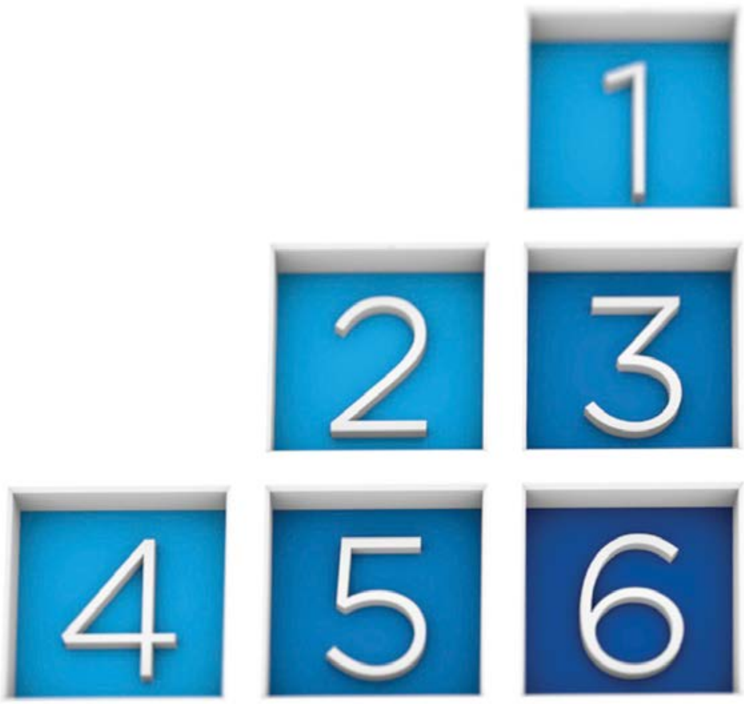
2 We will be active owners and incorporate ESG issues into our ownership policies and practices.

3 We will seek appropriate disclosure on ESG issues by the entities in which we invest.

4 We will promote acceptance and implementation of the Principles within the investment industry.

5 We will work together to enhance our effectiveness in implementing the Principles.

6 We will each report on our activities and progress towards implementing the Principles.



PRI's MISSION

We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.

The PRI will work to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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ABOUT THIS REPORT

This paper explores how investors are implementing the EU taxonomy. The three main objectives are to:

- Highlight examples of advanced practice;
- Support collective problem solving by outlining common challenges and possible solutions; and
- Encourage policy makers and supervisors to provide additional guidance to financial market participants.

This paper is a follow up to the PRI's original Testing the Taxonomy report, published in September 2020. It featured more than 35 case studies produced by members of the PRI Taxonomy Practitioners Group (TPG). Established in 2019, the TPG is a group of around 40 PRI signatories that came together to trial the EU taxonomy framework.

This updated report is based on interviews conducted with TPG members between October and November 2021. It is primarily aimed at investment management firms that are required to provide EU taxonomy disclosures. It may also be useful to other financial market participants, EU policy makers and supervisors, as well as those from non-EU jurisdictions that have launched – or are considering launching – sustainability taxonomies.

Some financial market participants are required to make EU taxonomy disclosures at both entity and product level. The focus of this report is on product disclosures under Articles 5 and 6 of the taxonomy regulation, but it may also be helpful for investors disclosing against the taxonomy at entity level, under Article 8.

The EU taxonomy is a living framework that will continue to evolve. At the time of writing, there is ongoing uncertainty over key elements, including the full scope and nature of the economic activities the taxonomy applies to. Despite these challenges, signatories interviewed for this report continue to view the EU taxonomy as an important and necessary tool in the transition to a greener and more sustainable economy.

A number of TPG members highlighted the importance of approaching the implementation of the EU taxonomy regulation with a long-term mindset. They recognise that some of the initial challenges are set to be resolved over time and they value the long-term benefits the framework brings as a means of substantiating, and providing clarity on, sustainability claims. The PRI hopes sharing insights from the TPG will contribute to broader efforts to enhance the usability of the EU taxonomy.

Any feedback, comments or questions regarding the report can be addressed to policy@unpri.org

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- SEB Investment Management – Andreas Johansson, Anne Kristin Kästner, Sofia Wärmlöf Helmrich
- StepStone Group LP – Suzanne Tavill

EXECUTIVE SUMMARY

The EU taxonomy is a tool to help investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy. Certain investors have been required to report their alignment with the taxonomy's climate change mitigation and adaptation objectives since January 2022. This report shares insights on the practicalities of making these disclosures and innovative ways in which investors are using the taxonomy. It also provides a summary of recent policy developments and offers recommendations for policy makers and practitioners.

How investors are using the EU taxonomy

At this point in time, investors are primarily using the EU taxonomy as a disclosure tool to report comprehensively and transparently on the sustainability performance of their portfolio holdings. TPG members are also using the EU taxonomy to enhance their investment strategies and meet sustainability goals. Additional applications of the taxonomy include:

- Assessing beneficiaries' sustainability preferences;
- Identifying sustainable investment opportunities;
- Conducting due diligence on current and potential holdings;
- Designing green financial products; and
- Guiding stewardship activities.

Key policy updates

There have been significant policy updates and proposals since the PRI's Testing the Taxonomy 2020 report. They include but are not limited to:

- The European Commission proposing including nuclear energy and natural gas in the taxonomy;
- The publication of draft technical screening criteria (TSC) for the remaining four environmental objectives;
- The Commission adopting a proposal for a European Single Access Point (ESAP);
- A consultation on a social taxonomy and taxonomy extension; and
- The Commission adopting the Corporate Sustainability Reporting Directive (CSRD) proposal.

Implementation challenges

During this initial stage of EU taxonomy implementation, challenges include:

- Investors being required to make product-level disclosures before the reporting templates for these disclosures have passed into law;
- Uncertainty over if, and on what terms, gas-fired power and nuclear energy will be classified as sustainable activities;
- Limited public data on the taxonomy alignment of investee entities/assets; and
- Uncertainty regarding how certain TSC (performance thresholds) should be interpreted.

Recommendations for practitioners

Recommendations are grouped into four main areas: data, criteria, operations and communicating with end investors. They include:

- Establishing cross-functional working groups to oversee implementation;
- Engaging with investee entities regarding the EU taxonomy to fill data gaps;
- Conducting thorough due diligence on any third-party data assessments;
- Building an audit trail of the data used to make KPI calculations;
- Providing written explanations to contextualise alignment KPIs; and
- Engaging with policy makers and supervisors for clarification on implementation questions.

Advanced implementation practices

Examples of advanced implementation practices from TPG members include:

- Engaging with investee entities regarding their alignment with the taxonomy TSC;
- Integrating the EU taxonomy into the investment process in a systematic way;
- Engaging with policy makers and supervisors regarding the scope and content of the regulation;
- Using third-party validators to verify taxonomy alignment disclosures; and
- Supporting capacity building efforts by educating stakeholders on the role and functioning of the taxonomy.

Recommendations for policy makers and supervisors

Below are actions that can be taken to support financial market participants to implement the EU taxonomy in a robust manner:

- Provide additional clarity on timelines;
- Take steps to facilitate data collection;
- Offer additional guidance on how to interpret criteria;
- Provide additional guidance to support assessments of non-EU issuers and assets;
- Enable investors to communicate limits of analysis and underlying data; and
- Collaborate internationally to harmonise taxonomies.

To support signatories, we also provide a list of helpful resources to implement the taxonomy, as well as a glossary of key terms.

THE EU TAXONOMY IN BRIEF

This section provides a brief overview of how the EU taxonomy has been developed, how it works and how investors are using it.

WHAT IS THE EU TAXONOMY?

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

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

Source: Final report of the Technical Expert Group on Sustainable Finance (March 2020)

The EU taxonomy Regulation (2020/852) was adopted in June 2020. It outlines how to identify sustainable economic activities that align with one or more of six environmental objectives: 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.

DELEGATED ACTS

Once an EU law is passed, it is necessary to ensure that it is implemented properly. To do this, the European Parliament and European Council can authorise the European Commission to adopt delegated acts, which provide these details.

Delegated acts that are proposed by the European Commission are subject to a four to six-month scrutiny period. During this time, the European Parliament and European Council assess whether they approve or reject the act. A delegated act can only enter into force once the European Parliament and the European Council have approved it and it has been published in the Official Journal, a list of all EU legislation.

The Platform on Sustainable Finance (PSF) advises the European Commission on how to develop the TSC in the delegated acts. The PSF was set up under Article 20 of the taxonomy regulation and consists of financial market participants, businesses, academics and members of civil society.

WHO DOES THE EU TAXONOMY REGULATION APPLY TO?

There are three main groups EU taxonomy rules apply to:

- Financial market participants, including occupational pension providers, offering financial products in the EU;
- Large companies which are required to report under the Non-Financial Reporting Directive (NFRD), which is set to be revised by the CSRD; and
- The EU and its member states.

Financial market participants offering products in the EU that contain investments pursuing an environmental objective are required, for each relevant product, to disclose the proportion of underlying investments that are taxonomy-aligned.

Financial market participants offering financial products in the EU that do not promote or pursue relevant sustainability-related objectives can either make EU taxonomy disclosures voluntarily or issue a statement that the financial product in question does not take into account the EU criteria for environmentally sustainable economic activities. In other words, they can disclose voluntarily or explain that they have chosen not to.

WHAT IS THE CONNECTION BETWEEN THE EU TAXONOMY AND THE SUSTAINABLE FINANCIAL DISCLOSURE REGULATION?

The Sustainable Financial Disclosure Regulation (SFDR), adopted in 2019, sets out the overarching framework for sustainability-related disclosures in the financial services sector at entity and product levels. The taxonomy regulation and the SFDR both apply to the same categories of funds and are designed to be complementary.

The EU taxonomy is the central tool for assessing the sustainability claims made under SFDR. Financial market participants marketing products with investments that pursue an environmental objective must disclose how and to what extent the EU taxonomy has been used in determining the sustainability of the underlying investments, the environmental objective(s) to which the fund contributes and the percentage of the underlying investments that are taxonomy-aligned (Articles 5 and 6 of the taxonomy regulation).

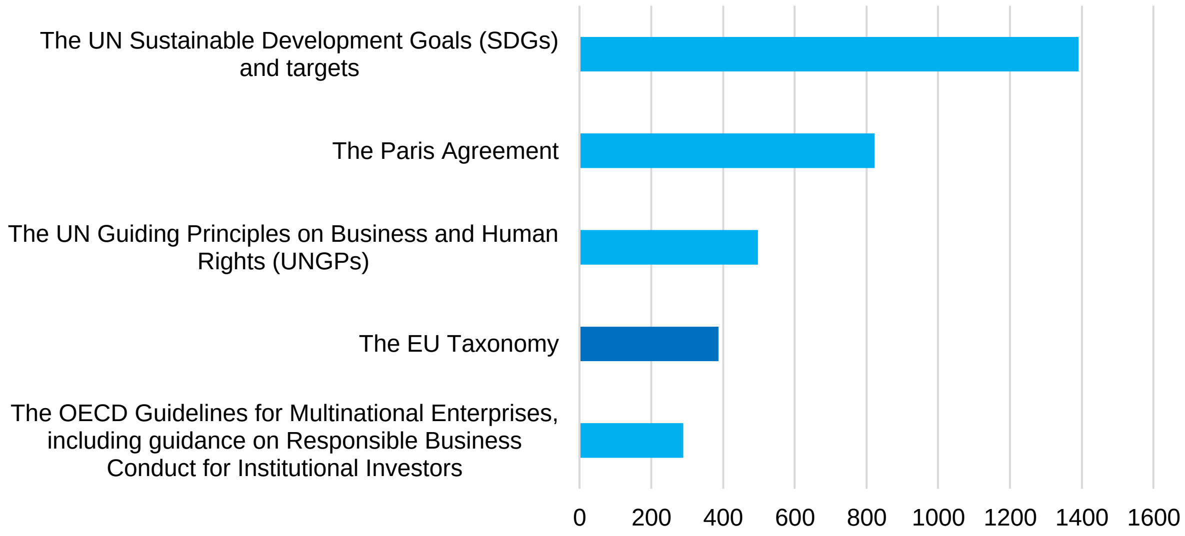
The draft Regulatory Technical Standards (RTS), published by the European Supervisory Authorities in October 2021, detail what the product-level taxonomy disclosures should entail and how they should be presented in pre-contractual and periodic documents. The RTS are expected to be fully adopted by the European Commission in 2022. Once formally adopted, the RTS will function as a 'single rulebook' for sustainability-related disclosures.

WHAT ARE INVESTORS USING THE FRAMEWORK FOR?

One of the primary uses is to measure the environmental performance of investment products. The framework can also be used by investors to:

- Assess beneficiaries' sustainability preferences;
- Identify sustainable investment opportunities;
- Conduct due diligence on current and potential holdings;
- Design green financial products;
- Guide stewardship activities; and
- Measure sustainability outcomes of an investment portfolio.

Figure 1: Number of PRI signatories using reference frameworks to measure sustainability outcomes in 2021



Data from the 2021 PRI reporting cycle shows that around 400 PRI signatories were already using the EU taxonomy to measure sustainability outcomes that year. Around 80% of the signatories were headquartered in Europe. The data was collected before EU taxonomy reporting became mandatory and when many of the key aspects of the framework were still in development. However, these findings underline the taxonomy's potential to drive investment decisions towards sustainability goals. The number of investors using the EU taxonomy to measure outcomes is set to rise as the framework develops and additional reporting requirements come into force.

KEY POLICY UPDATES

This section covers key policy updates and proposed developments since the PRI's Testing the Taxonomy report was published in September 2020.

April 2021

European Commission adopts CSRD proposal

In April 2021, the European Commission adopted a proposal for a new CSRD that would, if passed, revise the NFRD. Under current proposals, the directive would apply to large companies and companies listed on regulated markets (except listed micro-enterprises). Taxonomy reporting would be mandatory for all companies within the scope of CSRD.

Key differences between the NFRD and the proposed CSRD[1]

Non-Financial Reporting Directive (NFRD)	Corporate Sustainability Reporting Directive (CSRD)
▪ The NFRD applies to large, listed companies, banks and insurance companies ('public interest entities') with more than 500 employees ▪ Around 11,000[1] companies are required to report under the NFRD ▪ The NFRD was adopted in 2014	▪ The CSRD would apply to large and listed companies (except for micro-companies). A large company is defined as meeting two of the following criteria: (1) EUR€40 million in net turnover, (2) EUR€20 million on the balance sheet, (3) 250 or more employees ▪ Around 50,000 companies would be required to report under the CSRD

November 2021

Commission adopts proposal for European Single Access Point

In November 2021 and after a consultation, the European Commission adopted a legislative proposal for an European single access point (ESAP) – a central hub into which companies would be able to report entity-level taxonomy alignment data. This is the first step of the legislative process, and the proposal is now in the hands of the European Parliament and the European Council. Once an agreement is reached between institutions, the legislation will enter into force. The ESAP is expected to become operational by 31 December 2024.

December 2021

Commission adopts Taxonomy Disclosures Delegated Act

A delegated act was adopted in December 2021 for Article 8 of the taxonomy regulation. This article defines reporting requirements at entity level for companies that fall under the scope of the NFRD (which is set to be revised by the CSRD).

The Taxonomy Disclosures Delegated Act introduced the term 'taxonomy-eligible economic activities'. This is defined as "the share of economic activities that are described in the Commission's delegated acts, but that do not yet meet the relevant TSC". This is different from taxonomy-aligned economic activities, which need to meet the relevant TSC, and hence represent a much smaller share of an entity's total economic activities.

The DA also introduced phased requirements for entity-level reporting:

- As of 1 January 2022, for the reporting period 2021, only qualitative information and the proportion of *taxonomy-eligible* activities in relation to total activities must be disclosed.
- As of 1 January 2023, for the reporting period 2022, full taxonomy *alignment* disclosures will apply to non-financial undertakings.
- As of 1 January 2024, for the reporting period 2023, full taxonomy *alignment* disclosures will apply to financial undertakings.

The European Commission has published an FAQ on the Disclosures Delegated Act and the PSF has also published guidance on entity-level taxonomy disclosures.

Taxonomy Climate Delegated Act passes into law

A delegated act for climate mitigation and adaptation was adopted in December 2021. Financial market participants offering products in the EU that contain investments pursuing environmental objectives have been required to report their taxonomy alignment against the TSC included in this delegated act since 1 January 2022. To help with taxonomy disclosures, investors can use the draft RTS.

February 2022

PSF publishes final report on social taxonomy

On 28 February 2022, the PSF released a report setting out the proposed structure for a social taxonomy. It would enable investors to identify companies that make a substantial contribution to one or more of the three social objectives: decent work; adequate living standards and wellbeing for consumers; and inclusive and sustainable communities and societies. The publication of the social taxonomy report follows a consultation during the second half of 2021.

The European Commission now must prepare a report that outlines if and how it intends to respond.

European Commission proposes including nuclear energy and natural gas in the taxonomy

On 2 February 2022, the European Commission proposed a Complementary Climate Delegated Act covering nuclear energy and gas-fired power, cogeneration, and district heating / cooling.

This delegated act needs to be approved by the European Parliament and European Council before entering into force. If approved, it will amend the initial Climate Delegated Act, and reporting against the criteria will be due by January 2023. The PRI's position paper on alternative solutions to including gas-fired power and nuclear energy in the EU taxonomy is available here.

March 2022

PSF publishes draft TSC for the remaining four environmental objectives

On 30 March 2022, the PSF published its proposed TSC for the four remaining environmental objectives: sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; and protection and restoration of biodiversity and ecosystems. This proposal will inform the European Commission's delegated act.

PSF publishes final report on extended environmental taxonomy

On 29 March 2022, the PSF published a final report on the extended environmental taxonomy. An extended environmental taxonomy would cover four additional types of economic activities: unsustainable performance requiring an urgent transition to avoid significant harm; intermediate performance; unsustainable, significantly harmful performance where urgent, managed exit / decommissioning is required; and low environmental impact activities.

Following the publication of the extended environmental taxonomy report, the European Commission must prepare a report that outlines if and how it intends to respond.

RECOMMENDATIONS FOR PRACTITIONERS

This section sets out some of the most common implementation challenges, and how investors can address and mitigate them. The recommendations stem from TPG members and do not constitute formal guidance. It is important to note that data availability and quality are set to improve substantially as reporting becomes mandatory for a broader set of companies.

DATA

Challenges	Recommendations
Availability ■ The data required to calculate KPIs is not always available. ■ Non-financial market participants are only required to disclose taxonomy eligibility in 2022. ■ Data is particularly limited for non-EU companies and SMEs.	**Availability** Raise awareness of the benefits of reporting during engagements with companies that fall outside the scope of SFDR and NFRD, including smaller companies and firms operating outside the EU.
Granularity ■ Revenue figures often are not segmented by activity type. ■ A lack of expenditure data is limiting assessments of climate change adaptation. ■ Use-of-proceeds breakdown is often not available for green bonds.	**Granularity** ■ Engage with investees to request disclosures / verification of data on taxonomy-aligned revenues, capital expenditure and operating expenses. ■ If using data from third-party providers, conduct due diligence on the assessments. Take the time to understand the data providers' methodology, coverage, terminology and any assumptions they may be making in their assessments.
Consistency Available data may not match taxonomy classification requirements and may not be sufficiently relevant or reliable.	**Consistency** ■ Have regular check-ins with the data vendors to keep up-to-date with any methodological changes and raise questions regarding assessments. ■ Only include substantiated figures and be clear on data limitations.

CRITERIA

Challenges	Recommendations
Applying criteria to non-EU investments Many of the TSC reference EU standards relevant to specific economic activities. Assessing non-EU investments against these standards can be challenging as, in many cases, there is no information on whether issuers are meeting these standards.	**Applying criteria to non-EU investments** Engage with policy makers and supervisors on developing 'correspondence tables' between taxonomy criteria, existing certification schemes and other non-EU standards.
Definitions Some screening criteria are not clear to practitioners and / or involve interpretation. Take forestry activities as an example. The DNSH criteria for most of these activities require minimising the use of pesticides and fertilisers, but do not clarify to what extent. Is complying with local regulations and third-party forest certification schemes sufficient, or is there a specific threshold that needs to be complied with? There are many similar points on which investors are seeking clarification.	**Definitions** ■ When calculating KPIs, seek evidence to support any assumptions, build an audit trail and be transparent about processes. ■ Engage with companies on how to interpret criteria. ■ Consider using third-party validators to verify taxonomy alignment disclosures.
Timeframes In some TSC, timeframes are set out for meeting thresholds or taking action. Some investors have expressed uncertainty over what start and end dates should be used for assessing whether specified conditions are met.	**Timeframes, multiple layers of criteria, sovereigns, coverage** Engage with policy makers and supervisors on developing the screening criteria and the scope and content of the taxonomy.
Multiple layers of criteria Investors with certain products classified under Articles 8 and 9 of SFDR are required to conduct two levels of DNSH assessments. Investees need to be assessed at entity level, based on principal adverse impacts (PAIs) as	

defined by the SFDR regulation.[1] Investors also need to assess economic activities of the underlying holdings against the DNSH criteria set out in the EU taxonomy regulation.	
Sovereigns There is no methodology in place to calculate the taxonomy alignment of sovereign exposures.[2]	
Coverage Some activities that potentially contribute to climate change adaptation and mitigation, including relevant agricultural activities, are currently not included in the EU taxonomy.	

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=EN
[2] jc_2021_50_-_final_report_on_taxonomy-related_product_disclosure_rts.pdf (europa.eu)

OPERATIONS

Challenges	Recommendations
Resource requirements Implementing the taxonomy can be resource-intensive.	**Resource requirements** ■ Encourage cross-functional collaboration between investment teams, data specialists, compliance, and others, to promote efficiency. ■ Start small-scale. Use existing processes and resources, then build and adjust a framework to support a full roll-out. ■ Consider using a data provider to build on existing capabilities and adopt a pragmatic approach based on available data.
Uncertainty over deadlines Reporting deadlines are not always clearly communicated and are, in some cases, subject to change.	**Uncertainty over deadlines** ■ Engage with supervisory bodies to seek clarification. ■ Reporting 'test runs' often surface technical issues and other problems. The earlier these tests can be conducted, the greater the scope to resolve the issues ahead of cut-off dates.
Evolving standards There are frequent updates to the regulation and to the TSC.	**Evolving standards** Conduct regular training for teams involved in taxonomy implementation, covering how the framework is evolving.
Disclosure templates Investors have to make product-level disclosures before the reporting templates for these disclosures have passed into law. Disclosure templates are included in the draft Regulatory Technical Standards that set out the content and presentation of disclosures under SFDR, but are yet to be formally adopted.	

COMMUNICATING WITH END INVESTORS

Challenges	Recommendations
Manage investor expectations In many cases, end investors expect the taxonomy alignment KPIs of financial products to be higher than they currently are.	**Manage investor expectations** ■ Provide written explanations to contextualise alignment KPIs. ■ Educating end investors about the taxonomy. Explain how the framework works and outline economic activities it currently does, and does not, cover.

ADVANCED IMPLEMENTATION PRACTICES

This section details advanced steps investors are taking to navigate challenges in implementing the taxonomy and actions to harness the full breadth of opportunities offered by the framework.

ESTABLISH CROSS-FUNCTIONAL WORKING GROUPS

Many TPG members are keen to stress the importance of collaboration. Responsibility for implementing the regulation needs to be shared across departments if efforts are to be successful.

Investment managers are forming multi-disciplinary taskforces to coordinate implementation. For example, Neuberger Berman's cross-functional working group encompasses investment and data governance teams. Members of SEB Investment Management's 'ESG workstream', which includes investment staff specialising in a range of different asset classes, helps to steer its implementation strategy.

TPG members recommend taking a holistic approach to implementation. Teams focused on investment, compliance, data governance, technology and automation, communications, client services, and others all have a role to play in a comprehensive implementation strategy.

REPORT PROVISIONALLY AHEAD OF DEADLINES

Reporting 'test runs' often surface technical issues and other problems. The earlier these tests can be conducted, the greater the scope to resolve the issues ahead of cut-off dates.

By sharing provisional assessments with institutional investors, investment managers can help drive understanding and uptake of the EU taxonomy. Of course, such reporting needs to include the necessary caveats about the KPI figures being produced on a best-efforts basis. But, even with such caveats, they still serve a purpose.

Foresight Group started sharing provisional EU taxonomy KPIs in relation to climate change mitigation and adaptation with investors in its flagship fund before disclosure became mandatory. Part of the rationale was to help familiarise investors with the framework and the level of alignment. "One of our principles has been to approach this with transparency," says Jai Mallick, an associate at Foresight Group.

Reducing emissions, and protecting natural capital more broadly, are acutely time-sensitive tasks. Proactive reporting demonstrates that investors see the EU taxonomy not merely as a compliance exercise but also as a powerful mechanism for improving environmental performance.

INTEGRATE THE EU TAXONOMY SYSTEMATICALLY INTO THE INVESTMENT PROCESS

A wide range of investors are using the EU taxonomy to assess potential risks, opportunities and outcomes.

One step TPG members are taking to ensure that the taxonomy is incorporated into investment decisions systematically is to make taxonomy data easily accessible to all investment staff, including those that do not work on sustainability-focused strategies. In practice, this involves ensuring taxonomy alignment assessments are automatically fed into portfolio management software and included in investment dashboards of all investment team members.

"Making the data available in people's existing environments – in Aladdin, for example – is a form of best practice," says Hank Elder, ESG and Impact Investing Vice President at Neuberger Berman. "The data can't just be an output: it needs to be used from the outset, which is why it needs to be available in as many places as possible."

Another means of integrating the framework into investment decisions is creating a set of taxonomy-related ratios. One TPG group member referenced looking at the ratio of companies' aligned activities to their eligible activities, which provides an insight into companies' ability, and / or willingness to participate in the transition to a low-carbon economy. The ratio enables investors to identify companies that could be doing more to align with the taxonomy, with the information providing the basis for future engagement.

INCORPORATE THE TAXONOMY IN PRODUCT DESIGN

The EU taxonomy's detailed TSC provide a strong foundation for product design.

As more investors commit to aligning their portfolios with the goals of the Paris Agreement, demand for net-zero investment strategies is growing. Several TPG members report incorporating the EU taxonomy framework into net-zero investment strategies.

"Many have signed up to be net zero by 2030, 2040 or 2050. We need a structured way to get there. The taxonomy offers a science-based structure," says Andreas Johansson, Head of the Quantitative Equity Team at SEB Investment Management.

In the immediate term, product innovation is focused on climate change mitigation and adaptation. Investors also see the opportunity to use criteria for the four remaining environmental objectives to guide new investment strategies. "The biodiversity mapping is going to be particularly interesting as this is an area that's starting to receive a lot of investor attention," says Suzanne Tavill, Head of Responsible Investing at StepStone.

CONDUCT DUE DILIGENCE ON DATA PROVIDER ASSESSMENTS

The draft SFDR Regulatory Technical Standards (RTS) set out rules on when investors can use third-party data in their product-level EU taxonomy disclosures. The rules state that “public reporting data should be prioritised” but allow for the use of information provided directly from investee companies or third parties when there is no public reporting data available and when the information provided is “equivalent” to disclosures made under Article 8 of the EU taxonomy regulation.

There are several steps investors can take to ensure external assessments are robust. One is to bring in a range of providers to tender for contracts covering taxonomy data. This enables comparison of providers in relation to key elements of their offering, including methodology, data assurance processes and coverage.

SEB Investment Management and La Financière de l'Echiquier (LFDE) are among the TPG members that report using two different providers of taxonomy assessments. Having multiple providers allows investors to compare assessments of the taxonomy alignment of individual holdings. When there are notable differences in scores for the same entity, the next step is to ask the data vendors about the discrepancies to check if they are due to methodological differences or data errors.

Some investors have in-house research analysts, who have strong knowledge of specific issuers, assets and check taxonomy alignment assessment provided by data vendors. LFDE highlights the impact such checks can have: SPIE, an engineering solutions provider, began self-reporting its taxonomy alignment ahead of the implementation deadline, stating that 41% of its revenue was aligned with the EU taxonomy. Despite the disclosure, a data provider incorrectly assessed the company to have no taxonomy-eligible revenues. LFDE engaged with the provider regarding the assessment, which was subsequently revised.

OBTAIN EXTERNAL VALIDATION

Obtaining external validation of EU taxonomy assessments is not mandatory, but it is a step that numerous practitioners are taking to provide additional assurance to end investors. This step appears particularly common amongst private markets-focused practitioners investing in assets or companies that are not in the scope of the NFRD.

“Third-party validation is worth more in terms of communicating to investors. It has more impact and it's more credible,” says Henry Morgan, Sustainable Investment Manager at Foresight Group, which has obtained external validation of the taxonomy alignment of its flagship sustainable infrastructure fund.

CONDUCT TAXONOMY-FOCUSED STEWARDSHIP

Engagement is an important means by which investors can enhance their portfolios' taxonomy alignment. Most TPG members interviewed report having dialogues with investee entities about their taxonomy disclosures.

Impax is one investment manager that is planning multiple taxonomy-focused engagements. It intends to reach out to a broad swathe of its holdings to request that they publish data at economic activity-level to fill the data gaps. Impax will also be conducting focused engagements with its companies. For example, one of its investee companies, a Nordic industrials group with involvement in heating technology solutions, is classified as having low levels of taxonomy alignment due to falling short of 'significant contribution' criteria. In response to engagement questions, Impax received assurances that the company was acting to ensure the criteria would be met in coming years.

"Engaging with companies is very important because the whole of the industry is building capacity right now and we need to bring our companies along by sharing with them the questions which we need to answer," says Thea Cheung, Sustainability Research and ESG Analyst at Impax.

SUPPORT CAPACITY-BUILDING

The EU taxonomy can serve as an important tool to combat accusations of greenwashing. It can be used to highlight the scientific foundations of sustainability claims made by investors. In recognition of this, practitioners are working to promote understanding and adoption of the framework.

"Using the EU taxonomy framework is a good way of demonstrating objectivity and providing transparency," says Andreas Johansson, Head of the Quantitative Equity Team at SEB Investment Management. The Sweden-headquartered firm has held online discussions on the EU taxonomy involving academics and asset owners to educate market participants.

Investment managers are also collaborating with their peers to develop implementation practices. By participating in initiatives such as the PRI's TPG, and through contributing to discussions in conferences and forums, investors are strengthening their collective understanding of the EU taxonomy.

"We're all trying to solve the same problem, so it's not a case of trying to get some kind of competitive advantage over each other," says Sarah Peasey, Director of European ESG Investing at Neuberger Berman.

PARTICIPATE IN THE POLICY-MAKING PROCESS

The EU taxonomy regulation will continue to evolve. Through contributing to policy design, organisations can support their own implementation efforts.

The European Commission routinely seeks input from the industry on the EU taxonomy regulation and its broader Sustainable Finance Action Plan. The Commission also provides opportunities for investors to put forward staff to sit on expert advisory groups. Organisations can therefore help to ensure the rules are workable and feasible.

PRI signatories that are looking to develop their policy engagement work can sign up to the PRI policy newsletter or email policy@unpri.org for information.

RECOMMENDATIONS FOR POLICY MAKERS AND SUPERVISORS

This section provides recommendations for policy makers, supervisors and other EU advisory bodies on how financial market participants can implement the EU taxonomy in a robust manner. The recommendations are based on input from members of the PRI TPG and have been supplemented with PRI analysis.

Certain recommendations may also be relevant for policy makers and supervisors in other jurisdictions that are in the process of, or are considering, launching sustainability taxonomies.

- **Provide additional clarity on timelines.** There has been significant uncertainty surrounding deadlines for taxonomy disclosure. Regular and clearly-worded updates on timelines should be provided to investors, preferably through a dedicated webpage. These resources should clarify the difference between entity and product-level disclosures and explain different requirements related to the SFDR and taxonomy regulation.
- **Facilitate data collection**. The proposed creation of an ESAP is set to reduce the resources and costs required to source taxonomy data. Based on interviews with TPG members, there appears to be strong investor support for this proposal.
  - Maintain the proposal for the CSRD to cover listed SMEs and large undertakings as this would help address data availability issues.
  - In the absence of public taxonomy data, guidance should clarify under which circumstances information is deemed "equivalent" to disclosures made under Article 8 of the EU taxonomy regulation.[3]
- **Offer additional guidance on how to interpret criteria.** Worked examples of taxonomy alignment calculations should be provided across asset classes. There should also be a channel through which investors can pose questions.
- **Provide additional guidance to support assessments of non-EU issuers and assets**. It is recommended that comprehensive correspondence tables are developed by policy makers to map EU standards referenced in the taxonomy to non-EU standards.
- **Enable investors to communicate limits of analysis and underlying data.** The sequencing of reporting requirements means many investors will have to report based on partial data over the coming years. Until requirements under the taxonomy Article 8 Delegated Act and the CSRD fully enter into force, reporting templates should allow investors to outline any assumptions they have had to make in calculating KPIs.

[3] jc_2021_50_-_final_report_on_taxonomy-related_product_disclosure_rts.pdf (europa.eu)

- **Collaborate internationally to harmonise taxonomies**. Investors interviewed for this report stressed the importance of interoperability between international taxonomies: significant divergences across jurisdictions would add extra complexity and expense to taxonomy implementation. There is growing consensus amongst investors and institutions that taxonomies should be based on scientifically robust screening criteria, and that in ensuring interoperability between taxonomies, the more stringent criteria should be favoured. Investors that consistently apply the more stringent criteria across all their investments will be compliant with either framework at any time. In addition, applying the most stringent criteria will drive a race to the top in the harmonisation of global best practices rather than alignment with the lowest common denominator.

"The important thing is to think about timeframes. The taxonomy is here for the next 30 years at least. It might seem challenging to implement in the short term, but it's very valuable over the long term."

Alex Stevens, CEO of Greenomy

"It's like the Sagrada Família in Barcelona: it's never going to be finished. So rather than holding back and waiting for some kind of finalisation of the taxonomy, we've taken the approach of going ahead."

Sarah Peasey, Director of European ESG Investing at Neuberger Berman

"I estimate it will take five to seven years for EU taxonomy reporting to become comprehensive across private markets."

Suzanne Tavill, Head of Responsible Investing at StepStone

"The beginning stages are the most time consuming. I think data availability will improve in time because it is not only regulatory but also market demands that are driving reporting."

Silvia Koleva-Pancheva, ESG Manager at IWC

APPENDIX 1: ADDITIONAL RESOURCES

This section is divided into four sections: legislative documents; implementation guidelines and support; development proposals; and background documents.

This list of additional resources is intended to highlight some of the most relevant sources of information for practitioners looking to implement the taxonomy. The EU taxonomy is a dynamic piece of regulation, therefore the key documents will evolve with time.

Legislative documents

Resource	Published by	Publication date	Overview
Taxonomy Regulation	European Union	June 2020	Regulation on a framework to facilitate sustainable investment.
The Delegated Act Supplementing Article 8 of the Taxonomy Regulation	European Union	December 2021	This delegated act specifies the content, methodology and presentation of information that financial and non-financial entities must disclose regarding their environmentally sustainable activities. The annexes to the delegated act contain entity-level disclosure templates and specifications on the content of EU taxonomy KPIs to be disclosed by non-financial companies, asset managers, credit institutions, investment firms, insurers and reinsurers.
EU taxonomy Climate Delegated Act	European Union	December 2021	This delegated act defines the technical screening criteria for economic activities that contribute substantially to climate change mitigation and climate change adaptation.
SFDR Regulation	European Union	December 2019	Regulation on sustainability-related disclosures in the financial services sector. The SFDR regulation and EU taxonomy are interlinked, with the SFDR Regulatory Technical Standards providing rules on how to report taxonomy alignment at product level.

Implementation guidelines and support

Resource	Published by	Publication date	Overview
EU taxonomy Compass	European Commission	June 2021	A searchable database on the eligible economic activities that contribute to the taxonomy's six environmental objectives. There is also information on corresponding minimum social standards and DNSH criteria. The database is updated on an ongoing basis. It is available to download in MS Excel (xlsx) or JSON formats.
Sustainable finance implementation timeline	European Securities and Markets Authority	February 2022	A timeline of when disclosure requirements under various EU sustainable finance regulations apply.
FAQ on Article 8 of the EU taxonomy	European Commission	February 2022	This frequently asked questions document aims to clarify the content of the Disclosures Delegated Act under Article 8 of the EU taxonomy regulation.
FAQs: How should financial and non-financial undertakings report Taxonomy-eligible economic activities and assets in accordance with the Taxonomy Regulation Article 8 Disclosures Delegated Act?	European Commission	December 2021	Summary information on how entity-level reporting should be conducted in accordance with the Article 8 Delegated Act.
Platform considerations on voluntary	Platform on Sustainable Finance	December 2021	A document that helps users of the EU taxonomy with the disclosures required under Article 8 of the regulation.

information as part of Taxonomy eligibility reporting			
EU taxonomy NACE alternate classification mapping	Platform on Sustainable Finance	December 2021	This table maps out selected industry classification systems, and how they relate to the description of economic activities in the EU taxonomy Delegated Act.
EU taxonomy usability and data webinar series	Platform on Sustainable Finance, the Climate Bonds Initiative	June-July 2021	A webinar series exploring the role of the EU taxonomy, what it means for investors and corporations. The series also examines the prospect of extending the EU taxonomy to cover activities classified as "significantly harmful" or having "no significant impact" and a presentation on a proposed social taxonomy.
Testing the taxonomy: insights from the PRI Taxonomy Practitioners Group	The PRI	September 2020	The report summarises some of the challenges asset managers faced during preliminary efforts to calculate the taxonomy alignment of certain portfolios and assets. It also highlights potential solutions and shares recommendations for policy makers.
EU taxonomy alignment case studies	The PRI	September 2020	A series of more than 35 investor case studies detailing their preliminary strategies for assessing the taxonomy alignment of their holdings. The case studies also highlight challenges and contain recommendations for other practitioners and policy makers.
Practical approaches to applying the EU taxonomy to bank lending	United Nations Environment Programme Finance Initiative,	February 2022	The report explores practical considerations for banks that wish to use the EU taxonomy. Guidance contained may also be useful for other financial market participants.

	European Banking Federation		
Testing the application of the EU taxonomy to core banking products: High level recommendations	United Nations Environment Programme Finance Initiative, European Banking Federation	January 2021	A report on the benefits, challenges and practicalities of implementing EU taxonomy regulation for the banking sector.

Development proposals

Resource	Published by	Publication date	Overview
Complementary Delegated Act (CDA) of the EU taxonomy Regulation	European Commission	February 2022	Draft delegated act setting out the technical screening criteria for economic activities in the gas and nuclear energy sectors.
Final Report on draft Regulatory Technical Standards (SFDR)	European Supervisory Authorities	October 2021	The report sets out the required content and presentation of product-level EU taxonomy disclosures. It includes draft templates for product-level taxonomy alignment disclosures.
Proposal for a Corporate Sustainability Reporting Directive	European Commission	April 2021	A proposal to amend the existing reporting requirements of the NFRD. The proposal would make taxonomy reporting mandatory for a broader set of companies.
CSRD Q&A	European Commission	April 2021	Answers to frequently asked questions on the CSRD proposal.
European Single Access Point Regulation proposal	European Commission	November 2021	A proposal for an ESAP that would provide a centralised hub of publicly available information on entities, including their sustainability performance.

Preliminary recommendations for technical screening criteria for the EU taxonomy (for the four remaining environmental objectives)	Platform on Sustainable Finance	August 2021	The draft report outlines possible methodologies for developing TSC covering the EU's four remaining environmental objectives.
Environmental Transition Taxonomy Report	Platform on Sustainable Finance	March 2022	The report sets out options on possible extensions of the EU taxonomy on green and sustainable finance.
Social taxonomy Report	Platform on Sustainable Finance	February 2022	A proposed structure for a social taxonomy.
Draft report on a social taxonomy	Platform on Sustainable Finance	July 2021	The draft report sets out a possible structure, as well as pros and cons, for a social taxonomy.
Social taxonomy webinar	Platform on Sustainable Finance	July 2021	Presentation on the potential design of the proposed social taxonomy.
Public Consultation Report on Taxonomy extension options linked to environmental objectives	Platform on Sustainable Finance	July 2021	This report examines extending the EU taxonomy to include significantly harmful activities and no significant impact activities in relation to environmental sustainability.
'Significantly harmful' & 'no significant impact' taxonomies webinars	Platform on Sustainable Finance	July-August 2021	Webinar on the arguments for and against extending the EU taxonomy to cover economic activities that are 'significantly harmful' and 'do no significant impact'. The presentation also explores how these extensions work in practice.

Background documents

Resource	Published by	Publication date	Overview
Renewed Sustainable Finance Strategy	European Commission	July 2021	An update of the European Commission's 2018 sustainable finance action plan that covers proposed updates to the taxonomy.
Action Plan: Financing Sustainable Growth	European Commission	March 2018	The blueprint for an EU taxonomy, explaining the role the tool plays in the EU's broader objective of transitioning to a low-carbon, circular economy.
Transition finance report	Platform on Sustainable Finance	March 2021	Advice to the European Commission on how the EU taxonomy can enable inclusive transition financing for companies and other economic actors.
European Sustainable Finance Survey 2020	Adelphi, ISS ESG; supported by the German Federal Ministry for Environment, Nature Conservation and Nuclear Safety	September 2020	The survey assessed the extent of European-listed companies' economic activities that are aligned to the taxonomy as of 2020.
Final report of the High-Level Expert Group on sustainable finance	High-Level Expert Group (HLEG) on Sustainable Finance	January 2018	Recommendations from the HLEG to the European Commission on how the financial sector can be reformed to support a more sustainable and inclusive economic system. The recommendations include creating a sustainability taxonomy alongside other proposals relating to, amongst other things, accounting rules and benchmarks.
Improving Compatibility of Approaches to Identify, Verify	United Nations - Department of Economic and Social Affairs, International	September 2021	A paper that explores approaches to enhancing the comparability, interoperability and consistency of sustainability taxonomies globally.

and Align Investments To Sustainability Goals	Platform on Sustainable Finance		
Final report of the Technical Expert Group on Sustainable Finance	Technical Expert Group on Sustainable Finance	March 2020	The report sets out the TEG's final recommendations to the European Commission regarding the overarching design of the taxonomy.
Technical assessment of nuclear energy with respect to the 'do no significant harm' criteria	Joint Research Centre (JRC)	March 2021	A review conducted by the European Commission's JRC that explores whether nuclear energy does no significant harm to the EU's environmental objectives.
Review of the JRC report on technical assessment of nuclear energy	Scientific Committee on Health, Environmental and Emerging Risks	June 2021	A SCHEER review of the Joint Research Centre's technical report on nuclear energy (see above) with respect to the DNSH criteria of the taxonomy regulation.

APPENDIX 2: GLOSSARY

Article 8 products	Financial products classified under Article 8 of the SFDR Regulation that promote environmental and / or social characteristics.
Article 9 products	Financial products classified under Article 9 of the SFDR Regulation that pursue a sustainable investment objective.
Corporate Sustainability Reporting Directive (CSRD)	A proposed revision of the reporting requirements of the NFRD. The CSRD would require large companies and companies listed on regulated markets (except listed micro-enterprises) to disclose information on the way they operate and manage social and environmental challenges.
Do no significant harm (DNSH) criteria	DNSH criteria set out the rules for determining whether an activity does significant harm to any of the EU's six environmental objectives.
EU taxonomy	The EU taxonomy is a tool to help investors understand whether an economic activity is environmentally sustainable, and to navigate the transition to a low-carbon economy. It provides a common language between investors, issuers, project promoters and policy makers. It also helps investors to assess whether investments are aligned with high-level policy commitments such as the Paris Agreement on Climate Change.
EU taxonomy alignment	An economic activity is considered aligned with the taxonomy if it substantially contributes to at least one of the six environmental objectives, does no significant harm to the other five, and complies with the minimum safeguards.
EU taxonomy eligible	An economic activity is EU taxonomy-eligible if it appears in the taxonomy, irrespective of whether it meets the TSC.
European Supervisory Authorities (ESAs)	The European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority.
Key performance indicators (KPI)	Metrics used to disclose levels of taxonomy alignment.
Nomenclature des Activités Économiques	A classification system for economic activities.

dans la Communauté Européenne (NACE)	
The Non-Financial Reporting Directive (NFRD)	The NFRD requires the disclosure of non-financial and diversity information from certain large undertakings and groups.
Principal adverse impacts (PAI)	Negative, material or likely to be material effects on sustainability factors that are caused, compounded by or directly linked to investment decisions and advice performed by the legal entity.
The Platform on Sustainable Finance (PSF)	The PSF is a permanent expert group of the European Commission that was established to assist the development of sustainable finance policies, including the EU taxonomy.
Sustainable Financial Disclosure Regulation (SFDR)	EU regulation on sustainability-related disclosures in the financial services sector.
Taxonomy regulation	Regulation on the establishment of a framework to facilitate sustainable investment.
Technical Screening Criteria (TSC)	Criteria for determining whether an activity is EU taxonomy-aligned.

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The Principles for Responsible Investment (PRI)

The PRI works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with **UNEP Finance Initiative** and the **UN Global Compact**.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UN environment programme | finance initiative

United Nations Global Compact

The United Nations Global Compact is a call to companies everywhere to align their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to take action in support of UN goals and issues embodied in the Sustainable Development Goals. The UN Global Compact is a leadership platform for the development, implementation and disclosure of responsible corporate practices. Launched in 2000, it is the largest corporate sustainability initiative in the world, with more than 8,800 companies and 4,000 non-business signatories based in over 160 countries, and more than 80 Local Networks.

More information: www.unglobalcompact.org

United Nations Global Compact