PLATFORM ON
SUSTAINABLE FINANCE

Public Consultation Report on Taxonomy extension options linked to environmental objectives

July 2021

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1. Introduction to the EU Platform on Sustainable Finance

The EU Platform on Sustainable Finance is a permanent expert group of the European Commission, established under Article 20 of the Taxonomy Regulation, EU Regulation 2020/852. 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 implementation and further development of the EU Taxonomy. As provided for in Article 26.2(a) of the Taxonomy Regulation, the European Commission gave the Platform for Sustainable Finance a mandate to work on a possible extension to the taxonomy, to include activities significantly harmful to environmental sustainability and activities with no significant impact on environmental sustainability, and the Platform's Chair therefore established a subgroup dedicated to this task.

2. Purpose of this report

This report examines the premises, issues and options for and against extending the EU Taxonomy 'beyond green' to include significantly harmful (SH) activities and no significant impact (NSI) activities (both in relation to environmental sustainability) within the overall EU sustainable finance framework. This report represents a work in progress and is published to gather feedback which will further inform the Platform as it continues to work on these topics, aiming to publish a Final Report later in the year. The findings in the Platform's Final Report will help inform the Commission's decisions as they respond to the requirement of Article 26.2(a) of the Taxonomy Regulation, EU Regulation 2020/852. This Taxonomy Regulation Article requires the Commission to publish, by end December 2021, a report describing the provisions necessary to extend the scope of the TR beyond environmentally sustainable economic activities. The Commission recommitted to this timing in the recent Renewed Strategy for Financing the Transition to a Sustainable Economy.[1] The Platform has interpreted its brief to address environmental sustainability by taking into account the six environmental objectives of the Taxonomy Regulation (TR).

2.1. Important caveat

Whilst this report summarizes interim observations and recommendations, it should be noted that these are not final, that all members of the Platform are not fully aligned in their views on one or other extension of the taxonomy discussed herein, and that the topics covered by this report are still subject to ongoing work by the Platform. The feedback received in the public consultation on this report will be an important input to this ongoing work. Following the analysis of responses to the public consultation, and taking account of further considerations by the Platform, final recommendations will be put forward later in 2021.

[1] https://ec.europa.eu/finance/docs/law/210704-communication-sustainable-finance-strategy_en.pdf

3. Why extend the taxonomy?

3.1. The present 'green' taxonomy

The EU Taxonomy (subsequently referred to as the Taxonomy) is a classification system to identify economic activities that achieve performance levels making a 'substantial contribution' (SC) to at least one of six environmental objectives[2], 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 TR). Such activities with a level of performance meeting the relevant technical screening criteria (TSC) thresholds for SC and DNSH 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 most impact reduction potential, have been prioritised for the Taxonomy, and related TSCs defining SC and DNSH performance thresholds for each of those activities are established in Delegated Acts adopted by the Commission. At the time of writing, only the first climate Delegated Act had been published, covering the objectives of climate change mitigation and climate change adaptation. Work to identify activities and TSCs for the remaining four objectives, carried out by the Technical Working Group (TWG) of the Platform, is on-going, as well as work proposing criteria for some further activities for the two climate change objectives.

The Taxonomy, as described in the Action Plan for financing sustainable growth (2018), is the cornerstone of a larger framework for EU sustainable finance, involving several inter-linked regulations and actions on sustainable finance products, disclosures and reporting requirements, which reference the Taxonomy. Other EU policy refers 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 in Europe, but also amongst international taxonomy efforts.

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

3.2. The “binary classification” problem

In its recent Frequently Asked Questions document Q&A (europa.eu), the Commission underlined 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 as ‘green’ may be mistakenly considered by some users as environmentally ‘unsustainable’. In reality the Taxonomy is not binary, but rather only allows activities meeting high standards of environmental performance against objective criteria to be classified as green.

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 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 do significant harm to the environment.

Even before the Taxonomy Delegated Acts enters into force for first reporting in 2022, concerns have been raised 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 that the current Taxonomy design does not give sufficient recognition to corporates transitioning towards a more sustainable business model, but whose activities fail to meet SC, and risks penalising them and restricting their access to capital.

Some actors in the investment markets have also raised the prospect of a ‘green bubble’, arguing that with the current design of the Taxonomy, a large demand for sustainable financial products would seek the narrow supply of Taxonomy-aligned assets. Estimates put the volume of finance that would currently meet Taxonomy alignment ‘green’ criteria at 1 to 5% of all financial assets (see FAQ EU Taxonomy p.6), none the least because the design of the Taxonomy itself targets ‘pure green’ or best performance to incentivise best practice.

The Platform published a Transition Report in March 2021 titled Transition finance report - March 2021 - EU Platform on Sustainable Finance (europa.eu). The report details how the current Taxonomy, and financing of activities included in it, do not amount to a binary system. For instance, by including capex and opex as 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. This can make transition finance more widely available, whilst not 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.

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 significant impact. A balance needs to be struck between additional complexity in reporting, versus the additionality of more information being made available.

3.3. Feedback from outreach

Feedback from a wide range of stakeholders during Platform outreach events (see Annex 1) revealed a range of opinions and arguments for and against the need for an extended taxonomy, as summarised in Table 1. The Platform sought to understand the potential uses and risks of introducing an extended taxonomy from the perspective of four groupings of users:

- financial market participants and financial undertakings (asset managers, banks, insurers, etc.);
- private and public non-financial undertakings (large corporates, municipalities, SMEs, etc.);
- financial market regulators and associated actors (central banks, micro-prudential financial regulators, rating agencies, etc.); and
- wider society (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. However, further work will be required to reach our final recommendations.

The main arguments for extending beyond green were transparency for all investors - retail and institutional - who need to manage their climate and environmental risks, avoid environmentally harmful investments, and want better tools to identify stranded assets are:

- Achieving greater transparency in environmental performance, including and distinguishing activities that are significantly harmful from those with a low probability of significant negative impact on the environment.

- Contributing to better risk management at 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
- Identification of subsidies to harmful activities.

The main case against a taxonomy extension came from 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.

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 is that sustainable finance initiatives to date have neither significantly increased transition finance nor driven sufficiently ambitious environmental transitions. Alongside the growth in finance labelled as 'green', investments in and subsidies to fossil fuel industries and other environmentally harmful economic activities continue.[3] 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 to avoid significant harm. This 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; and address concerns about the perceived binary nature of the current EU

[3] For example, large commercial banks provided $750bn 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

Taxonomy classification; and help to provide greater clarity surrounding the nature of low environmental impact activities not yet covered by Delegated Acts.

Whist an NSI extension could help to provide greater clarity surrounding the nature of low environmental impact activities not yet covered by Delegated Acts, an NSI 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 NSI proposals, including further examination of options that may not involve Level 1 legislative changes in a longer term phased approach.

Table 1 General pros and cons of SH and NSI extensions from stakeholder dialogues and Platform discussions

	PROS	CONS
SH	• An SH-extension will help identify and prioritise the economic activities for which the urgent transition towards better environmental performance has to be supported to avoid significant harm. • An SH-extension would increase the transparency, completeness of environmental performance levels of activities and provide an encouraging description for activities with intermediate performance levels between SC and SH. • An SH-extension and associated "Intermediate" area 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 extension is a prerequisite to help markets define and develop efficient instruments for financing the transition out of SH.** • An SH extension may enhance 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 risks. • An SH extension could be used by policy makers to provide subsidies to the decommissioning of harmful activities and monitor changes in capital flows. • An SH 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 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 transition risk. • SH could impact the financing of companies with a high share of turnover deriving from 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.

	PROS	CONS
NSI	• Mitigates the risk of NSI 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 emphasis on climate-resilience in small businesses which are often the most vulnerable to climate change impacts. Without NSI, these activities could be left behind in access to finance for adaptation as well as other important green actions such as energy efficiency of the buildings, electric vehicles etc.	• Potential complexity when looking to define all activities and questionable benefits compared to market-led ESG labelling. • Usability considerations would prioritise developing an SH taxonomy first, including DNSH criteria for otherwise low impact activities, in which case an NSI taxonomy may not be needed. • The logic of the taxonomy argues against the revenues of NSI 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. • 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 a list of NSI activities up-to-date in the dynamic services sector. • Some doubts as to whether NSI exists when all 6 objectives are considered, and whether any activity should be classified as NSI without having to check DNSH criteria.

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 do not have a significant impact (NSI) on environmental sustainability, along with economic activities that significantly harm (SH) environmental sustainability. The Platform interprets this framework as potentially applying to the whole economy, such that every economic activity should fall into one of four 'boxes', as illustrated in Figure 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.

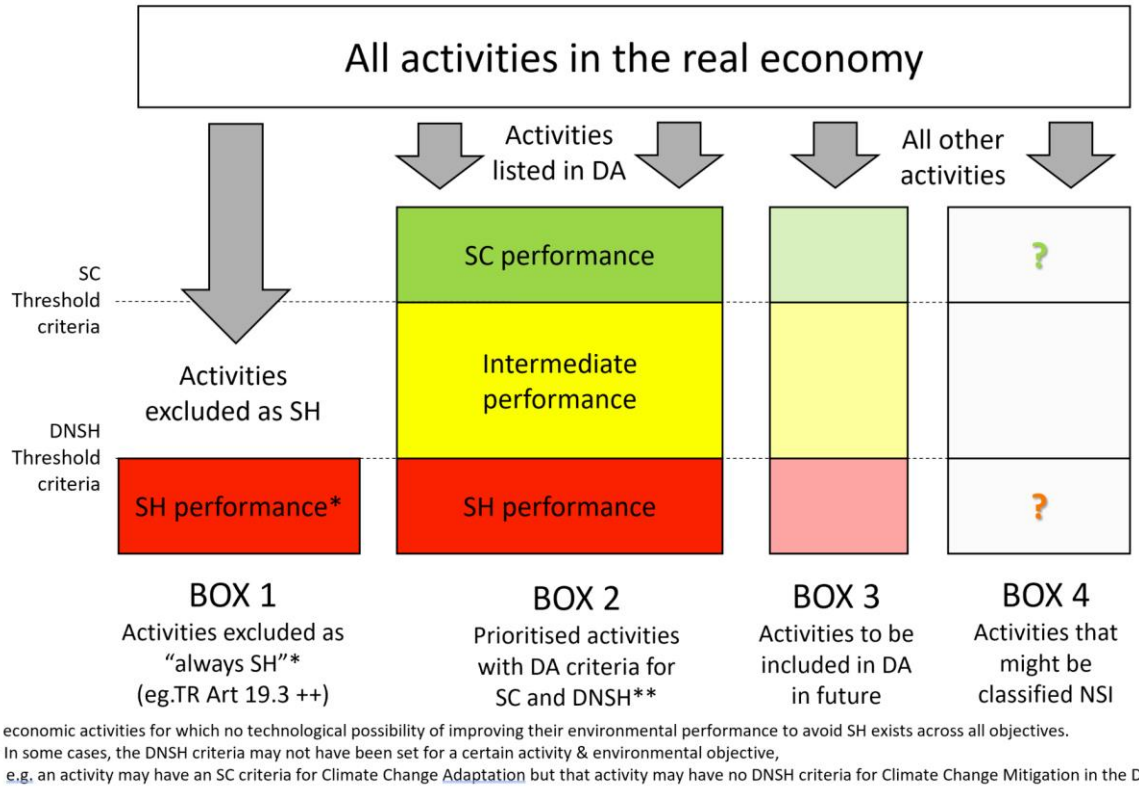


Figure 1. Conceptual model of extension categories for economic activities and their performance levels

Box 2 represents the existing 'green' taxonomy for activities, which are listed in a DA and for which TSC for SC and DNSH will have been set by the end of 2021.[4] It should be noted that there are activities for which no DNSH criteria are defined, implying that there is no SH performance, such as many service sector activities which have no DNSH criteria for the depollution objective. For other activities, SC 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.

Box 1 represents activities which are excluded from the green taxonomy as they are significantly harmful to one or more of the six environmental objectives, and are unable by their nature, to transition. The current Taxonomy Regulation Article 19.3 recognises only one activity to be excluded from the green taxonomy - namely 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 examples such as:

- Thermal coal mining and peat extraction (CC Mitigation).
- Construction of new housing in extreme high flood risk areas (CC Adaptation).
- Activities destroying high biodiversity value ecosystems. etc

Box 3 represents activities that have the potential to make a substantial contribution to one of the objectives. For this reason, 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 No Significant Impact on environmental sustainability (NSI). 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

[4] The published climate Delegated Act includes many activities with the potential to make a substantial contribution to climate mitigation and climate adaptation objectives. The Platform Technical Working Group (TWG) is working on developing TSC for activities considered a priority for the remaining four environmental objectives (water, circular economy, pollution, and biodiversity).

safeguards in place – and may want to make and report green investments; hence the green and red **"?"** symbols in Box 4 in Figure 1.

The interpretation and different levels of performance within each box are discussed further under the SH and NSI report sections (Sections 5 and 6 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 has decided 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 with avoidance of green-washing, clearly that colour has to remain. The Platform has chosen to firmly reject a 'brown' taxonomy, because of the inappropriate ethnic reference and because, when talking about brownfield and greenfield investments, the interpretation can be the opposite. To explain this last observation, consider the environmental impact of "a new factory built on a greenfield site" vs "rehabilitation and re-use of an old industrial brownfield area". The Platform has therefore decided to use the 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**. 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.

2. Fundamentally, there is no difference between the Significant Harm to environmental sustainability, and to the environmental objectives, caused by activities in Box 1 and Box 2. This is not a distinction between a very level of significant harm and somewhat less significant harm. The difference between significant harm in Box 1 and Box 2 is about 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 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. The activities in the Taxonomy performing at a significantly harmful level (Box 2 and Box 3) do on the other hand have options to transition and are needed in a low carbon future economy. They therefore can, and must, transition urgently away from levels of performance that cause significant harm.

3. It is a common misunderstanding that NSI 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 SC 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 SC and DNSH criteria. The NSI sectors, meanwhile, could be thought of as mainly service sectors with very little impact on the environment either positively or negatively – for example hairdressers, creches, tax advisers or lawyers. Clearly, some specific entities operating within the NSI activities may wish to “green themselves”, and this will be discussed in more detail in the NSI section of this report.

Figure 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. This increased clarity surrounding all non-green activities in the portfolio can help focus attention on the necessary transitions that our economies are facing. 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.

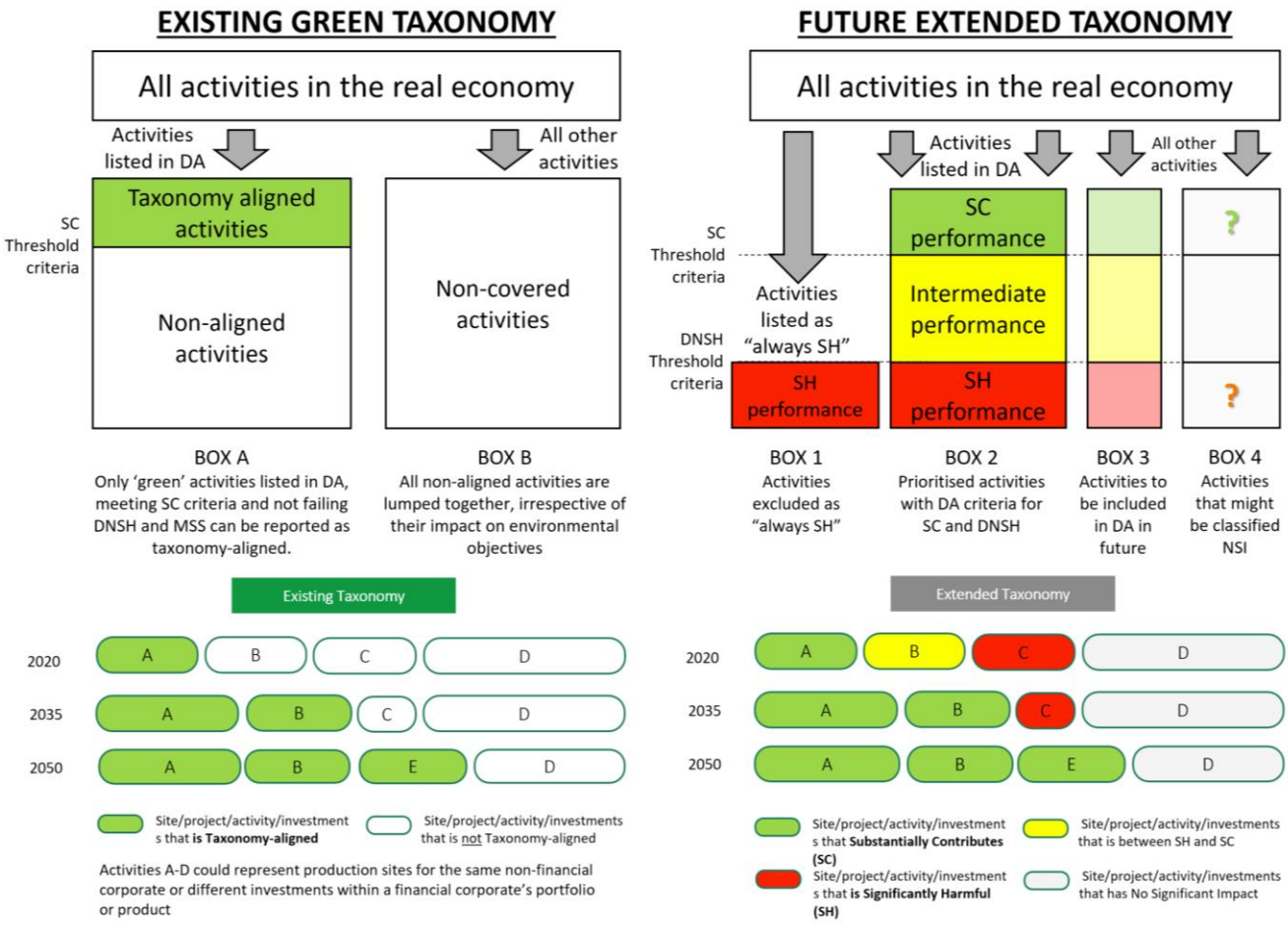


Figure 2. Extension of the Taxonomy can facilitate clarity and improved understanding of environmental performance of portfolios of activities and can thereby support improved transition strategies and access to financing.

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), either of which may form the basis for setting TSC. 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 TSCs are defined in terms of an absolute level of impact (for example GHG emissions),

whereas in exceptional cases, a few TSCs are described as a % reduction in impact[5] – for example 20% reduction in water leakage rates or improvement in building energy performance.

Additionally, Taxonomy TSC are themselves dynamic, except where process based, as they define the 'level of ambition', both for SC and for avoidance of SH, for the immediate forthcoming period, but clearly must in most cases tighten over time following a review process. The Platform has the task to advise on these reviews. For transitional activities contributing to the CC Mitigation objective, this review period is set as every three years (TR Article 19).

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 3a). Not all sectors would follow the same curves, as some have low-carbon technologies already available at scale, and others do not. For this reason, even individual activity "falling curves", for the CC Mitigation objection, may need to reach net zero earlier than 2050 – for example in global electricity generation sector, by 2040. "Falling curves" diagrams for other objectives may take a somewhat different shape. Figure 3b gives an example for the climate change adaptation objective, where criteria are process based and the diagram does not take a falling curve shape.

[5] Note that care needs to be taken using % 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 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 overall level of water consumption in a water-stressed catchment. etc

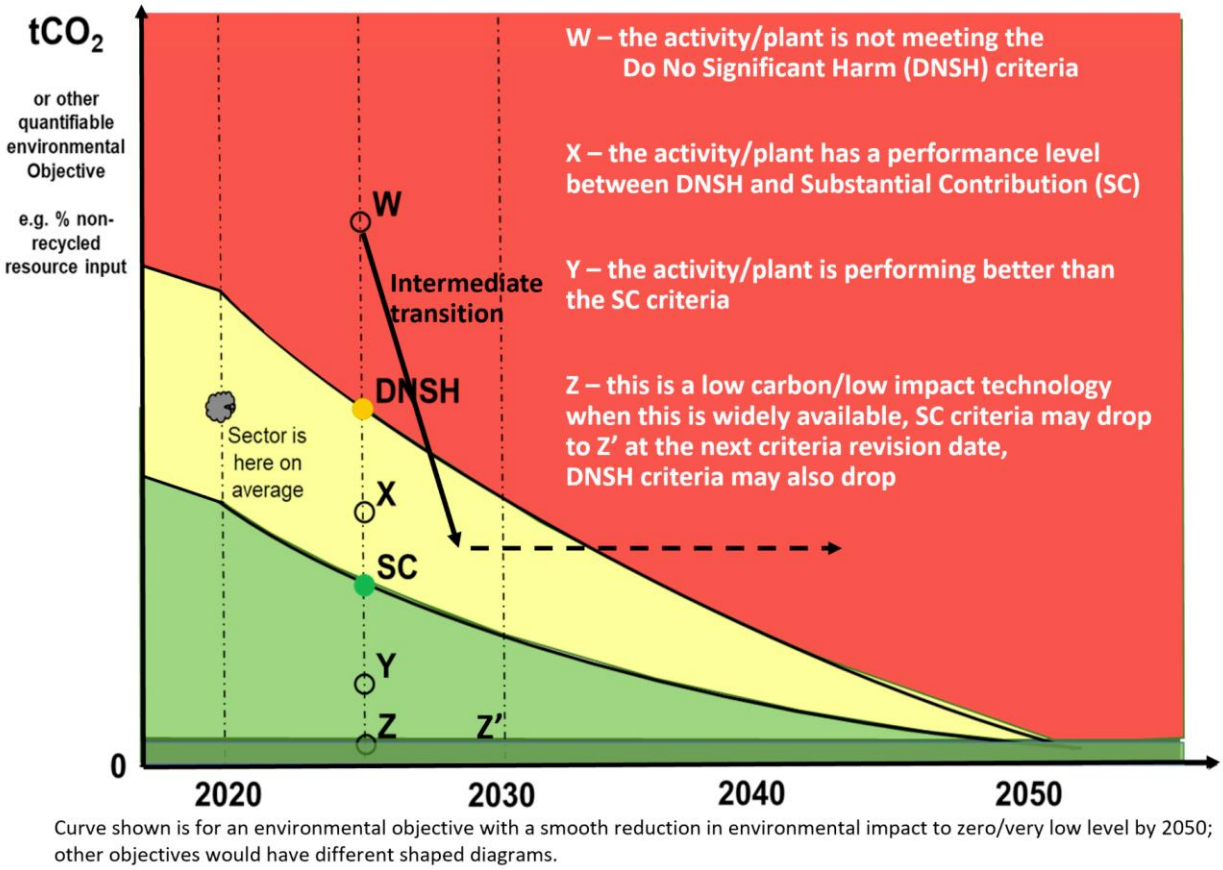


Figure 3a. Example of "falling curves" shaped diagram for an environmental objective e.g. Climate Change Mitigation, for a high impact activity moving to net-zero by 2050

This dynamic nature of the Taxonomy, both in terms of activities and criteria, has the following implications for most objectives and activities:

- 'Green' activities, or activities performing at or better than Substantial Contribution level: "green" level of environmental performance, need to continue to improve their environmental performance levels over time to continue to transition and make a substantial contribution to the environmental objective.
- Activities with environmental performance levels between the TSC 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 environment in a few years' time (ref the dotted horizontal arrow in figure 3a.
- Any valid transition, activity-specific transition plan, or entity level transition strategy benefits from being forward looking.

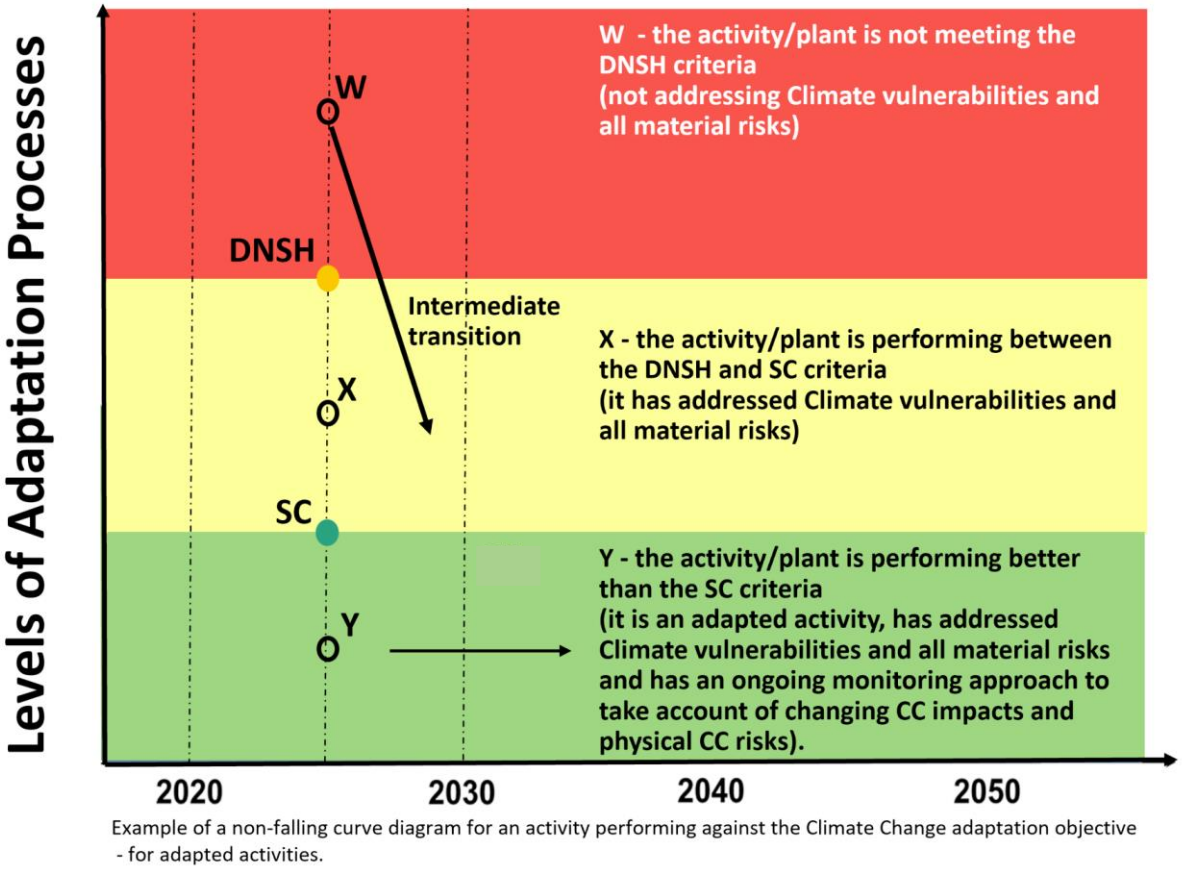


Figure 3b. Example of non-"falling curves" shaped diagram for an environmental objective with process-based TSC for SC and DNSH i.e. Climate Change Adaptation

The dynamic nature of the Taxonomy can still be seen in this diagram for climate change adaptation in Figure 3b. A fully adapted activity performing at the level of the SC criteria, has 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 middle space may be initially 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 operating without any assessment of the activity's vulnerability to climate change impacts and with no action taken to address material risks to the activity, 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.

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 2. Some taxonomy activities have no NACE code equivalent, for example restoration of wetlands, whilst others cover multiple codes.

Table 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 looking wider 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 TR 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, extensive mapping of NACE codes against other classification systems used in the market plus an analysis of NACE code data gaps. The Platform is actively working with Eurostat and other partners on this mapping exercise to improve usability of the Taxonomy. This work will also support clarity in the Platforms further deliberations on potential SH and NSI Taxonomy extensions.

5. Significantly Harmful activities

5.1. Why extend the taxonomy to SH activities

The Platform notes that stakeholders often have strong and divergent views surrounding what characterises economic activities that are significantly harmful to environmental sustainability, and regarding what the pros and cons could be for an extension of the Taxonomy framework to include such activities.

The Platform also notes that the building blocks of an extended taxonomy in terms of performance levels are embedded in the current Taxonomy regulation, and that SH performance levels are set through the Delegated Acts.

The Platform finds that it is both possible and justified to propose a balanced approach towards an SH-extension which may harvest the benefits of an SH-extension, while minimising the risks of such 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 outline premises and options for such a balanced approach

5.2. Three performance levels

Article 17 of the Taxonomy Regulation defines, in general terms, significantly harmful activities under each of the six environmental objectives. Articles 10 to 15 require that Delegated Acts define technical screening criteria for significantly harmful activities.

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 the Taxonomy Regulation Article 19.1 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 Do No Significant Harm (DNSH) criteria is technically equivalent to causing SH. However, a review of published DNSH criteria is needed for each activity to assess if its formulation is fit-for-purpose – not only to act as an SH criteria

but also in order to enhance its usability and practical application as an SH criteria. This is due to the fact that these criteria were set by the TEG 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, nor is it intended as reviewing the ambition level of the criteria.

Some criteria set with quantitative performance levels work well for screening out as DNSH and screening in as SH. For example, the process-based TSC for DNSH to CC Adaptation, or the figure of 270gCO2e/kWh for DNSH to CC Mitigation for electricity generation projects. There are two types of issues, however, that would need to be addressed before the DNSH criteria might be fit for purpose as SH criteria:

- A TSC for DNSH to CC Mitigation, found in Annex II of the Climate DA, may have been written referring to the green activity where it is placed, such as "The adaptation measures should not..." which means that it does not function as a stand-alone SH criteria.
- A TSC for DNSH to CC Mitigation may not have been set because it was deemed not necessary for CC adaptation purposes, such as there being no level of leakage in a water supply system set as a TSC for DNSH to CC Mitigation. Yet, if starting from an SH standpoint, it is clear that a certain level of leakage (e.g. the average water leakage rate, using the general approach to take the average performance level to set many DNSH criteria) might need to be set as an SH criterion.

Apart from issues mentioned above that would be captured by the review, it is now clear that the Taxonomy Regulation definition of significant harm, 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 TSC for SC.
- Doing significant harm to the environmental objective (SH) – performance below the threshold set in the TSC 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 TSC for SC.

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

In light of these considerations, the taxonomy of significantly harmful activities 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 Art. 19 (3) of the current Taxonomy; b) the activities that fail performance levels set by DNSH technical screening criteria in delegated acts where such DNSH criteria exists.

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 significant 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, nor 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, "Intermediate performance"**. The Platform notes that the Commission's newly released: '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 is committed to developing guidance on criteria for activity-specific investment plans 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 3.

The Platform stresses that this middle space naming and the overall concept of the **TRAFFIC LIGHTS FOR SUSTAINABLE FINANCE** (ref page 14), together with appropriate guidance and explanation, is 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, remaining permanently out of 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 (e.g. avoiding reputational or financial risks). This clarity is essential

to trigger activity level transition investment plans or entity level transition strategies, either within the Intermediate Performance space or the Substantial Contribution space.

The Platform notes that other EU legislation in the area of sustainable finance, such as SFDR, requires that Financial Market Participants (FMPs) on entity and fund level falling under the Regulation report on Principle Adverse Impacts (PAI). Further guidance and cross-linking between different parts of the EU sustainable finance architecture is 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.

5.3. Activities with no technological possibility to transition away from significant harm

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 transition to a low-carbon, environmentally sustainable performance level.

Adequate attention will need to be given to identify other such activities for which there is no technological solution that allows 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.

While the impact of both types of SH-activities may be equally harmful in principle, they differ in terms of future perspective: while the former can only be decommissioned, 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 SH space, and continues to stay out of that SH space (an activity-specific investment plan) could target SC or Intermediate performance level..

Clarification of this important difference, along with the establishment of a list of activities which cannot improve their environmental performance to avoid significant harm, has the advantage that appropriate planning can be made by public and private actors 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 loom nearer.

Such plans may also be relevant in the future for activities included in the green taxonomy where the company or operator chooses the closure option as part of their transition strategy

and identification of these activities does not pass any comment on what type of finance should be used to pay for such closure. Any such transition strategies including decommissioning/closure, be they public or private, must comply with minimum safeguards and must in parallel also carefully consider Just Transition-type measures and take account of policies, such as the EU Just Transition Mechanism.[6]

5.4. Transitions and Intermediate Performance levels

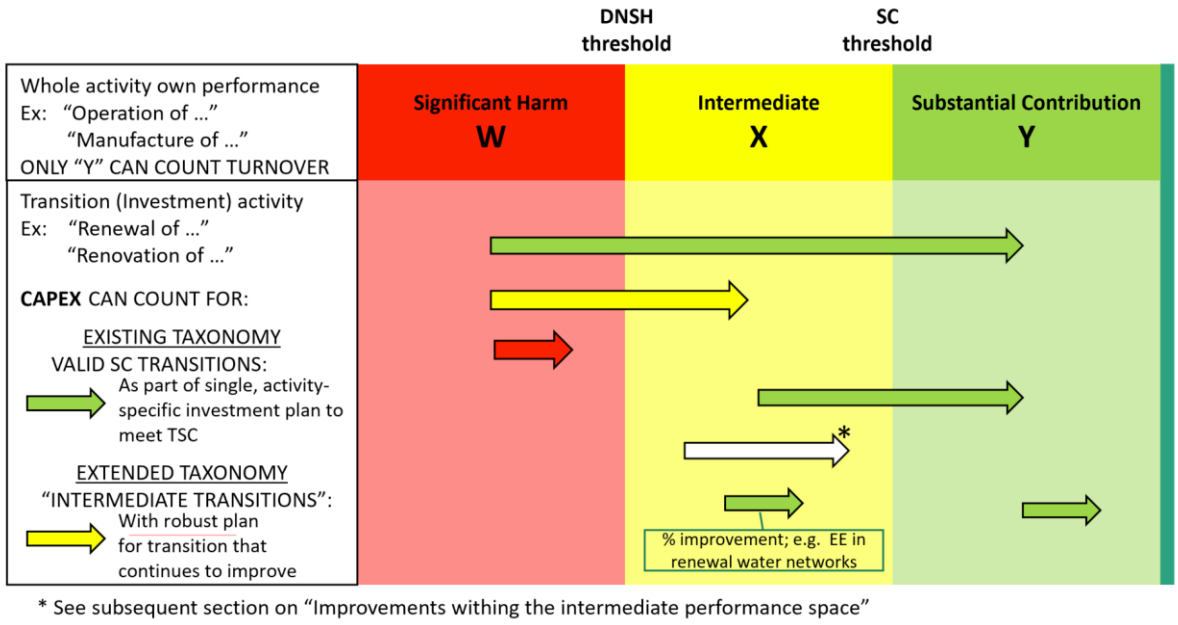


Figure 4. Performance levels and transitions

Figure 4 illustrates different types of transition between levels of absolute performance for an activity included in the Taxonomy. Any transition into SC levels of performance can count as green: the 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 current Taxonomy and are shown above as **green** arrows. But what about the other transitions represented by the red, amber and un-coloured (white) ***** arrows?

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

Most activities that perform at a significantly harmful level do have the potential to transition out of the space where their environmental performance continues to cause significant harm. If SH defines a damaging level of environmental performance, then any movement out of this performance level and staying out of this performance level must be a 'valid' transition. 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 improvement, the activity is still causing Significant Harm and hence undermining that objective. The latter improvement is indicated by the **red** arrow.

The Platform notes that whilst transitions into Substantial Contribution 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 into the Intermediate Performance space while considering the dynamic nature of the Taxonomy.

The Platform considers that capital and operational expenditures that lead economic activities with a starting point in the SH performance space, to improve and move into the Intermediate Performance space (IP, between SH and SC), and to remain there in a stable way, should be recognised by an extended taxonomy. This is provided there is a credible and robust activity-specific and time-bound transition plan to continue to improve performance, and these improvements in environmental performance levels are adequately monitored. The Platform is working to better qualify the requirements to which such activity-specific Intermediate transition plans and associated capex/opex must comply. See Table 3 for an overview which provides additional information and initial thoughts on guidance in relation to Intermediate Transition and related activity-specific investment plans.

Table 3 Requirements of a robust plan (initial Platform ideas)

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 IM	Yes	No
Validation	Yes (Art 8)	Yes (Art 8)
Transparency	Yes (Art 8)	Yes (Art 8)
Part of overall transition plan	Yes	No

Table 3 highlights similar requirements on Intermediate capex, as for the capex aimed at reaching Substantial Contribution. This latter is further elaborated upon in the Taxonomy article 8 Delegated Act. However, there are some important differences when considering a transition out of Significantly Harmful to Intermediate Performance:

First, crossing the boundary between SH and IP may follow a different logic than from IP to SC depending on sector and objective. It will be important to provide clear guidance on requirements for clearly crossing the boundary based on the type of TSC (quantitative or qualitative). For quantitative TSC where the criteria are expected to move towards zero, there ought to be a plan for continuous improvement to, over time, reach Substantial Contribution. It may also be relevant for companies to provide the argument for not meeting the Substantial Contribution in the activity specific Intermediate transition investment.

Second, in order to make the activity-specific investment plan credible, there is a need to put it in the context of the company's wider transition ambitions. Such plans are expected to be a part of the CSRD.

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 finance for investments for moving out of SH would in practice mean finance for 'stopping breaking the law'. This is clearly not the same as financing 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 substantial contribution to, or undermining of, six environmental goals. The Platform's view is that the issue of whether some transitions out of SH performance space are moving from an illegal to legal status cannot be addressed in the Taxonomy and would need to be addressed elsewhere in a legal framework. From a purely taxonomy perspective, the environmental impact is the same and the Platform believes these transitions should be included in the extended Taxonomy..

Concern has also been registered that simply getting out of SH space should not be rewarded as it is not a sufficient transition. These points are still under discussion by the Platform, but three points may mitigate these concerns:

i) A requirement on continued improvement to lower the risk of "falling back" into SH space that might occur without further improvements, as the DNSH/SH criteria tighten. This is still under discussion within the Platform.

ii) The market should continue to prioritise and incentivise 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.

iii) For some objectives, the change from SH to Intermediate performance is a very major and substantial shift, not represented by a smooth "falling curve". One example of this kind is avoiding Significant Harm to the biodiversity objective where DNSH is to avoid doing irreversible harm to biodiversity and ecosystems. Another example is avoiding Significant Harm 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 incentivised even if the activity cannot reach green performance.

Improvements within the Intermediate performance space

Additionally, some activities with a starting point in the Intermediate space, may make a "significant improvement", but remain in the intermediate performance space, these improvements in environmental performance levels may also, under particular circumstances, be seen as a valid transition. This is provided there is a robust activity-specific transition plan to continue to improve performance, and that any significant improvement in environmental performance levels will be monitored. There are a number of questions to be further analysed on these types of environmental improvements and because no recommendation is yet made currently on these – they are represented by an uncoloured arrow marked with * in Figure 4.

The Platform will continue to work on determining whether these significant improvements should be pursued as a generic and important transition for all activities, or whether these should, as they are currently, be addressed case by case, activity by activity and when found to be a special case where they can be identified as making a substantial contribution in achieving environmental goals, identified in the Taxonomy. In those particular cases, they would hence become part of the green arrow within the amber space.

The case-by-case approach mentioned above, is applied 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 SC criteria for the whole activity has not been defined. In this instance, TSC for a specific improvement activity might be included in the green taxonomy, making it a green activity. Such particular activities could be

described as “Renewal of…”, “Renovation of…”, “Rehabilitation of…”, “Environmental improvement of…”, and could follow the approach that has already been set for some activities in the CC Mitigation taxonomy, which effectively define green investments/Capex, e.g. **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, is another option for expanding the range of transition finance possibilities without changing existing legislation.

Reporting

Reporting by companies 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 companies develop clear activity-specific transition plans and access finance for those transitions in a very clear and transparent way, less subject to individual views of shareholders or stakeholders. It may have the same use in entity-level strategies to address these SH performance issues. The Platform has noted through its outreach that some companies 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 de facto provide ways of describing transition finance other than green, thereby supporting 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-like approach. The Platform highlights that a performance level of SH to CC Adaptation should not be seen as less serious than the others, but it may need to be addressed slightly differently.

Examples

This report makes the case for a category of ’Intermediate Transitions’ to improve performance away from significant harm, although not yet reaching Green performance for a given activity. Two potential cases for an **Intermediate Transition** are shown on the following pages.

Potential Case for an Intermediate Transition:
Production of Electricity from Gas (not exclusive to natural gas)

According to the Taxonomy Regulation Article 19, technical screening criteria should be technologically neutral and therefore, any electricity generation technology can be foreseen to be included in the taxonomy. The already adopted DA criteria for power generation state that, 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 declining threshold given by the Substantial Contribution Technical Screening Criteria for climate change mitigation: 100gCO2/kWhe and meet other Taxonomy requirements. The Long Term GHG emissions development strategy of the EU and its MS, submitted to the UNFCCC in March 2020 as per Article 4, paragraph 19 of the Paris Agreement, sets the objective of achieving a climate-neutral EU by 2050 and this is cross-referenced in the Taxonomy Regulation.

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 decarbonize (ref Section 2.3 and Figure 2.3 of the IEA report). In line with Article 19 of the Taxonomy regulation, a technology neutral Technical Screening Criteria for Do No Significant Harm to climate change mitigation objective has been set in the adopted DA, as 270gCO2/kWhe. This creates a middle space of environmental performance for the electricity production sector between 100g and 270gCO2/kWhe. Existing natural gas CCGT or CHP CCGT plants operating at higher than 270gCO2/kWhe would be doing Significant Harm (SH) to the climate change mitigation objective and it is important that a clear transition pathway can be supported by access to finance for the necessary investments to bring the emissions below the SH threshold and to stay below it.

Technological possibilities for transition may be foreseen through turbine conversion or replacement, moving to blended natural gas-green hydrogen and ultimately 100% green hydrogen, bio-methane or other synthetic liquid fuel produced using electricity generated from renewable energy sources and/or installing CCS technology.

In the case of an existing natural gas facility, the following transition pathway could potentially be seen as an **'Intermediate Transition'**: upgrading the plant for natural gas-hydrogen blending, up to operationally/legally feasible levels (perhaps up to 20% and/or possibly installing CCS technology) to reduce emissions from say 350g to below 270gCO2/kWhe. This could be categorized as an **'Intermediate Transition'**. Key components would need to be hydrogen ready, but could still run mainly on natural gas for a certain time. Turbines for 100% hydrogen are not yet commercially ready. In order to stay at an intermediate performance level. further improvements would be needed as the SH threshold is revised every 3 years towards net-zero. In order to meet current criteria for Substantial Contribution (<100 g CO2/kWhe), would require high heat offtake & probably >50% hydrogen blending. When 100% green hydrogen is available at scale, the plant could be upgraded or replaced.

(1) Fraunhofer ISE (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)

Potential Case for an Intermediate Transition:
Manufacture of steel

According to the latest industry de-carbonisation roadmap for carbon-neutral steel making in Europe(3) and analysis by the EC(4), no one technology will be able to deliver the required sector 80-95% GHG reduction targets by 2050. This transformation will require some €52 billion in investment. Several of the investments required will not immediately allow reaching the Substantial Contribution criteria for a transitional activity as set-out in the adopted Delegated Act as this is based on the average value of the 10% best performers in the EU under the EU Emission Trading System (ETS).

Meeting the targets will rely on future availability of green hydrogen and involve intermediate combinations of "smart carbon" and "carbon avoidance" (CDA) among other technologies. 'Smart Carbon' are technologies that are able to (partially) replace use of fossil coal in the iron and steel manufacturing processes, e.g. with biomass or renewable power. They have higher Technology Readiness Levels (TRL) and introduced into current production assets depending on the right legal framework to prevent carbon leakage. However, they are unable to achieve the level of de-carbonization for 2050 CO2 targets, e.g. typically only delivering 15% CO2 reduction. Some of the 'smart carbon' technologies reduce carbon over the exported waste gases, which are not counted in the ETS benchmarks that define SC for climate change mitigation in the Delegated Act. CDA technologies are hydrogen based, which have lower TRL and would replace current production assets. CDA technologies allow much deeper de-carbonization. However, they rely on availability of green hydrogen at affordable cost, and again with leakage risk.

Blue hydrogen might be used until enough green hydrogen is available and, 'smart carbon' or other innovative technologies could be combined with carbon capture and storage (CCS) to reach deeper decarbonisation for example. Thus an **'Intermediate Transition**' that moves steel production at a specific site out of Significantly Harmful 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 and life-cycle assessment is done.

(3) EUROFER (2019). LOW CARBON ROADMAP - PATHWAYS TO A CO2-NEUTRAL EUROPEAN STEEL INDUSTRY.

(4) EUROPEAN COMMISSION (2021). Towards competitive and clean European steel. COMMISSION STAFF WORKING DOCUMENT SWD(2021) 353 final Brussels, 5.5.2021.

5.5. Implementation options

Although the Taxonomy regulation incorporates principle building blocks for a future extended taxonomy of both a SH-space and Intermediate space through the three performance levels that have been described above, the current regulation does not allow for creating any other category of activities than "environmentally sustainable economic activities, as per Article 1 and 3. Additionally, the type of reporting required 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 the 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 Renewed Sustainable Finance Strategy, 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 the SH Taxonomy can be implemented should be evaluated, considering the effectiveness, timing and possible side effects of the different alternatives.

For this reason, the Platform's interim recommendations on SH can be articulated under two non-mutually exclusive options:

- Option 1: building on the current framework, i.e. what may be possible to develop in the context of the current Taxonomy regulation (without opening Level 1 legislation), primarily through a guidance document, and through appropriate activities being included into Taxonomy related DAs, being mindful of possible unexpected consequences of any guidance;
- Option 2: during a revision of the Taxonomy Regulation, i.e. what may be possible under the hypothesis that the Taxonomy regulation can be reopened to include new categories of economic activities causing significant harm and performing at intermediate level.

According to the Platform, when comparing alternative options it must also be considered that any announcement (either within a Guidance issued by the Commission or an initiative to change Level 1 legislation) that the Do No Significant Harm criteria in the delegated acts **technically** define Significant Harm performance level carries the risk of unintended consequences if not accompanied by a framework for supporting the decommissioning of harmful activities which cannot qualify as environmentally sustainable economic activities by nature (Art. 19(3)-type activities) and the transition of those activities which do not comply with DNSH.

Such supporting framework should be based on existing measures and financial incentives (e.g. in the EU Budget, Modernisation Fund and Recovery and Resilience Facility) but will probably also require other appropriate measures and incentives. The supporting framework needs to be implemented as soon as possible and in parallel with a taxonomy SH-extension to ensure that both the advantages are harvested while potential unintended consequences are minimized.

The framework should provide companies with a range of options for accessing finance for their transition plans in the context of an extended taxonomy.

6. NSI activities

6.1. Why extend the taxonomy to NSI activities?

During outreach events with a broad variety of public and private stakeholders in February and March 2021, a number of arguments in favour and against an NSI taxonomy were heard. Below is a summary of the key arguments for and against a possible NSI extension raised by stakeholders. This chapter should be viewed as a summary of feedback rather than the position of the Platform, which is presented in the following chapter.

Arguments for an NSI extension

A. Provide comfort

A non-significant impact taxonomy may provide comfort to non-financial and financial companies by explicitly defining and tagging those activities. By doing so, access to finance might be supported for those economic activities, and increased financing cost avoided.

For financial companies that want to deprioritise financing harmful economic activities that are not transitioning, a non-significant impact taxonomy might provide better clarity surrounding available investment opportunities. The same may be the case in relation to procurement decisions (for example by tier 1 companies) by showing non-significance of an economic activity in terms of environmental objectives.

An NSI taxonomy could also be combined with a minimum environmental certification at organisation level to provide clarity to taxonomy users that funding and reporting of green investments (Capex) of any other activity in the Taxonomy would be appropriate without caveats on the underlying company's purpose, and can be encouraged.

An NSI taxonomy can also provide clear confirmation that an activity is currently viewed as non-significant, whether carried by a private or public entity, which moves it from an ineligible activity (with unknown impact) in the current Taxonomy framework to a known (and low) impact category under an extended taxonomy. This shift provides users of the Taxonomy with more information surrounding non-significant impact activities to inform decision-making.

B. Lower transaction cost

Easy access to a non-significant impact inventory with low impact economic activities may help quick and cost-efficient assessment, in particular by financial actors. If this is not available, they would either have to perform their own analysis, or find out if an economic activity would fall under the Taxonomy regulation in its current form or under a potential significant harm taxonomy. Lack of public access to aggregated economic activities' data at the company level may be a significant obstacle for those financial actors without direct access to or leverage on their investee / financed companies.

A single definition of non-significant impact economic activities may support comparability and ease of understanding by financial actors and supervisory authorities. Delineating non-significant impact economic activities from intermediate performance of taxonomy activities would also contribute to clarity in distinguishing between these two categories.

C. Simplify communication and reporting between Taxonomy users

An NSI taxonomy would add nuance to the Taxonomy and enable simpler communication between Taxonomy users regarding the mix of different activities an organisation 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 no significant impact provides additional information to investors seeking to reduce investment in activities which may pose a Significant Harm risk.

Example of the impact on reporting of a potential NSI extended taxonomy

- **Portfolio A with 15% significant contribution and 5% NSI share**
- **Portfolio B with 10% significant contribution and 25% NSI share**

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

With an extended taxonomy, portfolio manager A will show a combined share of 20%, while portfolio manager B will show 35%. (A < B)

An enhanced understanding about portfolio transition risk is an important focus of financial markets' supervisory authorities. Having insight regarding the non-significant impact economic activities' share in lending and investment portfolios will provide additional nuance to risk

assessment as higher transparency about the environmental performance of financial products plays an increasing role in assessing market stability. The average risk-return profile of investment portfolios will likely require diversification beyond economic activities that substantially contribute the EU's environmental objectives. Thus, a non-significant impact taxonomy would enhance transparency surrounding financial instruments' overall performance by classifying the complete set of underlying assets. This additional nuance may also help Member States when implementing actions under Article 2.1 (c) of the Paris Agreement, which addresses aligning financial flows with the agreement goals.

Arguments against NSI extension

A. Lack of sizeable actual NSI activities

Further in-depth analysis is needed on a four-digit level to map economic activities that fall under the NSI definition.

However, one may hold up the view that all economic activities will have to adjust to climate change. Thus, expenses related to substantial contribution to climate change adaptation are relevant for all economic activities. In case the NSI definition of non-significant impact is amended accordingly, i.e. not counting economic activities as non-significant impact that in theory have the potential to contribute substantially to climate change adaptation, non-significant impact economic activities would be non-existent.

B. Low priority

As soon as a significant harm taxonomy as well as future activities that are likely to be included in the taxonomy are defined alongside the current environmentally sustainable green taxonomy activities, non-significant impact activities could be assumed as residual activities.

From a perspective of supporting transition, developing a significant harm taxonomy will likely have a higher potential by highlighting economic activities that are still significantly harmful and need to transition. According to this argument, a non-significant impact taxonomy should thus be deprioritised.

C. Non-significant impact already part of financial sector due diligence

The benefit of a non-significant impact taxonomy compared to market led ESG labelling may be limited as financial market participants already identify investments that they consider low environmental risk.

As part of their due diligence process, banks, insurers, and financial investors make their own judgement regarding environmental risks.

A non-significant impact taxonomy might have the unintended consequence of the financial market relying on a binary taxonomy classification for an activity (i.e. NSI or not NSI) rather than performing its own due diligence based on the specifics of a particular activity, under-taking and context.

D. The Taxonomy is already too complex

The current Taxonomy is still being implemented and adding further definitions and labels may introduce too much complexity into the market. An NSI taxonomy could overload an already fast-moving and complex sustainable finance architecture, suggesting additional reporting when current Taxonomy reporting is not yet in force. As a result, the cost-benefit ratio of an NSI extension may not be favourable.

E. Non-significant impact activity “greening” might be implemented in other ways

The logic of the taxonomy argues against NSI activity revenues being counted as green. Only the capex/opex expenditure of the entities that conduct those activities for certain green transversal measures (e.g. buildings, energy efficiency) may count. What might be covered by a NSI taxonomy, could alternatively be addressed by (a) developing common criteria for DNSH in low impact activities so that the economic actors that conduct activities not included in either the SH nor the Green Taxonomy can claim, for example, green capex/opex expenses;; and (b) including criteria within the Green Taxonomy for “green services”, for example for green financial advisory to green engineering services, so that such entities can count their revenues derived from those activities.

6.2. Definition

The Platform stresses that a potential category of activities with No-Significant Impact (NSI) to the six environmental objectives is **NOT** the same as the category of Intermediate environmental performance between SC and SH in the current Taxonomy. This misconception is common and needs to be countered with appropriate guidance.

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

NSI activities are those economic activities which:

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

   AND

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

   OR

c. are already included in Annex II of the climate DA as potentially substantially contributing to climate adaptation, AND have no criteria set (N/A) for causing significant harm to any of the other five environmental objectives.

The published climate Delegated Act Annex II for adaptation activities includes several service sector activities that might have been expected to be part of an NSI taxonomy, such as ***11. Education*** and ***13.2. Libraries, archives, museums and cultural activities***. In the Delegated Act, the DNSH criteria for environmental objectives other than adaptation are set to N/A. The fact that such low impact activities are already included in the adaptation taxonomy needs to be acknowledged when developing a definition of NSI activities.

This precedent set by the Commission suggests that one approach to introducing an NSI taxonomy would be to develop NSI generic criteria for SC to CC Adaptation (or other objectives such as circular economy or mitigation), and hence include such low impact activities into the existing green taxonomy.

6.3. How material are NSI activities?

Applying the definition above, a preliminary analysis by the Platform of economic activities defined at NACE-2 (noting that there is no direct relationship between NACE code activities and the definitions of activities in the Taxonomy) found that the scope of activities likely to qualify as NSI represents a significant portion of the EU economy. It includes most NACE-2 activities in macro-sectors J-U, predominantly in the service sectors. The economic relevance just for those sectors where data was (easily) available at NACE-2 is significant, representing approximately 25% of value added and employment and 35% of the number of enterprises in the EU economy.

Further, potential NSI sectors account for a very large proportion (>90%) of SME and micro-enterprises (less than 10 employees), a factor which needs to be considered when designing appropriate reporting mechanisms.

This confirms the materiality of NSI activities and deserves further analysis at NACE-4 level by the Commission to identify all activities not yet covered or not planned to be covered by the green or extended SH taxonomy, due to their low environmental impact on aggregate.

The Platform considers that any requirement for minimum environmental certification in NSI activities should take account of different sizes and hence capabilities of companies, and in particular should be extremely light for micro-enterprises. Conversely, large entities, even in NSI space should be asked to achieve a good level of certification such as EMAS. The Platform plans to work further on this question.

6.4. Options considered

The Platform considered the pros and cons of three options for an NSI taxonomy extension:

- **Option 1** – Establishing an NSI taxonomy based on pro-active identification of activities;
- **Option 2** – Deprioritising the establishment of a non-significant impact taxonomy until the current and the significant harm taxonomies have been established and used in practice for a number of years;
- **Option 3** – Reject the establishment of an NSI taxonomy.

On the basis of a preliminary materiality analysis and assessing the pros and cons of each option, the Platform sees merit in option 1 to extend the Taxonomy to include NSI activities. The counterfactual is that if an NSI taxonomy classification were not established, an important part of the EU economy not causing any harm to the environment would be unable to distinguish itself from those with environmentally harmful activities. For financial market participants, an NSI 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.

6.5. Implementation

In terms of implementation, the Platform considered three options:

(i) **Without amending the Level 1 Taxonomy Regulation**. Introducing a category including a list of NSI activities within the Adaptation Delegated Act without the requirement to change the Taxonomy Regulation. This could be an option involving grouping economic activities included in Annex II (climate change adaptation) with DNSH criteria equal to N/A not applicable, AND that are not included in Annex I (climate mitigation), together with those low impact activities identified through the materiality assessment discussed above.

(ii) **Amending or adding an additional element to the Taxonomy Regulation**, e.g. by analogy to Art 17. An additional article or subsection could define non-significant impact economic activities, called 'non-significant impact on environmental objectives'.

(iii) **Introduce non-binding Level 3 guidance.** The Platform could prepare non-binding guidance on NSI activities which could be published by the Commission for voluntary use by Taxonomy users. Such guidance would set out the types of activities which could be considered as potentially having no significant impact and how to assure basic levels of environmental performance.

The Platform notes the advantages of option (ii) to amend the Taxonomy Regulation to provide a straightforward and easy to understand definition of the No Significant Impact concept and lists of NSI activities.

The alternative of introducing an NSI extension 'indirectly' by creating a list of NSI activities under the Adaptation Delegated Act Annex II has limitations as a long-term solution, although it could be considered as an interim step. Firstly, there is a need for greater transparency by giving such low impact activities a clearly defined status within the overall Taxonomy framework, and secondly because including NSI activities in the green taxonomy with an SH extension would recreate the risk of confusion between Intermediate performance and NSI activities. Lastly, this option would not contradict any later inclusion of an activity into the green taxonomy, if this were to arise, as the activity could be taken off the NSI list at the same time as a full taxonomy fiche was created for it.

7. Further work

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

i) Outlining reporting and disclosure options for an extended taxonomy.

ii) Further details of a robust activity level transition plan focussed on moving out from SH performance level and continuing to improve to stay out of SH space, together with recommendations on monitoring.

iii) Further consideration on whether a generic, or case by case, approach is required for transitions making significant improvement within the Intermediate performance space and development of any subsequent recommendations (uncoloured arrow marked ***** in Figure 4.).

iv) Further consideration on how SH to CC Adaptation might be addressed differently from the other five objectives in such transition plans.

v) Further usability assessment for a NSI extension that incorporates dimensions flagged in the pros and cons sections of this report.

vi) Further consideration on how to establish NSI, including recommendations on what would be appropriate reporting and how it would affect already determined KPIs such as GAR or GIR currently recommended in the Article 8 DA.

vii) The possibility of a Platform guidance document to precede the recommended changes to the Taxonomy Regulation in order prepare the expansion of the taxonomy framework to NSI activities and start to identify NSI activities in a robust way.

viii) Considerations on pros and cons of minimum environmental certification in NSI.

ix) 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.

x) Considerations on the essential parts of a framework for supporting the decommissioning of harmful activities which cannot qualify as environmentally sustainable economic activities by nature (Art. 19(3)-type activities) and the transition of those activities which do not comply with DNSH. Identification of gaps in current provisions and advice on further measures necessary to support these urgent transition activities.

8. Interim Platform Recommendations

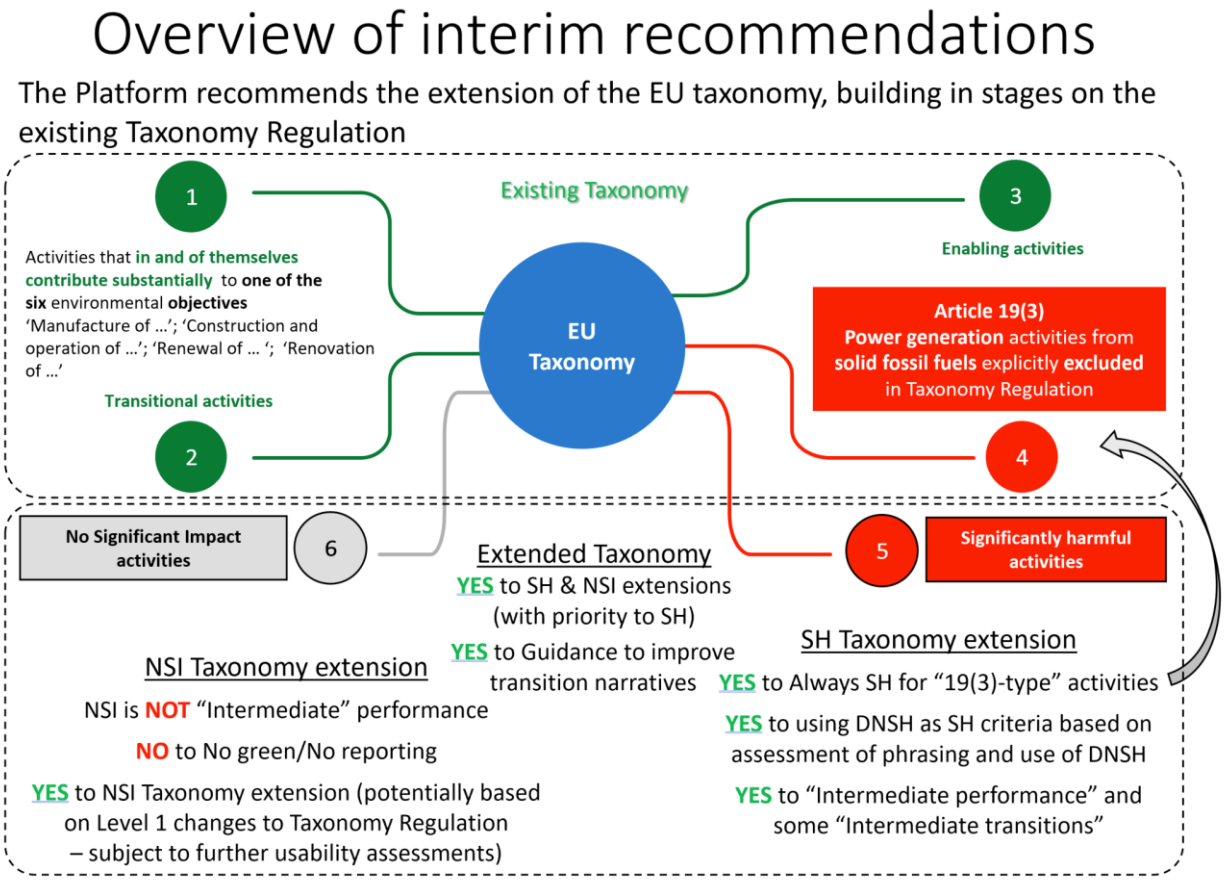


Figure 5. Overview of Interim Recommendations

General Recommendations

Extend the Taxonomy with priority on an SH-Extension

Recommendation 1. In response to the mandate given to the Platform in relation to Art 26 of the Taxonomy regulation, **the Platform recommends that the EU Taxonomy should be extended, with a priority given to an extension towards activities causing significant harm. An extended taxonomy will allow a wider coverage and recognition of activities with different performance levels, including intermediate and no-significant impact (NSI) activities. Further, it would help to provide a positive label for investments to move activities out of significant harmful performance.** This should be done in stages, building on the existing Taxonomy Regulation, and accompanied by an appropriate supporting transition policy framework.

Extend the Taxonomy with a transition focus and supporting policies

Recommendation 2. Noting the urgency and substantial investment needs over the present decade for meeting EU climate and the environment objectives, **the Platform recommends that the extended taxonomy must be part of a wider set of EU policy and legislative initiatives aimed at incentivising finance for urgent transition away from significantly harmful activities, along with building climate-resilience and supporting a greening of the whole economy.**

Define key parts of an SH-Taxonomy

Recommendation 3. The Platform stresses that the current Taxonomy framework already defines three levels of environmental performance and that failing Do No Significant Harm (DNSH) criteria is technically equivalent to causing SH.

Recommendation 4. 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 Art. 19 (3) of the current Taxonomy.

Recommendation 5. The Platform recommends that economic activities failing Do No Significant Harm (DNSH) criteria and those for which no technological possibility of improving their environmental performance exists are jointly considered as significantly harming environmental objectives from a technical point of view.

Naming the Intermediate Performance space

Recommendation 6. The Platform recommends that **the Commission names the middle level of environmental performance** (between SH and SC) **of economic activities "Intermediate Performance".** The Platform is against creating any further sub-divisions of performance levels.

Aim for rapid extension when the Taxonomy regulation is revised

Recommendation 7. Given the urgency to transition out of SH performance levels, **the Platform recommends that after a decision on an extended SH taxonomy is made, phasing in is rapid – aiming at first reporting by 2023. 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.

Recommendations regarding an SH taxonomy – not requiring amending the Taxonomy regulation

Technical assessment of DNSH-criteria for clarifying SH- 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 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: stock-take of current market practises, a review of the formulation of criteria where needed, i.e. existence and adequacy of the wording of DNSH criteria for avoiding significant harm and definition of the resulting intermediate performance space.

Define intermediate transition, corresponding investments and plans

Recommendation 9. Certain activities with SH performance level that significantly move into the intermediate performance levels with robust, monitored corporate-level transition strategies and activity-specific investment plans, should be recognised by an extended taxonomy. **The Platform therefore recommends identifying an additional type of transition for activities moving out of SH performance that do not meet the criteria for SC, to be called "Intermediate Transitions" with "intermediate transition investments" (capex) as a reporting KPI for financial products.** The Platform highlights that these are not SC, or green activities, but that identification of this type of transition will improve clarity and understanding in the transition finance market. **The Platform recommends that the Commission issue non-binding guidance to corporates, FMP and other Taxonomy users, on the use of SH and intermediate performance levels for informing activity-specific investment plans and transition narratives.**

Technically identify and develop criteria for significantly harmful activities which may not be able to reach a substantial contribution level

Recommendation 10. As suggested in the Platform's Transition Report, it is recommended to **develop technical screening criteria for potential "decommissioning/ closure of…"**

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 it may be possible to add "Decommissioning of…" in the next Delegated Act, similar to the 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.

Concerning a No Significant Impact taxonomy extension:

Recommendation 11. The Platform highlights the advantages of **establishing a no significant impact (NSI) taxonomy by pro-actively identifying activities that are characterised by a high likelihood of not being covered by the existing green taxonomy for substantial contribution nor by a significant harm taxonomy extension, with the exception of climate change adaptation objectives which should apply to the whole economy**. 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. This would help to create a category of low impact activities to support businesses to proactively show that they are not harmful. Such activities could be readily identified and would mostly fall into the NACE codes in macro-sectors J-U. This would also possibly include some light manufacturing activities with a high likelihood of very low environmental impacts, based largely on manual labour, for example, and with very low material throughput and resource consumption, i.e. other than human resources.

Identify potential NSI activities based on NACE-4 analysis

Recommendation 12. The Platform **recommends that the Commission carry out an in-depth materiality analysis at NACE-4 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 NSI activities.**

Ensure minimum standards and reporting for NSI activities

Recommendation 13. The Platform notes that to enable the reportng of NSI activities, it would be necessary to introduce **a requirement for companies to participate in a labelling / certification process (such as EMAS) that ensures minimum environmental performance as a prerequisite to reporting NSI activities**. However, micro-enterprises should qualify for NSI using a simplified approach that both links to the economic activity and is compatible with the forthcoming simplified reporting standard for SMEs under the CSRD.

Develop Guidance to clarify how NSI activities can access green finance

Recommendation 14. The Platform believes it would be necessary to **issue guidance on the existing Taxonomy to make clear that 'green' capital expenditure and related operational expenses made by enterprises operating in NSI activities could clearly qualify for green finance, for example through building renovation activities, buying electric vehicles, shifting to an organic local food supply and installing rooftop solar PV panels.**

Implementation of an NSI extension

Recommendation 15. In line with the recommendations with respect to an SH extension, which will require an amendment to the Level 1 Taxonomy Regulation, the Platform notes that amending **the Taxonomy Regulation to provide a straightforward and easy to understand definition of the No Significant Impact concept and NSI activities would also be necessary**. The alternative of introducing an NSI extension "indirectly" by creating a list of NSI activities under the Adaptation Delegated Act Annex II has limitations as a long term solution both due to lack of transparency and because it fails to give such low impact activities a clearly defined status within the overall Taxonomy framework. This approach might be explored further however as an interim step.

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.

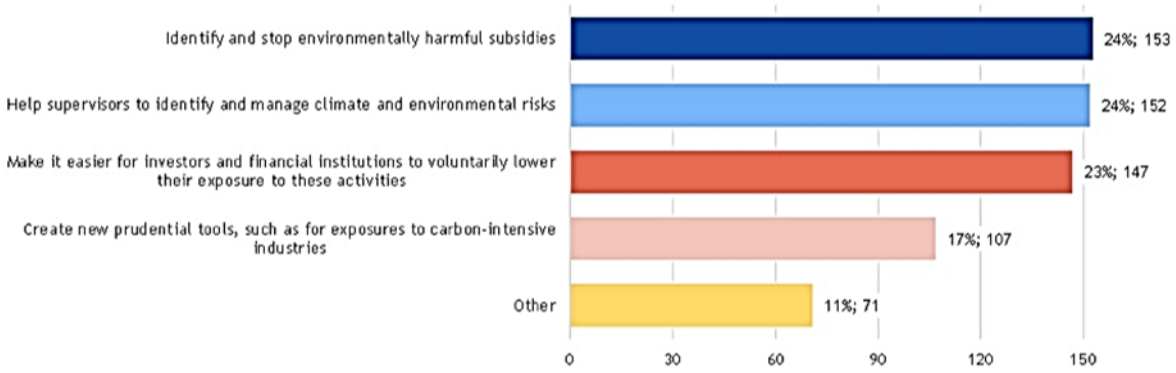
- Non-financial corporates in favour of an SH + NSI extension applying consistent criteria to their entire portfolio of activities in order to get a 'whole business' view of their transition needs.
- SMEs concerned that it would place a higher reporting burden on them indirectly from banks, their main source of finance, and requesting simplified reporting rules for smaller entities.
- Financial market regulators are in favour of a more granular SH + NSI 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 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

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 an NSI 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:



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[7]

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;

[7] 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

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 'do no significant harm' (DNSH) referred to in point of Article 2.17 of the SFDR (EU) 2019/2088.

The Technical Annexes to the TR 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 TR DA Annexes 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 TR 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[8] (C(2021) 1054 final), DNSH is to be interpreted within the meaning of Article 17 of the Taxonomy Regulation.

No Significant Impact (NSI)

The concept of NSI does not appear in the TR 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.*

Although not defined, the concept of NSI 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.

[8] C(2021) 1054 final

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.*

SFDR and CSRD

SFDR and Principle Adverse Impacts (PAIs)

The Disclosure Regulation[9] (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.[10] In addition, 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. EBA, EIOPA and ESMA (collectively, the 'ESAs'[11]) 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 ESAs, 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 RTS for the SFDR recognises that PAIs are looking at negative impact comparable to failing DNSH criteria from the TR. The PAIs are identified at asset level (e.g. share in a company), whereas the DNSH criteria are looked at from an activity level.

An extended taxonomy, in particular an SH-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

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[9] 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

[10] Art. 2 (17) SFDR

[11] 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

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 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 TR can facilitate SFDR disclosures

Next to the connection points on the precautionary principle, the TR, including an extension to SH and NSI, can offer an assortment of objectives to use for SFDR Article 9 products. The SFDR Article 9 covers financial products with sustainable investment as an objective and shall include information on how the objective is to be attained. Here, the TR 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 NSI 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.

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 TR and the CSRD

Article 19a of the CSRD 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 TR 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 NSI taxonomy to be useful in this regard, as a NSI taxonomy can help rule out significant impacts in both directions. The interlinkages continue throughout CSRD, 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[12] 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

[12] 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.

habitats, damage to water and damage to soil.[13] 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[14] as well as investments that are more damaging to the climate, are assumed to be riskier.

Do No Harm Principle

The Green Deal identifies a "green imperative" in chapter 2.2.5, which expands and strengthens the DNSH principle "Do 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

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[13] 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').

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

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.”15

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