

## FREQUENTLY ASKED QUESTIONS

### Commission Technical Expert Group on Sustainable Finance

This document contains answers to **frequently asked questions** regarding the work of the Technical Expert Group on Sustainable Finance (TEG) and the legislative proposals that frame their work.

#### CONTEXT

On March 8<sup>th</sup> 2018, the Commission launched its Action Plan on Financing Sustainable Growth. The Action Plan has three objectives:

- reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth;
- manage financial risks stemming from climate change, environmental degradation and social issues;
- foster transparency and long-termism in financial and economic activity.

In May 2018, the Commission adopted a package of measures implementing several key actions announced in its [action plan on sustainable finance](#). The package includes three key legislative proposals:

- A [proposal for a regulation on the establishment of a framework to facilitate sustainable investment](#). This proposed Regulation establishes the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity.
- A [proposal for a regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive \(EU\)2016/2341](#). This proposed Regulation introduces inter alia disclosure obligations on how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes. Requirements to integrate ESG factors in investment decision-making processes, as part of their duties towards investors and beneficiaries, will be further specified through delegated acts.
- A [proposal for a regulation amending the benchmark regulation](#). The proposed amendment will create a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprint of their investments.

The Commission set up a [technical expert group on sustainable finance \(TEG\)](#) to assist it in the development of a unified classification system for sustainable economic activities and methodologies for low-carbon indices, but also on an EU green bond standard (Action 2 of the Action Plan) and on metrics for climate-related disclosure (Action 9).

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## **THE TEG IN GENERAL**

### ***What are the tasks of the technical expert group on sustainable finance (TEG)?***

- As outlined in the call for applicants, the group's tasks are to assist the Commission, notably in the development of:
  1. technical screening criteria for environmentally sustainable economic activities under the EU taxonomy;
  2. an EU Green Bond Standard;
  3. a category of "low carbon" indices for use by asset and portfolio managers as a benchmark for a low carbon investment strategy; and
  4. metrics allowing to improve disclosure on climate-related information.
- The work of task 1 and 3 are framed by their respective legislative proposals (on taxonomy and on low carbon benchmarks). The Non-Financial Reporting Directive and the need for the Commission to update the non-binding guidelines by June 2019 frame the work of task 4.

### ***Who are the members of the TEG?***

- An overview of the members can be found [here](#) and [here](#).
- The group consists of:
  - 32 organizations including companies, sector associations, NGOs, trade unions, universities and research institutes (Type C members);
  - Two individuals appointed in their personal capacity – i.e. experts with proven knowledge and experience in their areas of expertise, acting independently and in the public interest (Type A members);
  - One individual appointed to represent a common interest shared by stakeholders in a particular policy area (Type B member).

### ***How many applications did the Commission receive?***

- The Commission received 185 applications from 62 individuals and 123 organizations. Some organizations proposed several individuals, leading to roughly 240 individuals that needed to be reviewed.

### ***How did the Commission choose the members of the TEG?***

- The Commission applied a robust methodology in reviewing the candidates. A team of 15 reviewers from DG CLIMA, DG ENV and DG FISMA reviewed all applications. Each applicant was reviewed by a minimum of two reviewers. The most important selection criteria in the review process were: (i) proven knowledge and expertise for one of the subtasks and (ii) knowledge on the intersection between finance and the environment. The Commission has also taken into account the need for a balanced representation of relevant expertise and areas of interest, geographical distribution, gender distribution, and a sufficiently wide variety in the representation of financial and real economic actors and sectors.
- This selection process has resulted in a group of individuals with 17 different nationalities from organizations representing 16 different nationalities. Among the members, 15 out of 35 are women.

### ***Will the TEG consult with experts and industry?***

- Yes. The TEG will reach out directly to relevant experts and stakeholders to gather additional technical expertise and broader stakeholder feedback on interim deliverables.
- Each of the four tasks (subgroups) of the TEG has different timelines and needs for this consultation process. Accordingly, timeframes and procedures of expert (targeted) and stakeholder (open) consultation may vary between the subgroups. However, all plans are streamlined and can be found [here](#). The plans will be updated regularly, as more details become known.
- In addition to the consultation on interim deliverables, the Commission will launch an open public consultation on the final report(s) of the TEG. This open consultation will feed into the development of the delegated acts under the taxonomy and the low-carbon benchmarks, and any other legislative or non-legislative measure that is deemed necessary.
- To reflect the broad variety of expertise required, DG FISMA, DG ENV, DG CLIMA, and DG ENER jointly coordinate the technical expert group, while several other DGs are closely associated.

### ***Why has the Commission decided to invite several international and EU organizations?***

- The European Commission can invite certain types of organizations – such as European bodies or international institutions – directly to participate. With their particular expertise in specific areas, they can be invited as members of expert groups. In addition, the European Commission can grant observer status to certain types of organizations to contribute to the work of expert groups. Both, members and/or observers directly invited to expert groups are expected to actively contribute to the work.
- In the case of the TEG, the European Commission invited six EU bodies as [members](#): the [European Banking Authority](#), the [European Central Bank](#), the [European Environmental Agency](#), the [European Insurance and Occupational Pensions Authority](#), the [European Investment Bank](#) and the [European Securities Market Authority](#). It further granted [observer status](#) to four international institutions or national institutions representing an international network: the [European Bank for Reconstruction and Development](#), the [OECD](#), the [UNEP Finance Initiative](#) and the [Banque de France/ Network for Greening the Financial System](#).
- Indeed, taking the European bodies into account, the total number of members and observers of the TEG is 45, 35 members through the public call, six members directly invited by the Commission, and four observers directly invited.

## **TAXONOMY**

### ***About the legislative proposal***

#### ***What is a taxonomy and what has the Commission proposed?***

- A taxonomy is a classification system. Usually it takes the form of a list or a table within which specific objectives, concepts, etc. are classified.

- The Commission - through the proposed Regulation – is aiming to clarify which economic activities<sup>1</sup> can be considered environmentally sustainable for investment purposes.

### *Is there a need for this taxonomy?*

- In order to meet the EU energy and climate targets for 2030 and to ensure a transition to a low carbon- and more environmentally sustainable economic model, the EU faces an investment gap of €180bn of additional investment per year to 2030.<sup>2</sup> Attracting private capital to the activities that have the highest impact on climate is therefore key.
- However, there is currently no common understanding of which economic activities can be considered environmentally sustainable for investment purposes, which is one of the factors contributing to this investment gap.
- Financial institutions presently identify sustainable economic activities and sustainable investable assets in-house and on a voluntary basis. This is time consuming and costly, and the result is that different financial institutions use **different taxonomies**. Consequently, investors often find it too burdensome to check and compare different information for different financial products. This creates uncertainty and discouragement for investors and hampers the transition towards a sustainable economy.
- An EU taxonomy would **fill these gaps**, as it would *inter alia*:
  - create a uniform and harmonised classification system, which determines the activities that can be regarded as environmentally sustainable for investment purposes across the EU;
  - address and avoid further market fragmentation and barriers to cross-border capital flows as currently some Member States apply different taxonomies;
  - provide all market participants and consumers with a common understanding and a common language of which economic activities can unambiguously be considered environmentally sustainable/green;
  - provide appropriate signals and more certainty to economic actors by creating a common understanding and single system of classification while avoiding market fragmentation
  - protect private investors by avoiding risks of green-washing (i.e. preventing that marketing is used to promote the perception that an organization's products, aims or policies are environmentally-friendly when they are in fact not);
  - provide the basis for further policy action in the area of sustainable finance, including standards, labels, and any potential changes to prudential rules.

### *Which economic activities can be considered environmentally sustainable?*

- The proposed Regulation itself does not yet provide for such a list of economic activities. Instead, the proposed Regulation **lays down the following four conditions that an economic activity needs to meet** in order to be deemed environmentally sustainable for investment purposes.
  - The activity **must contribute substantially to one of the six environmental objectives** set out in the Regulation;
  - the activity **must not significantly harm any of the other five environmental objectives**;

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<sup>1</sup> An economic activity takes place when resources, such as capital goods, labour, manufacturing techniques or intermediary products are combined to produce specific products (goods or services). Thus, an economic activity is characterised by an input of resources, a production process and an output of products [[Eurostat – NACE](#)].

<sup>2</sup> <https://sustainabledevelopment.un.org/post2015/transformingourworld>.

- the activity **must be carried out in compliance with minimum safeguards**, mainly in terms of fundamental labour rights.
- the activity **must comply with technical screening criteria**.
- The six environmental objectives as defined in the proposed Regulation are: (1) climate change mitigation; (2) climate change adaptation; (3) sustainable use and protection of water and marine resources; (4) transition to a circular economy, waste prevention and recycling; (5) pollution prevention and control; (6) protection of healthy ecosystems.
- The taxonomy, once developed, will be a list of economic activities that can be considered environmentally sustainable for investment purposes. For the environmental objective climate change mitigation, the activities that would qualify are expected to contribute substantially to the transition to a low-carbon economy and to reaching the goals of the Paris Agreement.
- To determine whether an activity can indeed be considered to contribute substantially to one of these objectives while not significantly harming the other five, technical screening criteria are needed. The technical screening criteria **allow being more precise and granular in determining which activities in a given economic sector would qualify as sustainable**.

Concrete examples will help to clarify why these technical screening criteria are needed:

- **Contribute substantially:** For the first environmental objective ‘climate change mitigation’, an economic activity could qualify for example, if that activity substantially contributed to the stabilization of greenhouse gas concentrations in the atmosphere at a level, which prevents dangerous interference of human activities with the climate system. In short, such economic activities must avoid or reduce GHG emissions. Technical screening criteria are needed to determine precisely when activities within a sector would qualify as environmentally sustainable. For climate change mitigation, these thresholds may for example take the form of GHG emissions limits. However, the respective qualification will depend on the economic sector and many sectors will need to undergo reforms to arrive at a path that is in line with the Paris Agreement.
- **Do no significant harm:** While contributing to one environmental objective, the activity must not significantly harm any of the other five environmental objectives. For example, some climate change mitigation activities may have an effect on local flora and fauna due to changes in water flows or land use. Technical Screening criteria (qualitative – and if feasible quantitative) are needed to determine when this effect on flora and fauna would be significant. For the condition ‘Do no harm’, the TEG will identify areas of potential significant harm to each environmental objective (so called ‘hot spots’) by priority of concern. Where no hot spot is identified for an environmental objective, this means that no significant harm is expected.

### *How will technical screening criteria be developed?*

- The proposed Regulation lays out among others, several requirements for the development of the technical screening criteria. They need to:
  - be based on scientific-evidence;
  - contain thresholds where possible;
  - build on relevant Union (environmental) legislation, such as labelling and certification schemes and methodologies for assessing environmental footprint (including the on-going work on Product and Organisation Environmental Footprint).
  - ensure that activities are treated equally if they contribute equally towards one or more environmental objectives to avoid distorting competition in the market;
  - take into account the nature and the scale of the economic activity;

- take into account the risk of certain assets becoming stranded as a result of losing value due to the transition to a more sustainable economy.
- Building on the third bullet point above, the technical screening criteria should translate existing environmental- and climate policies, best-in-class and best available practices for different economic sectors into a clear and easy to use list of activities for investors. The taxonomy can be seen as a **translation device**: translating best sustainability practices in different sectors into an easy to use list for financial institutions.
- The taxonomy will also take into account existing market practices. For example, the [Green Bond Principles](#), the [Climate Bonds Initiative](#), the [China Green Bonds Endorsed Project Catalogue](#) or the [FTSE Environmental Markets Classification System](#). Moreover, the High-Level Expert Group on Sustainable Finance (HLEG) published a preliminary taxonomy in their final report ([Annex III](#)) that the TEG will build on.

*Will the list of environmentally sustainable activities be developed for all the environmental objectives at once?*

- No, the list will be developed over time. The regulation can be seen as a **framework, which allows for the progressive development of this list**, i.e. of the EU environmental taxonomy. The Commission proposes to determine the technical screening criteria, and thereby the list of economic activities, through a series of delegated acts.
- Those related to climate change mitigation and adaptation will be adopted first (by December 2019). Those related to the other objectives will be progressively established and applied by December 2021 (transition to a circular economy, waste prevention and recycling as well as pollution prevention and control) and by December 2022 (sustainable use and protection of water and marine resources and protection of healthy ecosystems).

*What about social and governance issues?*

- For now, the taxonomy will consist of economic activities contributing to one or more environmental objectives, starting with climate change mitigation and adaptation. In the proposed Regulation, a review clause (Article 17) states that by 2021, and subsequently every three years thereafter, it will be evaluated whether it is appropriate to extend the scope to other sustainability objectives, in particular to social objectives. This also explains why the name of the proposed Regulation refers to ‘sustainable investments’ rather than to ‘environmentally sustainable investments’ – the long-term ambition of the taxonomy is to cover the whole sustainability spectrum (including activities contributing to social objectives).
- While an environmentally sustainable economic activity may in and of itself be socially neutral (with some exceptions), negative social impacts can materialise depending on *how* the activity is carried out. That is why the proposed Regulation already establishes minimum (social) safeguards, which ensure that all economic activities deemed environmentally sustainable have to be carried out complying with minimum safeguards, such as fundamental labour rights.
- The main reason to focus first on environmental objectives is that knowledge on how social objectives could be integrated in a taxonomy is not sufficiently developed in the market at this stage (far less consensus on data, metrics, and standards/reporting) for the Commission to commit to develop now a detailed taxonomy in that area.
- As for governance issues, these may be better addressed at company level than at economic activity level (see also [Action 10 of the action plan for sustainable finance](#)).

***What about ‘greening’ of polluting sectors? Does the taxonomy mean that activities that are not included are considered ‘brown’?***

- The taxonomy will identify economic activities that substantially contribute to one or more environmental objectives. This will include activities that have an environmental purpose, i.e. having a positive impact on the environment (like renewable energy production).
- However, the taxonomy will also include economic activities that may continue to have a negative impact on the environment, but where these economic activities have substantially reduced that negative impact. This will **enable polluting sectors to move onto greener pathways**.
- This is why technical screening criteria are important. They allow for identifying environmentally sustainable activities also within economic sectors, which overall are polluting: For example, a high GHG emitting economic activity is clearly not contributing to climate change mitigation. However, if this economic activity could be conducted or produced in such a way that significantly reduces GHG emissions this activity could qualify, even if it continues to emit some GHG in absolute terms. Technical screening criteria are needed to determine whether this is indeed the case, i.e., if and when a substantial contribution to climate change mitigation can be achieved.
- Activities that are **not a part of the taxonomy are not necessarily ‘polluting’**: There are plenty of economic activities with very limited negative environmental impact or with only **incremental contribution** to environmental objectives. The taxonomy will require **‘substantial contribution’** to environmental objectives for activities to be included. Therefore, activities that do not qualify under the taxonomy are not necessarily polluting. They will simply not be categorised.

***Will activities that are not part of the taxonomy still be financed?***

- The EU taxonomy – the creation of a common language that defines which economic activities are environmentally sustainable – will support companies in launching new environmentally sustainable activities and projects and in adjusting existing projects in order to qualify as green. However, the taxonomy will not replace companies’ existing sustainability policies. Rather it will make it easier for companies to finance those green projects that meet the criteria set out in the taxonomy.
- As explained above, activities that are not part of the taxonomy are not necessarily ‘polluting’. They may have only a very limited negative environmental impact or make only an **incremental contribution** to the environmental objectives and do therefore not suffice to contribute ‘substantially’ to one or more environmental objectives, as required by the taxonomy. However, this **does not mean that financing of those other activities not covered by the taxonomy would stop**.

***Will my sustainable technology be in?***

- As part of the taxonomy, technical screening criteria will determine whether and how an activity is considered to substantially contribute to one or more environmental objectives while not significantly harming any of these; where possible by setting clear thresholds. However, the taxonomy will **not prescribe what technology should be used** to meet these criteria. The taxonomy is expected to be technology-neutral in that regard. Therefore, it is not possible to answer the question whether a given sustainable technology will be included in the taxonomy, as this will ultimately depend on the thresholds (or other criteria) being set.

### *How will the taxonomy take into account policy and technological developments?*

- The taxonomy will provide clarity and stability for investors as to which economic activities can be considered environmentally sustainable. Nevertheless, the taxonomy will have to be kept up to date, taking into account the latest policy and technological developments and innovations.
- To facilitate this process, the proposed Regulation foresees the establishment of a Platform on Sustainable Finance. One of the tasks of this platform will be to review the thresholds by taking into account technological changes and to advise the Commission on the need to update the taxonomy by including or excluding certain activities. This process should not lead to uncertainty or liability risks for investors.
- Financial market participants who feel that a certain activity should be considered as environmentally sustainable for investment purposes should inform the Commission by submitting scientific evidence for their suggestion. This feedback will help the Commission and the Sustainable Finance Platform to evaluate the appropriateness of complementing or updating the taxonomy.
- Please note that some of the technical criteria proposed may take the form of dynamic thresholds that are tightened over time in order to meet the increasingly ambitious objectives in a gradual way. This is an approach that allows for dynamism but also provides for certainty upfront as the path of tightening can be determined when establishing the thresholds.

### *About the links between the taxonomy and the financial markets*

#### *Who will have to use this taxonomy and how?*

- The taxonomy, once developed, will **have to be used** by:
  - **Member States for the purposes of any measures setting out requirements on market actors** in respect of **financial products** or corporate bonds that are marketed or deemed as environmentally sustainable.
  - **Financial market participants<sup>3</sup> offering financial products<sup>4</sup> as environmentally sustainable investments** or investments having similar characteristics. They would have to disclose information on how the criteria for environmentally sustainable economic activities are used to determine the environmental sustainability of the investment.

Note that the taxonomy is not and will **not be a mandatory list of activities in which to invest**. The requirements to use the taxonomy relate to disclosures, they are not behavioural requirements. Market-led labels can continue to exist and funds targeting environmental objectives are not limited to investing in taxonomy-compliant activities – they just need to be clear on whether and to what extent their green products finance activities that qualify under the taxonomy.

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<sup>3</sup> Financial market participants are defined in Article 2 (a) of the Commission proposal for a Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 as “an insurance undertaking which makes available an IBIP, an AIFM, an investment firm which provides portfolio management, an IORP or a provider of a pension product; (ii) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013; (iii) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013; (iv) a UCITS management company”.

<sup>4</sup> Financial products”, are defined in Article 2 (j) of the Commission proposal for a Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341 as “a portfolio management, an AIF, an IBIP, a pension product, a pension scheme or a UCITS”.

- In addition, the taxonomy can also be used on a **voluntary basis** by any financial institution. For example, banks could potentially use it as a basis for their lending activities. The taxonomy should moreover encourage companies to raise funds for projects that meet the criteria of the taxonomy, or to show the percentage of revenue or turnover from green activities with reference to the taxonomy, in order to raise green funding.
- The **establishment** of a taxonomy and its **uses** have to be distinguished here:
  - On the one hand, the establishment of the **taxonomy needs legislation to set out in clear and certain terms criteria for economic activities to qualify as ‘environmentally sustainable’** for investment purposes.
  - On the other hand, the **uses of the taxonomy need to be flexible** to allow various investment strategies to build on this taxonomy. For this reason, the proposed Regulation introduces **disclosure requirements**, rather than telling investors in what to invest. There is no obligation to invest only into taxonomy-compliant economic activities. However, **if a financial product is marketed and/or sold to investors as ‘environmentally sustainable’**, then **the extent to which it is green (the ‘greenness’) must be disclosed to investors by reference to the taxonomy**. This allows for many different investment strategies to co-exist, while avoiding a straightjacket approach.

*How is the taxonomy proposal linked to the Proposal on Disclosures relating to sustainable investments and sustainability risks?*

- The Proposal on Disclosures requires disclosure of information to end investors about:
  - 1) how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes;
  - 2) the sustainability related impact of their investments, in particular how a given sustainability objective is reached.
- The proposed Regulation on Disclosures covers all three sustainability objectives (environmental, social and governance). Therefore, its disclosure requirement applies also when there is an environmental sustainability objective to a given financial product.
- The Taxonomy Proposal complements the Proposal on Disclosures by requiring those financial market participants that are subject to the disclosure obligations set out in that proposal to disclose the **degree of environmental sustainability of the financial products that they claim pursue environmental objectives**. The disclosure requirement under the Taxonomy Proposal will have to reference the EU taxonomy to show how and to what extent the criteria are used to determine the environmental sustainability of the investment. This disclosure will allow investors to understand and compare more easily the degree of "greenness" of investment strategies. The Taxonomy Proposal therefore provides more clarity on what green investments offer in terms of environmental outcomes. It also provides clear signals to economic operators on what constitutes substantial contribution to environmental objectives.
- Financial market participants offering ‘green’ financial products will therefore have to:
  - disclose how they reach their environmental sustainability target under the Proposal on Disclosures – having some freedom in how to best describe their environmental investment strategies;
  - reference the EU taxonomy when describing the degree of ‘greenness’ of the given product. This will introduce an element of comparability, without prejudging those green investments that do not contain underlying economic activities from the EU taxonomy.

### *How can environmentally sustainable economic activities be linked to financial products and investment strategies?*

- The proposed Regulation provides the basis to identify environmentally sustainable economic activities for investment purposes, rather than a list of environmentally sustainable companies or assets. While the Regulation will not regulate how to link the taxonomy to the greenness of companies and financial assets, exemplary ideas how these links could work are given below:
- Link to companies: The taxonomy can help to determine which percentage of activities that a company carries out contributes substantially to environmental objectives. **If a company performs only environmentally sustainable activities, this company could be deemed environmentally sustainable. If a company performs several activities and only some of them are environmentally sustainable, the company may have a varying degree of environmental sustainability.** The degree of 'greenness' of the company could, for instance, be determined on the proportion of turnover or revenue that originates from environmentally sustainable activities included in the taxonomy. However such an indicator should **always be considered together with other company specific indicators that could help to determine the 'greenness' of a company**, such as the GHG emissions of the company.
- Link to financial assets (loans, bonds, equity): Assets that are used to finance only the environmentally sustainable activities of the company (e.g. "green bonds" with transparent use of proceeds for environmentally beneficial purposes) could be considered environmentally sustainable, while other assets that only partially finance green activities may have various degrees of environmental sustainability. The degree of environmental sustainability can similarly be determined for investment portfolios consisting of several companies, which will incentivise investments into environmentally sustainable economic activities, without penalising or creating disincentives for investments into other economic activities.
- Link to financial products (i.e. funds) and investment strategies: As the taxonomy provides a tool to assess the degree to which financial assets or companies (see above) contribute substantially to environmental objectives, it also allows financial market participants to use the taxonomy as a factor for selecting their investments. However, it does not prescribe such strategy and allows for different degrees of 'greenness' and for different investment strategies currently existing in the market, such as those purely based on exclusion criteria.
- The Commission is looking into the development of an EU Ecolabel for financial products, which will consider the issue of how the taxonomy links to financial products, and therefore indirectly how it links to financial assets and companies.

### *How can the taxonomy generally be linked to standards and labels?*

- The taxonomy will provide a core reference to define the potential pool of underlying environmentally sustainable activities that a sustainable product might finance.
- However, the taxonomy does not constitute a financial product standard or label<sup>5</sup>. The determination of minimum investment percentages in activities or additional investment- or

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<sup>5</sup> To clarify the relation between a product standard, a process standard and a label: (1) A financial **product standard** requires compliance with certain characteristics (for example, that 20% of an equity fund is invested in firms with more than 50% of revenues in green activities). (2) A **process standard** requires that procedures have been used throughout the investment process that respect ESG criteria. (3) A **label** finally requires the **verification** and assurance to investors by a third party that a financial product meets the product and/or process requirements of a given standard.

process criteria for the purpose of standards and labels do not fall within the scope of the taxonomy.

***How can investors get information about the extent to which companies engage in green activities?***

- The EU's Non-Financial Reporting Directive requires large European companies to disclose material environmental information (in addition to other issues: social, human rights, anti-corruption and bribery). That requirement is a major step forward in terms of incentivising environmental disclosure for investment purposes. While complying with the Directives requirements, companies may well already disclose the desired information to investors. However, the disclosure requirements remain largely principles-based, quite high level and not very prescriptive. The Directive does not impose any specific reporting framework.
- In mid-2017, as required by the Directive, the Commission published supplementary Non-Binding Guidelines, to help companies implement the Directive, especially those who may be reporting non-financial information for the first time.
- In the Sustainable Finance Action Plan, the Commission made a commitment to update the guidelines with regard to climate-related information. The Technical Expert Group on Sustainable Finance is helping with that task, developing climate-related disclosures that will feed the update of the guidelines in mid-2019.
- To the extent possible, the updated guidelines will refer to the forthcoming EU taxonomy of environmentally sustainable economic activities. They might encourage companies to disclose what proportion of their turnover, revenue or other financial metric correspond to activities that will be defined as 'environmentally sustainable' by the taxonomy.

***What is the role of the European Supervisory Authorities in the taxonomy work?***

- The taxonomy is first and foremost a tool for investors. The regulation does not propose any use of the taxonomy by the ESAs.
- Nevertheless, as part of the Action Plan on Sustainable Finance, the Commission is working with the ESAs on incorporating ESG-risks in their work. The taxonomy may play a role in helping the ESAs and the Commission better understand any impact that prudential frameworks may have on sustainable investments and lending. In particular, on the banking prudential framework, the Commission intends to explore the feasibility of including risks associated with climate and other environmental factors in institutions' risk management policies and the potential calibration of capital requirements. Any recalibration of capital requirements, based on data and the assessment of the prudential risk of banks' exposures, would need to rely on and be coherent with the future EU taxonomy on environmentally sustainable activities. For these reasons, the ESAs are also members of the current Technical Expert Group and will be part of the future Sustainable Finance Platform.
- As the Taxonomy regulation contains a disclosure obligation that forms part of the EU financial acquis, adherence to this regulation can and will be subject to supervision by the competent national supervisory authorities.

## Summary Box: What the proposal does, what it does not, and who it helps

### Is there a need for this taxonomy?

- In order to meet the EU energy and climate targets for 2030 and to ensure a transition to a low-carbon and more environmentally sustainable economic model, the EU faces an investment gap of €180bn of additional investment per year to 2030. Attracting private capital to the activities that have a substantial impact on climate is therefore key.
- There is a need for a common taxonomy, because there is currently no common understanding of which economic activities can be considered environmentally sustainable for investment purposes and which activities are the most important to finance in order to reach the EU's sustainability targets.
- This missing common understanding creates costs for financial institutions, as they have to identify environmentally sustainable activities and assets in-house and on a voluntary basis. It also creates uncertainty for investors, as they have to check and compare information in a burdensome way. Therefore, the lack of a common language hampers the transition to a greener economy.
- An EU taxonomy has the potential to fill this gap, as it would provide all market participants and consumers with a common understanding of environmentally sustainable economic activities. Thereby, it would send appropriate signals to economic actors by providing more certainty and protect private investors by avoiding risks of green washing. Furthermore, it could provide important input for further policy action in the area of sustainable finance, including standards, labels, and any future changes to prudential rules.

### What the Taxonomy proposal does:

- It harmonises definitions of environmentally sustainable economic activities, in accordance with the Regulation and in line with the Paris Climate Agreement.
- It creates a common reference point for national public labels across the EU.
- It offers a common language to investors, companies and financial market participants, translating what substantial contribution to the EU environmental objectives means in terms of concrete criteria for companies pursuing economic activities.

### What it does not do:

- The Taxonomy Proposal does not prescribe to financial market participants what to invest in or how to compose financial products that are offered to investors as “green”.
- The Proposal does not prescribe any investment strategy, as financial market participants and investors are free to decide the degree of greenness for their investments and their overall sustainable finance strategies.
- The Proposal does not establish a label itself: it does not set any minimum requirements as to how many economic activities that meet the taxonomy criteria should be financed by a “green” financial product.

### The Taxonomy Proposal helps:

- **Companies** have clarity as to what requirements their activities have to comply with in order to be considered environmentally sustainable under the EU taxonomy. Living up to the standards of the taxonomy will help these companies raise funding for their green and transformational (‘greening’) projects;
- **Investors** who want to invest in environmentally sustainable companies and projects will better understand and be able to compare across different ‘green financial products’ offered in the market, and will be able to better compare these products in terms of their impact on the

environment;

- **Financial market participants** offering environmentally sustainable financial products. It will be easier for them to identify investable assets with a substantial contribution to the environmental objectives – without prejudicing any other methodologies or investment strategies they might pursue. Moreover, as there is no geographical restriction on the identified green activities, the taxonomy could potentially be applied to assets worldwide.

### *About the progress of the TEG in developing criteria for the taxonomy*

#### *What will the TEG do exactly in relation to this taxonomy?*

- The TEG has been tasked with determining a (first) list of environmentally sustainable economic activities and developing the technical screening criteria that determine under which conditions these activities are considered environmentally sustainable. The TEG is expected to start their work with the environmental objectives of climate change mitigation and climate change adaptation. The Commission has proposed that it will adopt the list of environmentally sustainable economic activities and their technical screening criteria gradually through delegated acts.

#### *What are the challenges of developing a detailed taxonomy and how does the TEG intend to deal with them?*

- Several challenges may arise in developing the taxonomy:
  - The taxonomy must be detailed enough to provide unambiguous certainty on what can be considered environmentally sustainable. At the same time, it must be user friendly to avoid that it becomes overly burdensome or costly to determine whether an asset is green or not.
  - **Economic activities within a specific sector should be treated equally, if they contribute equally towards one or more of the environmental objectives** set in the proposed Regulation, to avoid distorting competition. The potential capacity to contribute to environmental objectives may however vary across sectors, which should be reflected in the technical screening criteria for the different sectors.
  - **The taxonomy must not lead to inconsistent policy incentives**, i.e. the signals given to economic actors on what activities are considered environmentally sustainable must be consistent.
  - The taxonomy, once developed, might possibly have an effect on the liquidity in financial markets. This could be the case for assets that were considered green under voluntary market standards, but which may perhaps now no longer be included. When developing the taxonomy, the impact on liquidity will be carefully assessed.
  - The taxonomy could also potentially influence the risk of stranded assets, i.e. the risk that certain assets may lose value as a result of the transition to a more sustainable economy. This risk is expected to be limited, as the TEG is in the process of defining *sustainable* activities. Stranded assets are more likely an issue for *polluting* activities. Nevertheless, the Commission and the TEG will assess the impact on the risk of stranded assets when developing the taxonomy carefully, as stipulated in the proposal.
- **In developing the taxonomy, the TEG will take these challenges into account through extensive stakeholder dialogue, consultation of experts and impact analysis reports so that the technical screening criteria are clear, unambiguous, easy to use, and will not have adverse effects on financial markets.** Moreover, regularly updating the taxonomy to take into

account scientific and technological developments would provide an additional safeguard to address any possible problematic.

***Does the TEG have the necessary expertise to determine what is environmentally sustainable?***

- For the group to be successful, it needs to have a strong combination of expertise and skills, ranging from finance professionals, environmental experts, to industry experts, civil society and academia. The Commission believes that the current group provides for a wide variety of expertise. It consists of several representatives from different trade and business associations, reflecting wider industry interest. It further includes several businesses.
- Nevertheless, additional expertise may be necessary to be able to properly develop the technical screening criteria for different economic sectors. The group is currently finalizing its consultation plans. The group expects to publish and launch its consultation strategy by the end of November. The consultation plans will differentiate between sectors where the TEG already feels comfortable proposing specific technical screening criteria, as market-practices already have led to well-developed criteria, and sectors where further technical input is needed to be able to propose the technical screening criteria. As a result, the consultation strategy will consist of three elements: (i) open consultation seeking technical feedback on proposed technical screening criteria proposed for “high confidence” / phase 1 climate change mitigation sectors, ie. those sectors for which market-practices have already led to well developed technical screening criteria; (ii) targeted consultation seeking technical input on phase 2 mitigation sectors as well as for adaptation activities. The TEG intends to launch an open call for application seeking experts to help develop these technical screening criteria; and (iii) open consultation on usability of the taxonomy, the TEG will invite comment on the fitness for purpose of the taxonomy format for practical implementation. Please find more information online, including for the other tasks for the TEG here. The document will be updated on a regular basis as the plans develop further in order to provide stakeholders with information about all ongoing events. To reflect the broad variety of expertise required, DG FISMA, DG ENV, DG CLIMA, and DG ENER jointly coordinate the technical expert group, while several other DGs are closely associated.

***What is the TEG's work plan over the next few months?***

- In terms of climate change mitigation, the group has identified a list of first round priority sectors on which to focus initially (based on GHG emissions as well as climate mitigation potential).
- For climate change adaptation, the group is currently debating a possible methodology for identifying economic activities delivering on the climate adaptation objective.
- The group is starting to carry out targeted and open consultation to gather additional technical expertise and stakeholder feedback in accordance with its [consultation plans](#) as mentioned above.

**EU GREEN BOND STANDARD**

***Why is the EU developing its own standard instead of endorsing already-existing ones?***

- As explained in the [final report of the HLEG](#), developing an EU standard should be understood as a way to “*help the market to develop fully and to maximise its capacity to finance green projects that contribute to wider sustainability objectives. (...) The EU green bond market has yet to reach its full potential, currently representing a relatively modest percentage of overall outstanding*

*bonds from EU issuers. But it has attracted significant public interest, and it has had a disproportionate demonstration effect in support of green finance”.*

- One of the objectives of having an EU green bond standard is to strive towards a more unified market in the EU: by setting the standard’s characteristics right through the recommendations of the expert group, the EU standard aims to become the market reference. As set out in Action 2.1 of the [European Commission Action Plan on Sustainable Finance](#), the group will build its work on current best practices.
- In addition, the work of the TEG on an EU Green Bond Standard has to be understood in the broader context of the Commission’s work on sustainable finance. The EU Standard would be closely linked to the creation of an EU taxonomy for environmentally sustainable activities. By being clearly grounded in this taxonomy, the ‘greenness’ of green bonds under the EU standard would be made more transparent and immediately identifiable, therefore limiting risks of green-washing.

***What are the links between the EU Green Bond Standard and the other existing or ongoing market initiatives?***

- In developing recommendations for an EU Green Bond Standard, the Technical Expert Group will consider existing market-led initiatives to capitalise on current best practises, while identifying potential areas for improvement.
- The Commission and the TEG also intend to consult other bodies currently developing their own standards to ensure synergies where possible and limit risks of market fragmentation.

***What is the link between the EU Green Bond Standard and the EU Ecolabel for green financial products?***

- The Commission has recently started its work on an EU Ecolabel for green financial products. The legal framework is set out in the EU Ecolabel Regulation (Regulation (EC) No 66/2010 of 25 November 2009 on the EU Ecolabel).
- The Ecolabel would cover a variety of green financial products, including green bonds. Moreover, the Ecolabel will provide information to retail investors on whether a financial product respects a green standard.

As far as green bonds as concerned, the subgroup’s recommendations on an EU Green Bond Standard should serve as a basis for the requirements for a potential future label.

***Why will the Commission explore the use of the EU Ecolabel framework for certain financial products as set out in Action 2 of the Action Plan on Financing Sustainable Growth?***

- Labelling schemes are very useful for retail investors. The retail market represents a significant portion of the total assets under management in the EU. Individuals are increasingly investing in products with a positive sustainability impact.
- The success of the EU organic label and the EU Ecolabel shows that labels help to guide consumers in making informed choices.
- Labels for sustainable financial products may enable to flag investments in sustainable activities in order to raise awareness about these products.
- The EU Ecolabel Regulation lays down a voluntary EU-wide scheme subject to surveillance and control mechanisms, with well-established governance rules and convergence tools.

***What are the links between the Commissions work on a prospectus for green bond issuances and the work of the TEG on a Green Bond Standard?***

- It was announced in the [Action Plan to finance sustainable growth](#) that “Within the framework of the Prospectus Regulation, the Commission will specify by Q2 2019 the content of the prospectus for green bond issuances to provide potential investors with additional information”.
- This work aims at providing additional transparency to investors, and is in itself separate from the TEG work on an EU Green Bond Standard.
- Nevertheless, it was agreed that the experts working on recommendations for an EU the Green Bond Standard will in addition work closely with Commission services on the topic of prospectus to give guidance on the content and ensure consistency between the two initiatives.

***Does the Commission have any concrete plans for a legislative proposal with respect to a Green Bond Standard?***

- No, the Commission does not have any concrete plans for a legislative proposal with respect to a Green Bond Standard at this stage. The Commission will wait for the subgroup's report and the respective recommendations in Q2 2019 and use this work as a basis to decide on the next steps.
- The work of the subgroup on an EU Green Bond Standard should feed into the work currently undertaken by the Commission on an EU Ecolabel. It will also inform the work on the content of the prospectus for green bond issuances.

## **CLIMATE-RELATED DISCLOSURES**

***Will the Commission's guidelines on non-financial disclosure remain voluntary?***

- Yes. The existing guidelines are non-legally binding and the update of the guidelines will not alter that status.

***Why has the Commission decided to endorse the recommendations of the Taskforce for Climate-related Financial Disclosures (TCFD)?***

- The TCFD recommendations have seen significant interest and uptake by the market and by policy-makers. They were developed "by the market, for the market". They have been endorsed by authorities in a number of jurisdictions around the world. Since the EU and its companies are perceived as world leaders in addressing climate change, it is important that the Commission's guidelines on climate-related disclosures are aligned with existing and developed best practices.

***Will the update of guidelines cover issues other than climate?***

- No. The update of the guidelines will relate to climate-related disclosures only. The work of the TEG with regard to the guidelines will therefore only cover climate-related disclosures. The Commission's Sustainable Finance Action Plan announces an intention to update the guidelines with regard to other ESG issues at a later date.

## BENCHMARKS

### *Why do we need measures addressing low-carbon benchmarks now?*

- Benchmarks have an indirect but important impact on investments. **Many investors rely on benchmarks for portfolio allocation and measurement of financial performance.** While index providers have been developing a wide range of indices considering climate change, their significance for overall portfolio allocation remains limited.
- The performance of the majority of funds and portfolios is still benchmarked against conventional indices, which is not appropriate to reflect low-carbon investment strategies. The Commission identified varying methodologies and levels of transparency among indices pursuing low-carbon or climate-related strategies.
- The lack of transparency and the risk of ‘greenwashing’ have made it difficult for investors to compare the various types of low-carbon or climate-related indices and to use them to assess the performance of low-carbon funds/portfolios.
- Finally, the benchmarks currently provided by the market do not necessarily align with the objective of limiting global warming to below 2°C pursuant to the Paris Agreement. Rather, they are likely to be in line with a 3 to 4°C increase scenario, if the climate-related commitments currently established are respected.
- The majority of stakeholders consulted by the Commission agreed that there is a merit in developing a set of minimum requirements for index methodologies integrating climate considerations at EU level. This should address the current problems, such as very limited comparability and reliability of methodologies used to calculate the carbon footprint and set the stage for a prospective low-carbon environment.

### *What is the Commission proposing with regards to benchmarks?*

- The Commission is proposing **two essential measures:**
  - 1) **Create two new categories of benchmarks:**
    - A ‘**low-carbon benchmark**’ and a ‘**positive carbon impact benchmark**’ with minimum standards for the methodology of these two benchmarks.
    - The Commission is proposing to introduce a **clear distinction** between low-carbon and positive carbon impact benchmarks in the Benchmark regulation:

While the underlying assets in a **low-carbon benchmark** should be selected with the aim of **reducing carbon emissions of the index portfolio** comparing to the parent index, a **positive carbon impact index** will have a **net positive carbon impact** (i.e. carbon savings will exceed carbon emissions). The positive carbon impact index is therefore much more ambitious and narrow when it comes to the investment universe.
  - The main objectives of this proposal for these two categories are to:
    - allow a significant level of comparability of the benchmark methodologies while leaving benchmark administrators with an important level of flexibility in designing their methodology and
    - provide investors with an appropriate tool that is aligned with their investment strategy.
- In addition, this measure will increase transparency towards investors on their impact on climate change and the energy transition.

## **2) Improving the disclosure requirements for ESG benchmarks**

- This proposal goes beyond carbon related issues to include broader ESG considerations.
- A variety of benchmark administrators claim that their benchmarks pursue ESG objectives. However, investors do not always have the necessary information on the extent to which the methodology of those benchmarks takes into account those ESG objectives.
- This is why the Commission proposes to increase the disclosure requirements on how the benchmarks methodologies take into account the ESG factors for each benchmark that is promoted as pursuing ESG objectives. This information should also be disclosed in the benchmark statement.

### ***Will the Commission's proposal hinder innovation?***

- The new framework would define minimum standards, including key elements, for the construction of low carbon and positive carbon impact benchmarks.
- Significant flexibility will be left to benchmark administrators in designing the formula for the calculation of their methodology. More generally, this approach will leave room for market players to develop innovative new strategies for addressing environmental challenges.

### ***Why is this proposal not linked with the taxonomy?***

- As explained in the explanatory memorandum of the proposal for Benchmarks, the Regulatory Scrutiny Board suggested that the impact assessment did not appropriately consider the risks of requiring administrators of low-carbon benchmarks to use the taxonomy.
- In order to address the Board's concerns, the Commission has removed the obligation on administrators of low-carbon and positive carbon impact benchmarks to use the EU taxonomy when designing the parameters of the methodology for selecting underlying assets.
- In addition, the Commission believes that low-carbon benchmarks can already help tackling the existing lack of transparency and 'greenwashing' currently existing in the market.

### ***Is there any link between a given category of benchmark and the alignment with the Paris Agreement?***

- The expert group will need to advise on one or more robust methodologies focused on corporate and sector behaviour that reflects a 2-degree trajectory.