Response to Consultation on “Sustainable finance – EU classification system for green investments” related to Regulation (EU) 2020/852

With reference to the European Commission’s proposal and consultation documents which can be accessed here.

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The Stockholm Environment Institute (SEI) is an international non-profit research and policy organization that tackles environment and development challenges. Headquartered in Sweden, the institute has centres in Estonia, Thailand, Kenya, UK, US, and Colombia. We connect science and decision-making to develop solutions for a sustainable future for all. Stakeholder involvement is at the heart of our efforts to build capacity, strengthen institutions and equip partners for long-term change. Our knowledge and findings are accessible: as our own open access material, in leading academic journals, and repackaged for effective decision support.

A background to the contributors to this response, and a disclosure of their interests can be found in Annex A.

Key recommendations

- The threshold of 100gCO2e/kWh for power generation should be kept and oil and gas infrastructure should not be reintroduced in the taxonomy.
- The TEG’s recommendation to reduce the life cycle emissions threshold of energy generation activities from 100gCO2e/kWh in increments every five years in line with a net-zero CO2e in 2050 trajectory should be reintroduced.
- Technical requirements or transitional activities should be made clearer and more stringent with respect to ensuring 1) that lock-in of carbon intensive assets are avoided, and 2) that credible pathways to climate neutrality are promoted.
- Technical criteria should exclude investments in new long-lived and carbon intensive assets in manufacturing even if these assets are best in class today.
- What counts as meeting the criteria of “no technological alternative” should be clarified and how these assessments will change with more stringent climate policy should also be made clear.
- Greater clarity on the updating of thresholds & technical requirements is crucial if the taxonomy is going to credibly include very carbon intensive sectors as transitional given that these sectors must achieve drastic emissions reductions.
- The technical criteria should set a percentage of renewable feedstock that must be achieved for plastics production to be treated as taxonomy aligned and/or

thresholds of reduced lifecycle emissions compared to fossil based primary plastics production.
- Criteria encouraging circular production models throughout the plastics value chain and thresholds for recycled or renewable feedstocks should be reintroduced into the Delegated Act's technical requirements.
- The screening criteria for adaptation should emphasize that for investments with lifespans over 30 years, the projections should also be equivalently long term.
- The mandate of the sustainable finance platform is automatically renewed every three years from 2023 to support the review process of the EU Taxonomy Regulation outlined in Article 26.
- The platform is given additional resources to solicit external advice from experts that have relevant expertise on technical criteria, data requirement, usability, or impact of the EU Taxonomy regulation.
- Include calls for research in Horizon Europe on the impact of the EU Taxonomy on the financial market and the flow of capital in support of the EU's 2030 and 2050 climate targets.

Raising technical thresholds in line with the best available science and emerging technological solutions

Declining emission threshold for power generation
We commend the Commission for keeping with the recommendations of the TEG to define sustainable energy generation as activity with life cycle emissions lower than 100gCO2e/kWh. We also support the Commissions' decision to exclude oil and gas infrastructure from the taxonomy. These activities should not be reincluded in the taxonomy despite the European Council's conclusions from December 11, 2020 which mention gas as a transitional activity to achieve the EU's 2030 emission reduction target. Any investments in natural gas infrastructure are likely to end up as stranded assets while also carrying significant climate and environmental risks.

We also agree to the consultations responses from scientists and civil society which have stressed that the Commission should adhere to the TEG's recommendation to reduce the life cycle emissions threshold of energy generation activities from 100gCO2e/kWh in increments every five years in line with a net-zero CO2e in 2050 trajectory. The omission of the declining emission trajectory calls into question the alignment of the EU Taxonomy Regulation with the EU's 2050 target of carbon-neutrality.

Transitional activities – general recommendations

The draft Delegated Regulation identifies a number of 'transitional activities' that can qualify as contributing substantially to climate mitigation. As per Regulation (EU) 2020/852, an economic activity that is not low-carbon can be considered as contributing significantly to mitigation "if their greenhouse gas emissions are substantially lower than the sector or industry average, they do not hamper the development and deployment of low-carbon alternatives and they do not lead to a lock-in of assets incompatible with the objective of climate- neutrality, considering the economic lifetime of those assets." The act also notes that the "technical screening criteria for such transitional economic activities should ensure that those transitional activities have a credible path towards climate-neutrality, and should be adjusted accordingly at regular intervals." The draft Delegated Regulation also notes that for economic activities to be considered in alignment with the taxonomy they should not hinder the transition to a circular economy and that circular economy requirements "should be tailored to the specific sectors in order to ensure that economic activities do not lead to inefficiencies in the use of resources or lock-in linear production models".

We agree with these general principles for how to establish the alignment of transitional economic activity with the standard of contributing substantially to mitigation. However, the specific requirements and thresholds for several transitional activities as described in Annex I to the Commission Delegated Regulation (EU) supplementing Regulation (EU) 2020/852 leave it unclear if the proposed technical requirements satisfy the principles outlined in Regulation (EU) 2020/852 and cited above. Specifically, we suggest that the technical requirements of the taxonomy be made clearer and more stringent with respect to ensuring 1) that lock-in of carbon intensive assets are avoided, and 2) that credible pathways to climate neutrality are promoted.

With respect to ensuring lock-in is avoided, the technical criteria should exclude investments in new long-lived and carbon intensive assets in manufacturing even if these assets are best in class today. For example, investments in new blast furnaces in the steel sector lock-in polluting production capacity even when emissions performance is well above average among the existing reference group of production sites.

There should be more clarity on how the taxonomy defines "no technological alternative" for the purposes of treating an economic activity as transitional. In manufacturing, technological alternatives will often be available but not cost competitive given current policy, e.g. given current carbon price exposure. For example, CCS on cement production will often be technically feasible but not economically viable now *or in the future* unless a stronger carbon signal is introduced by policy makers. What counts as meeting the criteria of "no technological alternative" should be clarified and how these assessments will change with more stringent climate policy should also be made clear.

With respect to 'credible pathways', we note that the Delegated Act and its technical Annexes lacks an explanation for how thresholds and other technical requirements will be updated in a way that is consistent with meeting the climate targets of the Paris Agreement and the EU's mid-century climate-neutrality target. Clarity on the updating of thresholds & technical requirements is crucial if the taxonomy is going to credibly include very carbon intensive sectors as transitional given that these sectors must achieve drastic emissions reductions. This is especially true for manufacturing sectors given the long lifespan of many production sites. Without clearer requirements on transitional activities, the taxonomy risks incentivising investments in long-lived assets that are 'best in class' today but not at all compatible with achieving climate neutrality.

Plastics

Annex 1 of the Delegated Regulation treats the production of plastics as a transitional activity. The technical criteria state that plastics production can be considered as in alignment with the taxonomy if it is "3.(c) derived wholly or partially from renewable feedstock and its life-cycle GHG emissions are lower than the life-cycle GHG emissions of the equivalent plastics in primary form manufactured from fossil fuel feedstock."

This technical criterion is too vague and weak and risks treating very marginal uses of renewable feedstocks and very marginal improvements in lifecycle emissions as making a substantial contribution to mitigation. The technical criteria should instead set a percentage of renewable feedstock that must be achieved for plastics production to be treated as taxonomy aligned and/or thresholds of reduced lifecycle emissions compared to fossil based primary plastics production.

The TEG in its report recommended that for plastics production to be considered taxonomy aligned "at least 90% of the type of plastic manufactured" should be "(1) not used for single use consumer products, or (2) based on recycled plastics as feedstock." Criteria encouraging circular production models throughout the plastics value chain and thresholds for recycled or renewable feedstocks should be reintroduced into the Delegated Act's technical requirements.

Adaptation
We recommend that the technical screening criteria for adaptation include climate risk assessments which are "consistent with the expected lifetime of the activity" (Taxonomy Report Technical Annex, p25). We support the statement that "the assessment is performed using high resolution, state-of-the-art climate projections across a range of future scenarios consistent with the expected lifetime of the activity, including, at least, 10 to 30 years climate projections scenarios for major investments" (Annex I and II). However, the screening criteria should emphasize that for investments with lifespans over 30 years, the projections should also be equivalently long term. As climate risks will change more dramatically 30+ years out, we should encourage and ensure that longer lifespan investments consider also climate projections for a longer time period.

Creating a flexible governance structure of the taxonomy regulation to respond to new scientific knowledge and innovations

We welcome provisions made in Article 20 of the EU Taxonomy regulation which lay out the governance structure to develop and maintain the EU Taxonomy and the role of a "Platform on Sustainable Finance". We think that the platform holds the potential to involve relevant actors in the implementation and revision process of the EU Taxonomy.

However, we are concerned about the limited resources and time that is available to members of the platform to meet the expectations placed on them by the EU Taxonomy Regulation. Members of the platform are expected to advise the Commission on development and update of technical criteria. Beyond the development of technical screening criteria, the platform is also expected to advise the commission on inter alia usability, data requirements, policy developments and coherence.

The fact that the platform is only appointed for a two your period, and in this time is expected to advise the commission on delegated legislation on the other four environmental objectives constrains its ability to review climate-related criteria and respond to stakeholder requests at the same time; and contribute to the review of the EU Taxonomy Regulation under Article 26 due in July 2022.

To ensure that the EU Taxonomy Regulation is underpinned by a flexible governance structure that can respond to new scientific knowledge and technological solutions, we make the following recommendations:

- The mandate of the sustainable finance platform is automatically renewed every three years from 2023 to support the review process of the EU Taxonomy Regulation outlined in Article 26.
- The platform is given additional resources to solicit external advice from experts that have relevant expertise on technical criteria, data requirement, usability, or impact of the EU Taxonomy regulation.
- Promote research under Horizon Europe on the impact of the EU Taxonomy on the financial market and the flow of capital in support of the EU's 2030 and 2050 climate targets.

Annex A. Background and disclosure of interests

This response includes contributions from:
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As part of our work, over the past several years, SEI has actively engaged with European-based organizations and activities seeking to promote sustainable finance. This includes:

- Observers to the Advisory Council of the Green Bond Principles, Social Bond Principles, Sustainability Bond Guidelines and Sustainability-link Bond Principles of the International Capital Market Association.
- Members of the Expert Network on Second Opinion on Green Bond Frameworks.