The Grand Green Plan
The EU Taxonomy as a Tool to Identify the Opportunities of the Green Industrial Revolution

June 2021

For professional investors/qualified investors/qualified clients.

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Executive Summary

The EU Green Deal is a transformational project, not only for our environment but also for our economy. The race to Net Zero offers a once-in-a-generation opportunity for Europe to become a leader in the Green Industrial Revolution that is underway globally and to cement its global leadership in sustainable finance.

If policy is built to reward Europe's companies through the transition phase via access to cheaper capital, this will help fund more innovation, create new products and services and provide more jobs, all which will help the EU achieve greater EU prosperity and achieve its climate goals, a dual model of success for the rest of the world to follow.

The EU Sustainable Taxonomy has the opportunity to become the roadmap to achieve this goal, by defining Net Zero investments and to mainstream the climate transition.

However, as currently designed, the EU Sustainable Taxonomy will fall short. For it to become the cornerstone of the EU's approach to Net Zero and sustainable finance, it needs to be supported by broader policy and to better incorporate the need for companies to transition. The journey to Net Zero is as important as the end destination. The Taxonomy is also too European centric to be able to become a global standard, which will limit its usefulness and create multiple competing frameworks. And lastly its complexity will likely add, rather than reduce the burden on European companies and investors that wish to invest sustainably. There should be some organic carrots to balance out the sticks in the approach.

Therefore, to fulfil the EU's ambition for the EU Sustainable Taxonomy, we believe the policy framework in Europe needs to evolve to address four priorities and we make 4 recommendations to achieve this:

- **Scaling-up green financing**
  Closing the financing gap for Taxonomy-aligned investments
- **Focus on transition**
  Building out the Taxonomy as an economy-wide tool for transition
- **Make it a global standard**
  Transforming the Taxonomy into a global standard to attract global capital
- **Reduce the cost and burden of building the green economy**
  Operationalising the Taxonomy to reduce the costs of financing the green economy

> "Though the path may be green, the returns could be golden.
>
> **Clive Emery**
> Fund Manager, Multi-Asset, Invesco

Introduction: the EU Green Deal as a driver of economic renewal

The global commitment to achieve Net Zero carbon emissions by 2050 represents a critical challenge, one that will require strategic and fundamental transformation of the global economy.

But it also represents a unique investment and growth opportunity. Globally, the benefits of shifting to a low-carbon pathway are estimated at $26 trillion by 2030 compared to our current high-carbon pathway[1]. The scale of the investment opportunity is significant, with commensurate returns for those that back the technology and infrastructure of a zero-carbon future. Research and development of new technologies offer a prospect of high returns; doubling of investments in this area could generate returns of $20 billion per annum[2].

Europe has grand ambitions and a once in a generational opportunity to steal a march on other continents. Most of the tools are in place to achieve success, however failure to promote existing European companies in the transition phase could endanger the goals, including those beyond climate change. With small adjustments to the current agenda, Europe has the potential to achieve Net Zero and in doing so become the Silicon Valley of Green Tech including the vibrancy, jobs and innovation that comes with it.

> Europe needs a new growth strategy that will transform the Union into a modern, resource-efficient and competitive economy.
>
> **European Commission**

Figure 1
A balanced low-carbon stimulus portfolio can produce significant economic and environmental benefits

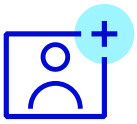
Estimated capital mobilized and impact of a low-carbon stimulus package for a European country[3]

Capital mobilized

€75-€150bn

of capital mobilized[4]

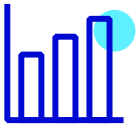
Induced employment



1-3 million

"job years" of employment created, excluding knock-on effects[5]

Gross value added



€180-€350bn

in GVA created[6]

Decarbonization

15-30 percent

reduction in CO_2 by 2030[7]

Source: McKinsey on Climate Change, September 2020

Achieving Net Zero in Europe is no easy task. It will require significant investment and innovation, supported by broad policy changes across the economy, including financing the transition.

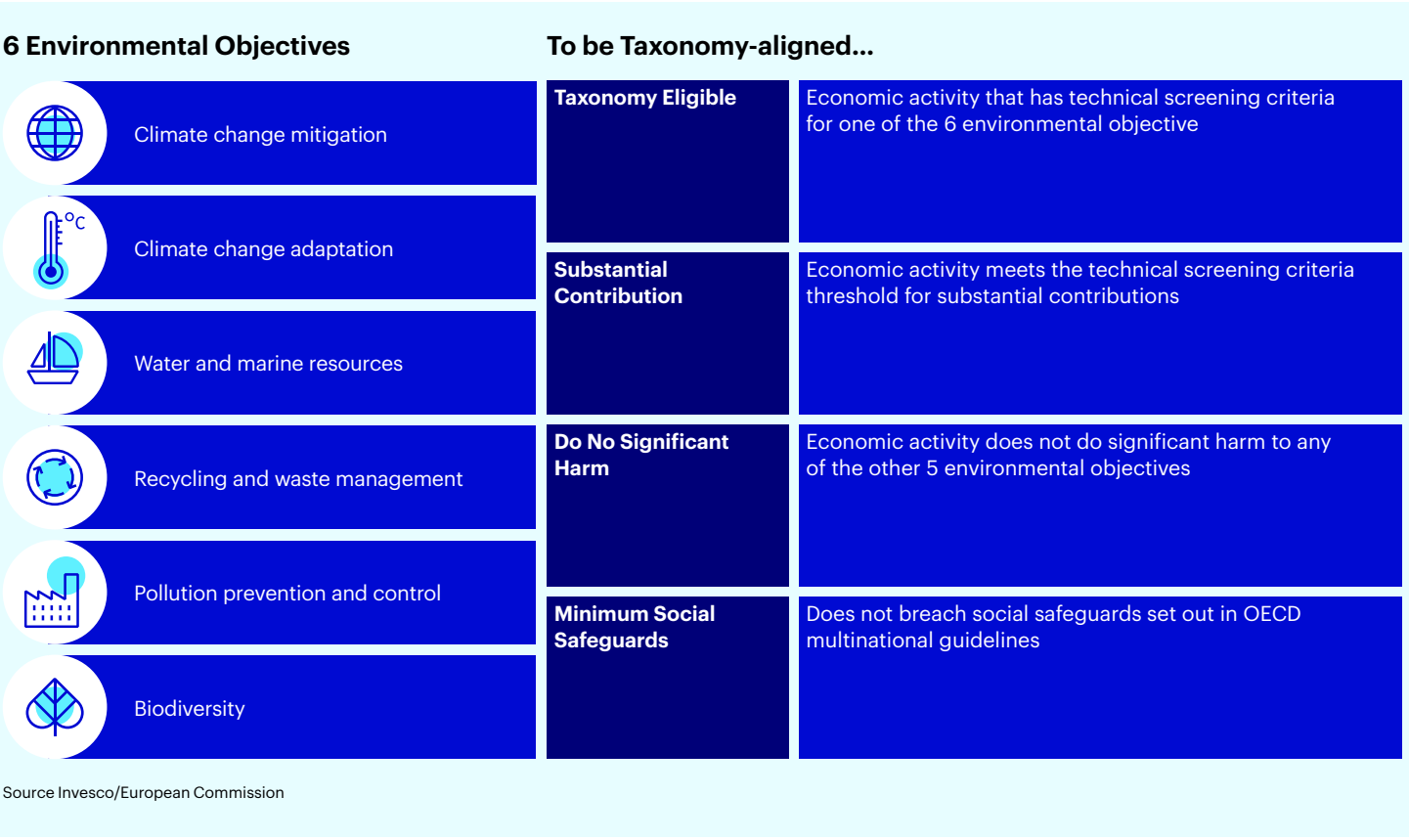
The EU Sustainable Taxonomy aims to channel investment towards activities that will deliver Europe's Net Zero ambitions, and therefore represents an integral part of the EU Green Deal. However, as we set out below, the current Taxonomy framework fails to live up to the ambitions of the EU Green Deal to transforms the EU economy.

What is the EU Sustainable Taxonomy?

The EU Sustainable Taxonomy aims to define economic activities that make a significant contribution to the EU's environmental goals and can therefore be considered as "environmentally sustainable".

The framework defines 6 environmental objectives and sets out that three key tests an activity must meet in order to be Taxonomy-aligned: make a significant contribution to one of the environmental objectives, do no significant harm to the other environmental objectives and meet minimum safeguards. The detail as to how an activity can meet these tests are enshrined in the sector-specific technical screening criteria.

EU companies subject to the Non-Financial Reporting Directive[8], i.e. large listed companies with more than 500 employees, must report the percentage of turnover, CapEx and/or OpEx that are aligned to the Taxonomy. Financial products with an environmental objective under the Sustainable Finance Disclosures Regulation must also disclose their alignment with the Taxonomy.



Source Invesco/European Commission

While the genesis of the EU Taxonomy was to combat the risk of "greenwashing" by setting clear standards and a reporting framework for green financial products and corporate bonds to compare themselves against, it has become clear that the potential of the EU Taxonomy extends beyond the narrow confines of green finance. By including companies within the reporting framework and now, as a reference for green investment under the Recovery and Resilience Facility, the EU Taxonomy is increasingly becoming the guidance framework for defining how the EU can meet its climate neutrality goal and for framing its ambitions in relation to the EU Green Deal. It is also increasingly seen as a gold standard internationally, with many other jurisdictions looking to the EU Taxonomy for inspiration when it comes to their own sustainable finance frameworks.

However, to fulfil this broader remit, the EU Taxonomy need to be supported by broader public policy incentives, to evolve beyond a narrow definition of "green" to embrace the concept of "transition", to become more internationally relevant and to be simpler for users to implement.

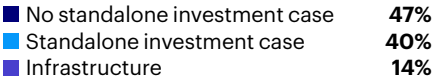
Scaling-up green financing

Closing the financing gap for Taxonomy-aligned investments

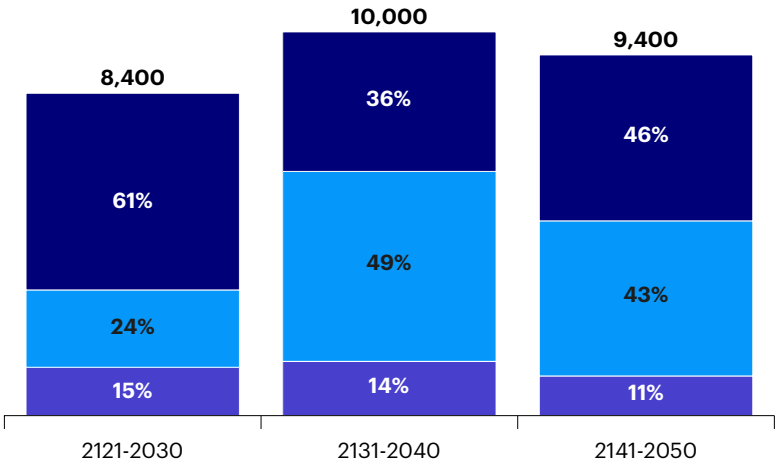
The aim of the EU Taxonomy is to identify economic activities that align with the goals of the Paris Agreement to achieve climate neutrality by 2050, which the European Commission estimates at €350 billion more annually in the period 2021-2030 compared with 2011-2020.

According to analysis by Eurosif/McKinsey, while more than half the emissions reductions needed to achieve Net Zero in Europe could be achieved with mature and early-adoption technologies, about 25 percent of emissions reductions would come from pilot-stage technologies, such as carbon capture and storage, and 15 percent from technologies now in the R&D phase. However, more than 50% of these investments, that would fall within the EU Taxonomy, do not have a standalone investment case in the current economic environment. Such investments represent a significant growth and investment opportunity for Europe but will require public support, both in terms of investment but also setting the right policy incentives to make suck investments attractive to private investors.

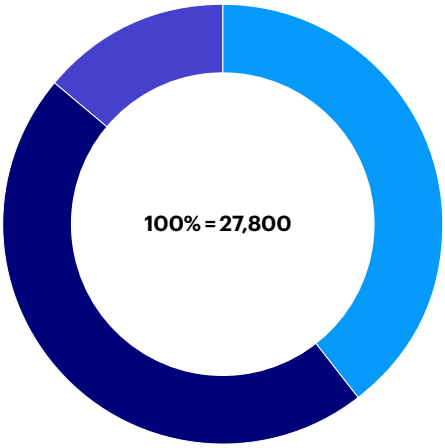
Figure 2
About half the required investments do no have a positive standalone investment cases for their stakeholders



Emission-reduction investments by type of investment case for individual stakeholders (%)
(total CapEx in EU-27, BN EUR (total within time bracket)



Emission-reduction investments by type of investment case for individual stakeholders (%)



Source: Eurosif/McKinsey, March 2021

One way of achieving a fertile landscape for investing is to mobilise EU capital through the EU Budget and Recovery and Resilience Facility (RRF). However, investing for the transition will need to extend beyond the current lifecycle of the EU Budget and RRF, and therefore we believe it needs to become a permanent part of the EU's fiscal framework Building on the climate tracking methodology being developed in the context of the RRF, there is an opportunity to integrate the Taxonomy across the fiscal and budgetary landscape to turbocharge investment into the Green Industrial Revolution. Gathering such data at a macroeconomic level could also enable the develop of new tools for investors to assess the climate resilience of government bonds outside of green issuances based on a country's alignment with the Taxonomy at economy-level.

Recommendation 1
Align public finance and incentives with the EU Green Deal to scale-up Taxonomy-aligned investments to finance the Green Industrial Revolution:

a. Building on the approach developed for the Recovery Facility and EU Budget, the EU Taxonomy should be integrated into the European Semester, the EU Budget and the EIB investment framework to finance early-stage GreenTech investment.

b. Eurostat to develop a database of macroeconomic Taxonomy-aligned metrics based on the RRF climate tracking methodology to track progress at EU and national level, which could form the basis of developing a Taxonomy-alignment methodology for government bonds.

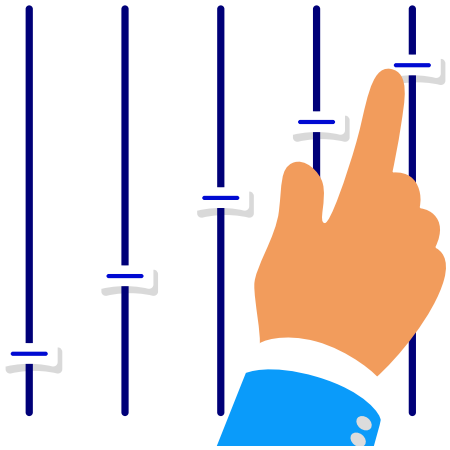
Focus on transition

Building out the Taxonomy as an economy-wide tool for transition

Investing in innovative green technologies, such as green hydrogen and offshore solar, is critical if the EU is to meet its long-term goal of climate neutrality by 2050. However, the path to carbon neutrality is a journey as well as an end destination, with critical milestones along the way. The EU Taxonomy, however, fails to integrate the tools to facilitate an economy-wide transition.

A good measure of how narrow the current EU Taxonomy is illustrated by the ESMA/JRC work to model current levels of Taxonomy-alignment of large listed companies in Europe, which shows that revenues derived from the current Taxonomy represents only around 2.5%. (**see figure 3**). A similar study looking at major European equity benchmarks found similarly low-levels of Taxonomy-aligned revenues (**see figure 4**). Such low levels of alignment can be explained by two factors: 1) the fact that the Taxonomy remains focused on so-called "dark" green" technologies and fails to consider the transition; and 2) that the Taxonomy excludes a majority of sectors of the economy from being part of the solution.

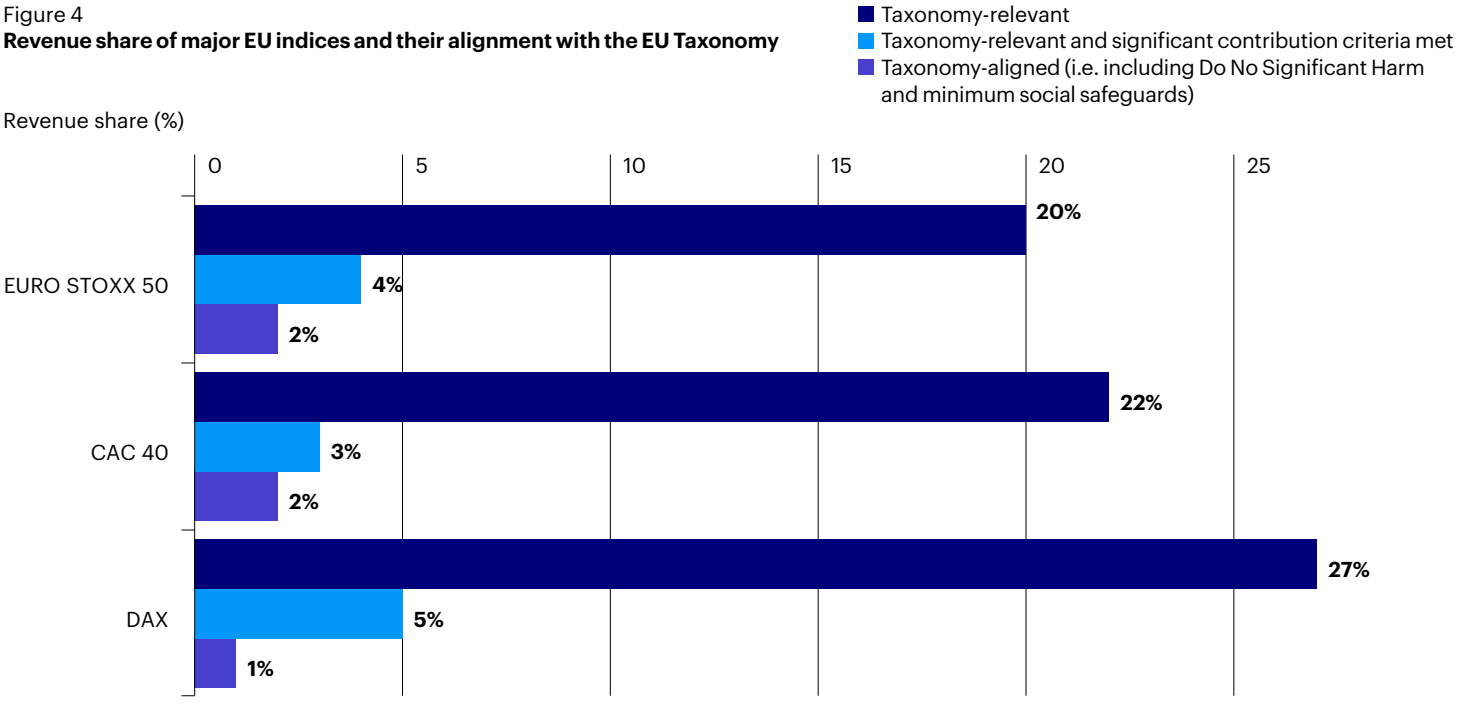
Figure 3
Estimated Taxonomy-aligned turnover, OpEx and CapEx of EU-27 non-financial undertakings in NFRD scope, by NACE Macro-sector (million Euro)



NACE Macro-sector	Turnover	OpEx	CapEx
C – Manufacturing	32,102	30,052	1,724
D – Electric, gas, steam and air conditioning supply	87,145	79,984	12,313
F – Construction	27,623	25,368	774
G –Wholesale and retail trade, repair	175	170	6
H – Transporting and storage	1,926	1,514	372
L – Real estate activities	5,140	2,454	622
N – Administrative activities	306	281	3
Estimated Taxonomy-eligible total	**154,419**	**139,735**	**15,818**
Share of total NFRD sample (%)	**2.49**	**2.45**	**3.74**

Sources: FIRDS, Refinitiv Eikon, Alessi et al (2019), TEG report, ESMA.

Figure 4
Revenue share of major EU indices and their alignment with the EU Taxonomy



Source: Adelphi/ISS October 2020

The journey and the destination

As we have explored above, many of the technologies that will be needed to achieve climate neutrality in 2050 are still in the development stage, but achieving the EU's 2030 carbon reduction target will require significant investment to rapidly expand the deployment of existing technologies to decarbonise the economy.

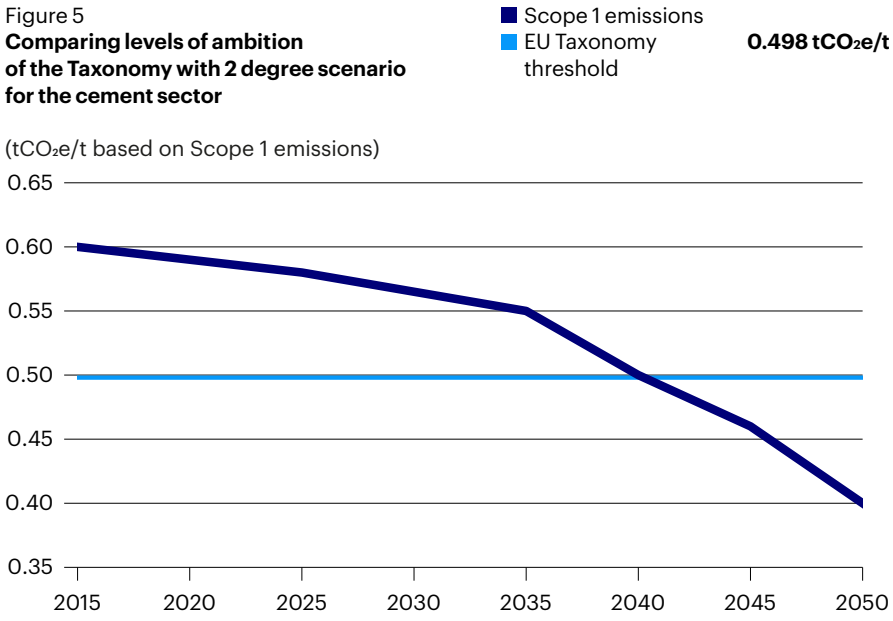
The EU Taxonomy, however, does not adequately reflect the investment needs to achieve these 2030 goals. This is because the Taxonomy is focussed only on the end goal of Net Zero climate solutions. This means that low carbon and transition technologies are seen as mutually exclusive – but these steps are crucial on the journey.

For example, the EU's hydrogen strategy recognises that while green hydrogen is the ultimate goal, other low-carbon forms of hydrogen need to be scaled up in the interim. At the other end of the spectrum, decarbonising the economy by transitioning away from coal will equally be important if the EU is to meet it's 2030 carbon reduction targets, including switching to natural gas as an interim step towards clean energy[9].

Even the current "transition" thresholds are in many cases aligned with climate neutrality, for example, the threshold for cement manufacture is aligned with a 2040 sectoral decarbonisation pathway (**see figure 5**). Furthermore, by only focusing on what is "green", the EU Taxonomy fails to incentivise transition away from the most polluting activities towards less polluting activities.

> "Phasing out coal from the electricity sector is the single most important step to get in line with the 1.5 degree goal.
>
> **Antonio Guterres,**
> United Nations Secretary-General

Figure 5
Comparing levels of ambition of the Taxonomy with 2 degree scenario for the cement sector



Source: Institut Louis Bachelier, Alignment Cookbook (July 2020)

A policy framework which seeks to penalise existing companies and legacy assets and indirectly encourages divestment from such companies risks imposing significant costs on Europe in terms of growth but also puts the goal of climate neutrality at risk.

The current approach risks excluding our existing stock of European companies from being part of the solution. Failure to nurture companies in transition could cause them to wither before sending up new shoots and lead to Europe being dependant on imports to achieve its goal.

It also risks stifling innovation in green products and services, which not only comes from "green" companies but, increasingly the most successful innovations in this space are coming from companies that would traditionally be considered "brown": academic evidence shows that the energy sector produces more and better "green" patents than almost all other industries.[10] Many existing companies that are leaders in their respective industries also benefit from know-how, infrastructure (such as access to the electricity grid) and access to value chains that will be important to scale-up green activities.

While the TEG work has to date focused on those sectors that are most material to climate mitigation, effective policy needs to also consider the ability of each sector to transition and the cost associated with that transition. As highlighted above, many of the technologies that will be required for sectors to transition, particularly in hard-to-abate sectors, are not yet economically viable at scale, and therefore transitional pathways and technologies will continue to be important for these sectors in the medium-term, consistent with the EU's 2030 climate target strategy.

Therefore if policy rewards companies through the transition phase we will grant our existing enterprises access to cheaper capital as they change and hence fund more innovation and create the products, services and refreshed jobs to achieve EU prosperity and its climate goals.

In our view, the EU Taxonomy should be restructured to align with both the long-term aims of the EU Green Deal to achieve Net Zero but also the intermediate 2030 (and potentially 2040) goals, by recognising different levels of decarbonisation and alignment with Net Zero:

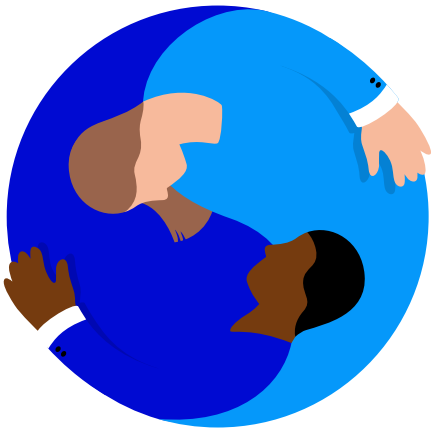
- Aligned with Net Zero
- On a pathway to alignment with Net Zero
- Incompatible with Net Zero

Such an approach could be achieved by further developing the distinction between low-carbon and transitional activities that is already present in the design of the EU Taxonomy, without the two being mutually exclusive, and expanding the Taxonomy to include criteria for significantly harmful criteria:

- Low-carbon activities should be defined as those that are aligned with Net Zero, as currently set out in the technical screening criteria.
- Transition activities should be those that are necessary to achieve the EU's 2030 goals, based on relevant sectoral decarbonisation pathways, with a sunset clause to be re-evaluated/reduce in conjunction with the EU's 2040 targets, and ultimately, phased out by 2050.
- Significantly harmful activities to include activities that are incompatible with the EU's 2030 goals, with the thresholds increasing over time to align with climate neutrality.

Some examples of where transitional activities could be added to the Taxonomy include:

	Transport	**Hydrogen**	**Biomass**
Low-carbon	Zero-tailpipe emission vehicle	Green hydrogen	Biomass with CCS
Transition	Vehicles emitting less than 50g/CO_2	Blue hydrogen	Biomass under REDII
	Rationale: As per TEG advice	Rationale: As recognised in the EU's hydrogen strategy, blue hydrogen will be an important intermediate step to scale up the technology with only at-scale deployment of green hydrogen likely after 2030	Rationale: Biomass is likely to continue to be an important fuel for hard-to-abate sectors such as transport and shipping



Include, don't exclude

While recognising that the focus sectors defined by the TEG as the most critical from a carbon emissions perspective, the sectors currently captured by the technical screening criteria only make-up around 20% of the economy. However, transitioning to Net Zero implies an economy-wide paradigm shift and therefore we believe that the Taxonomy could further be expanded to incentivise economy-wide transition for sectors not currently defined in the technical screening criteria.

This could be achieved in two ways. Firstly, the Taxonomy could define carbon reduction targets that are consistent with the EU's 2030 climate targets or relevant sectoral decarbonisation pathways for companies to commit to, subject to external verification. Such an approach could leverage the criteria defined by the JRC for the eco-label that includes the following criteria:

- A strategic plan that includes the actions to achieve a 1,5°C scenario goals of the Paris Agreement and the actions to achieve Net Zero carbon emissions by 2050, as well as intermediate targets aligned with 2030 goals.
- A credible investment plan to achieve these goals, including targets for Capex
- Evidence of the annual reduction of the company's GHG emissions

The framework should also seek to leverage existing standards in the market, such as the Science-Based Targets Initiative.

The framework could also seek to expand existing concepts introduced by the TEG to recognise CapEx investments that seek to deliver carbon reduction or energy efficiency measures across sectors. For example, in the TEG's advice for real estate, CapEx expenditure that aims to reduce carbon emissions by 30% are considered Taxonomy-aligned. Expanding this principle to all sectors, particularly other hard-to-abate sectors such as transport, shipping, and manufacturing, would broaden the Taxonomy to other sectors of the economy and introduce incentives to transition.

Beyond companies, government debt remains an important asset class where investors are increasingly looking to align with Net Zero. As suggested in ESMA's report on Taxonomy reporting, there would be merit in exploring how the Taxonomy could be leveraged to assess government bonds beyond green issuances, based on Taxonomy-aligned GDP, investment and policies (see above).

Recommendation 2

Make the journey as important as the destination – Transform the Taxonomy into an economy-wide tool to guide the transition, aligned with the EU's 2030 climate goals:

a. Transitional activities and green activities should not be mutually exclusive but clearly distinguish between those that are transitional activities aligned with 2030 goals (with a sunset clause) and those that are low carbon activities aligned with Net Zero.

b. Beyond the high emitting sectors currently in scope of the technical screening criteria, develop principles for other sectors to be part of the transition based on sectoral decarbonisation pathways aligned with EU Green Deal or IPCC sectoral decarbonisation pathways.

c. Develop a significant harm Taxonomy to give credit for phasing out the most harmful activities, such as coal-to-gas switching.

d. Work to develop a framework to assess Taxonomy-alignment for government bonds beyond green issuances.

Make it a global standard

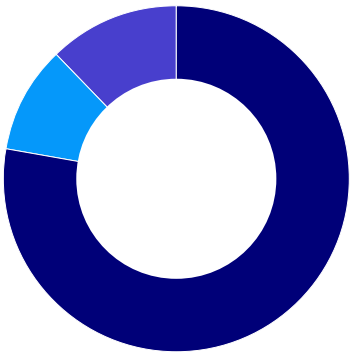
Transforming the Taxonomy into a global standard to attract global capital

Achieving climate neutrality, by definition, requires global change. However, in its synthesis report on Nationally Determined Contributions under the Paris Agreement, the UN Secretariat found that "the estimated reductions [...] fall far short of what is required, demonstrating the need for Parties to further strengthen their mitigation commitments under the Paris Agreement".

Indeed, many of the investment needs to achieve climate neutrality lie outside of the EU, in particular in Asia. Ensuring global consistency is also important for EU investors given the significant holdings of non-EU investments in EU portfolios.

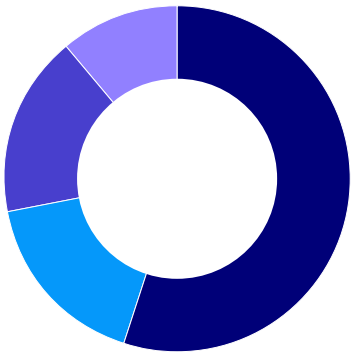
Figure 6
Summary of Investment Need

Common decarbonization themes across sectors



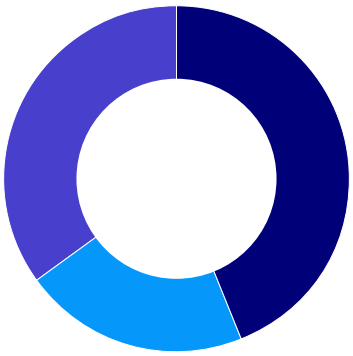
Electrification & Renewables	**78%/$95T**
Efficiency & Circularity	**10%/$12T**
Available Technologies	**12%/$15T**

Majority of investment need is in Asia



Asia	**55%/$66T**
North America	**17%/$21T**
Europe	**17%/$21T**
Rest of World	**11%/$14T**

Need for financing across assets classes



Loan	**44%**
Bond	**21%**
Equity	**35%**

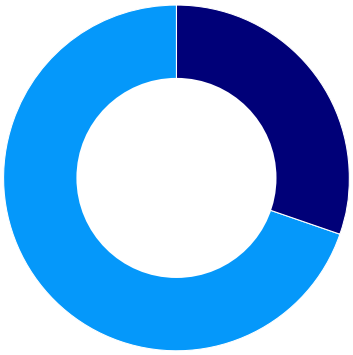
Source: GFMA/BCG (December 2020)

Many jurisdictions around the world are increasingly interested in developing Taxonomies. For example, work is currently underway in Singapore, Canada and Australia to define taxonomies, in addition to the work currently underway under the auspices of the International Platform on Sustainable Finance. Internationalising the Taxonomy could contribute to better cooperation and alignment of global capital. However, any global approach needs to recognise that different jurisdictions will decarbonise at different speeds and will need to cater to local economy specificities.

As highlighted by the OECD in its report on sustainable taxonomies "[a] second issue worth considering here is that different countries will have different transition pathways. For instance, the trajectories to a Net Zero economy by 2050 is likely to involve quite different sectors and thresholds in India and in Germany, while both these countries' Net Zero trajectories would contribute to a global Net Zero by 2050 scenario." Sector decarbonization pathways could therefore be used to define differentiated decarbonization thresholds for different regions and countries, which can be tailored to reflect different jurisdictions' Nationally Determined Contributions. Such pathways are increasingly being used as the basis for global investment frameworks such as the UNEPFI Alliance Setting Protocol. In the Protocol, UNPEFI states that "[t]hese pathways can account for the different rates at which a given sector can decarbonize, and anchor this in their existing global emissions budget. They can also provide decision useful information on sector-specific R&D, technological development, decommissioning and in other areas."

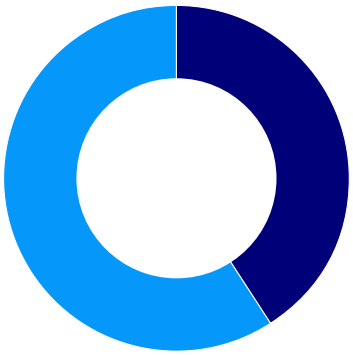
Figure 7
Share of EU fund holdings of equities and corporate bonds issues by region of incorporation (EUR billion)

Equity



EU	**30.5%/1,212**
Non-EU	**69.5%/2,753**

Corporate bond



EU	**41%/445**
Non-EU	**59%/641**

Source: Morningstar, ESMA.

In its current form, the EU Taxonomy is steeped in the specificities of the EU legal and environmental framework, making it challenging for other jurisdictions to adopt the EU Taxonomy for their own needs. Achieving global consistency and interoperability of taxonomies could be achieved by developing common principles that currently underpin the EU Taxonomy.

A common framework could emerge based on the core principles of the EU Taxonomy:

- Defined environmental objectives, based on the EU's 6 environmental objectives
- Sector-specific thresholds for significant contribution, framed around common principles but adapted to each country's decarbonization pathway
- Universal "Do no significant harm" and minimum safeguards based on universal norms and internationally recognised industry standards

Defining an equivalent level of ambition and translating this into jurisdiction-relevant thresholds represents the greatest challenge. However, we believe that some of the core principles that underpin the way the thresholds have been set in the EU Taxonomy could be developed into core design principles that would enable other jurisdictions to define their own approach with similar levels of ambition. For example, the EU Taxonomy uses the EU Emissions Trading Scheme (ETS) benchmark for certain sectors, which represents the top 10% of installations. Therefore, a core design principle could be that economic activities qualify as sustainable where they represent the top 10% of any sector. For jurisdictions where this data may be more difficult or burdensome to establish, using a decarbonisation target approach could be an alternative, for example a carbon reduction target aligned with that country's Nationally Determined Contribution or based on the IPCC's sectoral decarbonisation pathways.

In seeking convergence, use of consistent metrics (even where thresholds differ) is critical. As highlighted by the Singaporean Green Finance Task Force "the CO_2 emissions per unit of energy generated is a metric that can be used globally to evaluate the carbon efficiency of power generation. However, the same climate change scenario may include different thresholds for different regions. The IEA's Sustainable Development Scenario, which sets out a pathway to limit warming to well below 2 degrees, includes a target for global emissions intensity of 327g/kwh by 2025 – but includes different thresholds for different regions which take into account the regional base-line (i.e. current carbon intensity and pathway to transition)." Defining and integrating such metrics into any emerging global sustainability reporting standards, will therefore be critical to foster convergence and international consistency (see next section).

In relation to Do No Significant Harm and minimum safeguards, while the principles underpinning these as outlined in the Taxonomy are universal, the way that they have been translated into the technical screening criteria is in many cases EU-specific. Jurisdictions could develop equivalence tables of relevant regulations that conform to same principles or identify global industry standards that could be referred to, such as those identified by the Singaporean Green Finance Task Force.[11]

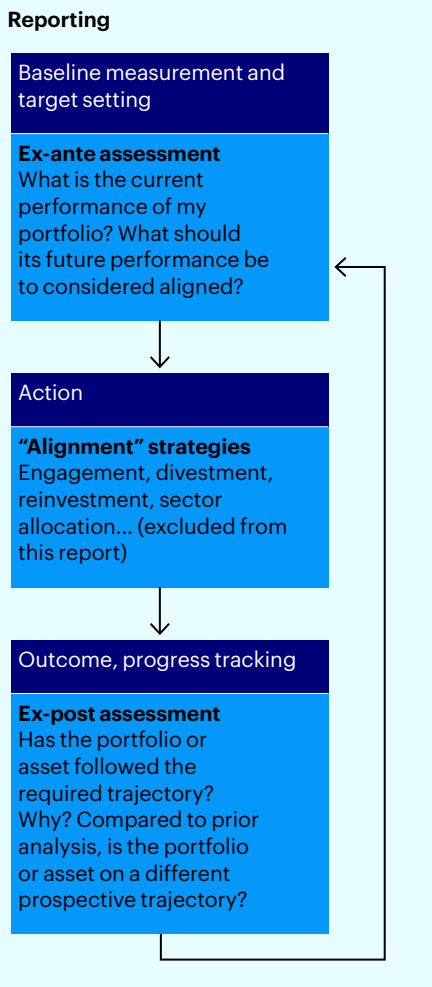
Recommendation 3

Be a global Net Zero standard setter – Collaborate with international partners to internationalise the Taxonomy

a. Develop common principles for global taxonomies that can be adopted by other jurisdictions for green (e.g. top 10-15% of companies/activities per sector) and transition financing (based on sectoral decarbonisation pathways).

b. Create a common approach to assessing Do No Significant Harm and minimum safeguards based on international norms or global industry standards.

Figure 8
Summary figure: Temperature alignment assessments within the portfolio transition framework



Source: Institut Louis Bachelier, Alignment Cookbook (July 2020)

Ultimately, the success of the Taxonomy will rest on its adoption by the market and governments as a reference framework to mobilise capital to finance the climate transition.

Ensuring that the appropriate data and reporting is in place for companies, investors and governments will therefore be key, many of which is lacking today. The old adage of what gets measured, gets done is entirely valid and needs addressing to ensure the goals are achieved.

In our view, the Taxonomy should not be seen in isolation but needs to be integrated into a holistic sustainability reporting framework such as the EU's Corporate Sustainability Reporting Directive or the Taskforce for Climate-related Disclosures, and ultimately, any global sustainability reporting standards. Such a reporting framework should focus not only on the historic levels of Taxonomy-aligned revenues but should also be forward-looking by emphasising Taxonomy-aligned CapEx as well as the broader strategy and targets that companies may have in relation to Taxonomy-alignment in the future as part of a broader narrative for companies' decarbonisation plans.

A focus on dynamic transition also needs to be carried through into any reporting obligations imposed on investors, which should also place Taxonomy-aligned revenues and CapEx on an equal footing, as well as emphasis actions taken by investors through engagement with investee companies and the outcomes achieved as core components of a successful reporting regime that will drive positive incentives throughout the value chain.

However, we need to recognise that the Taxonomy is a new framework and that it will take time for full adoption by the market. Setting out a clear roadmap that would allow companies to phase in the requirements over a period of time, for example over 2-3 years would ensure that companies and investors have the time to put in place the necessary processes and reporting frameworks.

Simplification and useability should also be key considerations to enable broad adoption. For example, the Do No Significant Harm criteria have been shown to significantly reduce the available investment opportunities linked to the Taxonomy, in many cases due to lack of appropriate data[12]. Merging the Do No Significant Harm and minimum safeguards into a single test and applying a differentiated approach depending on the type of financing (simplified due diligence at entity-level for general purpose financing such as equity financing compared with asset-level due diligence for project finance or green bonds) could improve useability by companies and the market. Pragmatic guidance for the application of the DNSH test, for example leveraging existing industry standards, as suggested by the Singapore Green Task Force, could also reduce the administrative burdens on companies and investors, thereby speeding up market adoption and ensure that companies use resources to define their climate transition plans that further the EU's climate transition goals rather than putting in place onerous reporting requirements.[13]

Recommendation 4

Reduce the cost and burden of building the green economy – Endeavour to simplify and integrate as possible.

a. Integrate Taxonomy into sustainability reporting that focuses on the strategic opportunities linked to the transition and captures the forward-looking opportunities through CapEx investment rather than just historic revenues.

b. Simplification and useability should be considered, taking into account different types of financing, for example in the application of the Do No Significant Harm test and producing implementation guidance that leverages existing market standards.

c. Develop a clear roadmap for phasing in the Taxonomy requirements, recognising that different sectors and companies have different levels of readiness to implement and report against the Taxonomy.

Summary of our recommendations

1 Scale-up green finance

Align public finance and incentives with the EU Green Deal to scale-up Taxonomy-aligned investments and finance the Green Industrial Revolution:

a. Building on the approach developed for the Recovery Facility and EU Budget, the EU Taxonomy should be integrated into the European Semester, the EU Budget and the EIB investment framework to finance early-stage GreenTech investment.

b. Eurostat to develop a database of macroeconomic Taxonomy-aligned metrics based on the RRF climate tracking methodology to track progress at EU and national level, which could form the basis of developing a Taxonomy-alignment methodology for government bonds.

2 Make the journey as important as the destination

Transform the Taxonomy into an economy-wide tool to guide the transition, aligned with the EU's 2030 climate goals:

a. Transitional activities and green activities should not be mutually exclusive but clearly distinguish between those that are transitional activities aligned with 2030 goals (with a sunset clause) and those that are low carbon activities aligned with Net Zero.

b. Beyond the high emitting sectors currently in scope of the technical screening criteria, develop principles for other sectors to be part of the transition based on sectoral decarbonisation pathways aligned with EU Green Deal or IPCC sectoral decarbonisation pathways.

c. Develop a significant harm Taxonomy to give credit for phasing out the most harmful activities, such as coal-to-gas switching.

d. Work to develop a framework to assess Taxonomy-alignment for government bonds beyond green issuances.

3 Be a global Net Zero standard setter

Collaborate with international partners to internationalise the Taxonomy.

a. Develop common principles for global taxonomies that can be adopted by other jurisdictions for green (e.g. top 10-15% of companies/activities per sector) and transition financing (based on sectoral decarbonisation pathways).

b. Create a common approach to assessing Do No Significant Harm and minimum safeguards based on international norms or global industry standards.

4 Reduce the cost and burden of building the green economy

Endeavour to simplify and integrate as possible.

a. Integrate Taxonomy into sustainability reporting that focuses on the strategic opportunities linked to the transition and captures the forward-looking opportunities through CapEx investment rather than just historic revenues.

b. Simplification and useability should be considered, taking into account different types of financing, for example in the application of the Do No Significant Harm test and producing implementation guidance that leverages existing market standards.

c. Develop a clear roadmap for phasing in the Taxonomy requirements, recognising that different sectors and companies have different levels of readiness to implement and report against the Taxonomy.

Figure 9
Evolving the EU Taxonomy

Taxonomy 1.0

- Environmentally sustainable economic activities
- Unclassified economic activities

- Limited to dark green investments, everything else is unclassified
- Backward-looking revenue. CapEx and OpEx
- Limited international relevance

Taxonomy 2.0

- Environmentally sustainable economic activities
- Transitional/decarbonising economic activities
- Neutral activities or activities with potential to transition
- Significantly harmful activities

- Shades of green, clearly delineating between environmentally sustainable (i.e. Net Zero) transitional, and significantly harmful activities
- Forward-looking tool based on decarbonisation pathways, and short, medium, and long-term targets
- Internationally applicable framework and standards

Source: Invesco

1 Building a private finance system for Net Zero: Priorities for private finance for COP26, November 2020

2 Idem

3 Population of 50 million to 70 million. Low-carbon stimulus package includes 12 stimulus measures.

4 Includes direct government spend and "crowded-in" private sector capital; exact cost to state is dependent on funding mechanism

5 Job years correspond to 1 job for 1 year; job multipliers measure only employment created during spend. In practice, economic stimulus could create jobs that become self-sustaining, resulting in more job years than shown here

6 Based on gross-value-added multiplier at a sector level for a typical European country of 50 million to 70 million people

7 Reduction is relative to current emissions and estimated based on potential; actual reduction will depend on societal factors

8 The Non-Financial Reporting Directive is set to be replaced by the Corporate Sustainability Reporting Directive, which was published on 21 April 2021 and currently under negotiation by the European co-legislators

9 European Commission Communication on the 2030 Climate Target Plan: Stepping up Europe's 2030 climate ambition Investing in a climate-neutral future for the benefit of our people (September 2020)

10 www.growthepie.net/how-brown-stocks-produce-green-patents/

11 Green Finance Industry Taskforce (GFIT) Taxonomy Public Consultation (January 2021)

12 According to the European Commission's work on the Development of EU Ecolabel criteria for Retail Financial Products- technical report 4.0 (March 2020), the impact of applying the DNSH and minimum social safeguards has a significant impact on the level of Taxonomy alignment: "A full-fledged Taxonomy assessment incl. DNSH and MSS has severe implications for the market coverage of the EU Ecolabel. Subtracting the "share of G" that is still subject to a DNSH/MSS assessment, following ISS-ESG's draft Taxonomy solution, presents a different picture. None of the funds would be even close to the proposed portfolio threshold of 40%."ns

13 Green Finance Industry Taskforce (GFIT) Taxonomy Public Consultation (January 2021)

Risk warnings

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

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Data as at 31 May 2021, unless otherwise stated.

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EMEA4420/2021