

Introduction

The UK Sustainable Investment and Finance Association (UKSIF) is the leading membership organisation for sustainable finance in the UK, committed to promoting a financial system that works for the benefit of the environment, society, and us all.

UKSIF represents a diverse range of financial services institutions committed to these aims, and our nearly 300 members, representing over £10trn of assets under management (AUM), include investment managers, pension funds, banks, financial advisers, ESG data and research providers, NGOs, among others.

UKSIF and our members have played a prominent role to embed sustainability in the UK's policymaking and regulatory framework over recent years, while finding new ways to overcome barriers to the growth of sustainability at home. For example, UKSIF is a representative of the UK's Green Technical Advisory Group (GTAG) advising on the delivery of the UK's 'green taxonomy', and we are working to ensure the taxonomy can set the highest standard possible for green investment for the rest of the world to follow.¹

We are pleased to provide our response to the APPG's 'Call for evidence' considering the UK's 'green taxonomy'. Our response reflects UKSIF's latest perspectives on the future of the UK's taxonomy alongside those of our members, many of which have already been reporting on the EU's taxonomy and making preparations for the incoming UK taxonomy.

UKSIF and many sustainable investors see the taxonomy as a vital element of the UK's future sustainable finance regulatory framework that can promote the transition of financial services, and wider economy, towards a sustainable future. We believe it is therefore critical that the incoming government continues to progress at pace the delivery of a robust and science-based taxonomy, informed by the advice of the GTAG, and clarity is needed as soon as possible on the UK's upcoming approach.

The treatment of transitional activities

We welcome the APPG's focus in its 'Call for evidence' on the treatment of transitional economic activities within the UK's taxonomy.

Despite foreseeing implementation challenges, we would like to see from government in the coming years consideration of a 'transitional environmental taxonomy', once work on the UK's 'green taxonomy' is complete. This could encourage the substantial part of the economy that is not 'green' today towards more sustainable practices, and ensure that transitional activities are time-bound with clear 'phase-out dates' to help guide investors. A private survey of UKSIF's membership towards the end of last year indicated strong investor support for a 'transitional taxonomy', as well as the creation of a 'social taxonomy'. We would be pleased to share details of this private market survey with the APPG in confidence.²

As part of our membership of the GTAG, we will be advocating for government to consider this separate taxonomy in due course, drawing on existing global initiatives and work such as the EU Platform on Sustainable Finance's [report](#) earlier this year.³

More specifically, a 'transitional taxonomy' could have the following benefits for the UK economy and users reporting against the taxonomy: providing more clarity and transparency to investors over 'transitional' activities in the economy; lending support to the transition of the whole economy, recognising that investing in 'green activities' alone will not create the real-world change we need to see; ensuring greater recognition of certain industries and sectors not captured by the EU's taxonomy, such as low-carbon manufacturing technologies, and helping avoid dilution of the criteria for the 'green taxonomy' that has happened in the EU, with natural gas activities for example incorporated in the EU taxonomy.

¹For more information on UKSIF and our membership, visit www.uksif.org.

²Further publicly available details of UKSIF's taxonomy survey from last year with our membership can be found on our website [here](#).

³EU Platform on Sustainable Finance, *The Extended Environmental Taxonomy: Final Report on Taxonomy extension options supporting a sustainable transition*, https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220329-sustainable-finance-platform-finance-report-environmental-transition-taxonomy_en.pdf, March 2022.

As mentioned, we do foresee possible significant implementation challenges should the UK pursue a 'transitional taxonomy', which would need to be very carefully considered with industry. This is particularly important given the ongoing usability issues that many investors have experienced in regards to the existing 'green taxonomy', including the issue of the taxonomy's application to a broader range of asset classes beyond listed equities and bonds.⁴ This means that policymakers should proceed cautiously with the creation of a 'transition taxonomy', despite the potential benefits this could bring in principle in our view.

Views on nuclear energy and natural gas's treatment in the 'green taxonomy'

We note the APPG's interest in this 'Call for evidence' on insights into the EU's revised designation of natural gas and nuclear energy under its transitional derogation.

UKSIF and many of our members continue to harbour very strong concerns on the prospect of natural gas's inclusion in the UK's 'green taxonomy'. In June this year, we wrote an [open letter](#) to government alongside the Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI), expressing the UK investment community's opposition to the possible inclusion of natural gas activities in the taxonomy.⁵

Our letter emphasised the need for a credible, science-based taxonomy that is fully aligned with the UK's net-zero strategy. It acknowledged that gas may be necessary as a 'bridge' during the transition, but it should not be labelled as 'green'. It highlighted that important, short-term considerations on energy security must not be conflated with the taxonomy, and that any inclusion of gas would risk sending very misleading signals to investors at a time when they require greater clarity on reporting on the sustainability of their portfolios to clients. Conflating the taxonomy with energy security considerations could have negative consequences with investments in the unsustainable use of natural gas possibly 'locked in', and putting at risk the British Energy Security Strategy's objective to reduce gas consumption by "over 40%" by 2030.⁶

Our collaborative letter alongside IIGCC and PRI came in response to widespread media reports earlier this summer that government was actively considering this step. We will continue to actively make the case to government on the significant economic and leadership opportunities for the UK should it not follow the EU's lead in incorporating natural gas activities, with investors and companies consequently more likely to see our taxonomy as world-leading.⁷

'Enabling activities'

We would like to see the role of 'enabling activities' more clearly recognised in the UK's 'green taxonomy'. While the EU's taxonomy does contain a provision on 'enabling activities', we understand that companies have used this provision very conservatively, due to the way in which the legislation has been drafted.⁸

The UK's taxonomy should not seek to actively discourage investments in important enabling activities which can be harder to identify in companies' supply chains, but can still lead to positive sustainable outcomes and facilitate climate solutions. For example, this includes technologies such as electrical equipment or industrial automation that will be needed to promote a renewable energy system. At present, we believe the EU's taxonomy sets overly complex criteria for those reporting against the taxonomy to meet on efficiency levels for the 'manufacture of low carbon technologies' that could result in substantial emissions reductions in others sectors of the economy.⁹

⁴Another important consideration with a 'transitional taxonomy' will be the need to avoid this becoming an effective 'black-list' of activities that should not receive short-term funding in the capital markets, damaging some companies' ability to transition.

⁵Our open letter to government earlier this year on natural gas's treatment in the taxonomy can be read [here](#). June 2022.

⁶HM Government, '[British energy security strategy](#)', 7 April 2022.

⁷Further details on UKSIF's views on natural gas's treatment in the UK taxonomy can be read [here](#) in a recent op-ed for ESG Clarity.

⁸Enabling activities are defined in the EU Taxonomy Regulation as follows: "An economic activity should qualify as contributing substantially to one or more of the environmental objectives set out in this Regulation where it directly enables other activities to make a substantial contribution to one or more of those objectives. Such enabling activities should not lead to a lock-in of assets that undermine long-term environmental goals, considering the economic lifetime of those assets, and should have a substantial positive environmental impact, on the basis of life-cycle considerations".

⁹ABB Group has published a [report](#) highlighting the lack of guidance in the EU taxonomy in regards to enabling technologies, which has helped to reduce the utility of the taxonomy as companies have made little use of the taxonomy's provision under the 'Manufacture of low carbon technologies' which covers 'key components that result in substantial GHG emission reductions in other sectors of the economy'.

In the EU's experience, many enabling activities have likely been missed we believe, and we would like to see the UK adopt its own tailored approach in this area, recognising more explicitly the important role that enabling technologies can play. We have advocated for this approach during discussions of the GTAG, and would argue that better reflection of these activities could help ensure effective implementation of the UK's taxonomy in the coming years.

Which aspects of the example set by the EU should the UK seek to avoid/loosen/tighten, why and how?

As highlighted previously in our response, a critical area where the UK should seek to diverge from the EU is in regards to the treatment of natural gas activities in the taxonomy.

Separately to this area, we would like to see the UK consider its own approach to the 'Do No Significant Harm Principle'. For an economic activity pursuing one or more of the taxonomy's six objectives to qualify as sustainable, it cannot cause significant harm to any of the other taxonomy objectives while respecting basic human rights and labour standards. In principle, we are very supportive of the DNSH principle, but the EU has experienced considerable challenges with applying the DNSH criteria in practice, which has been seen as burdensome for many companies reporting against the taxonomy.

Recent analysis from a number of our members, including from FTSE Russell and Bloomberg, has indicated considerable use-ability issues with DNSH with extremely low taxonomy-alignment for companies in the EU once DNSH has been applied.¹⁰ Compliance with DNSH has, we understand, required significant technical and resourcing skills within companies, alongside very granular data, that generally has not been readily available. We support the GTAG's discussions on ways the UK could improve the usability of DNSH in the UK context, and we believe any benefits from divergence with the EU would need to outweigh the inevitable costs as part of this.

To what extent should the UK base its technical screening criteria (TSC) on the EU's?

We are supportive of the UK largely basing its TSC for the taxonomy's six objectives on those of the EU, which will help minimise the costs for financial institutions and businesses incurred through wholesale divergence from the EU. For the taxonomy's first two objectives- climate change mitigation and climate change adaptation-the UK had indicated in last year's 'Greening Finance' roadmap that the TSCs will "be based on those of the EU taxonomy which the UK supported the development of whilst still a Member State", which we very much welcome.¹¹

Despite this positive commitment in last year's roadmap, we are yet to see clarity on the UK's approach to the TSC for any of the taxonomy's six objectives, with the long-awaited consultation paper on the TSC for the first two objectives still yet to be published. Clarity on this is needed as a matter of urgency, and Treasury must publish, as soon as possible, this consultation paper which has been delayed a number of times by government this year.

The sooner clarity is provided, the more quickly that UK-based investors and businesses can begin preparations for reporting against the taxonomy and planning for any divergence that may take place with the EU's taxonomy. It is also important given the EU continues to progress with implementation of its taxonomy, with its climate mitigation and climate adaptation requirements coming into force from the start of this year, and in order for the industry to remain competitive, the UK must not fall further behind.

One specific area where the UK could consider some divergence from the EU relates to the TSCs for agriculture. We have advocated at the GTAG for the UK to consider TSCs which would differentiate between agricultural practices contributing to climate mitigation and those that do not. Agriculture has a potentially significant role to play in decarbonisation the economy in the coming years (for example for its carbon sequestration potential if regenerative practices are employed), and we believe should be included within the UK's taxonomy.

¹⁰FTSE Russell, "[Do No Significant Harm](#)" and "[Minimum Safeguards](#)" in Practice Navigating the EU Taxonomy Regulation', December 2021.

¹¹HM Government, "[Greening Finance: A Roadmap to Sustainable Investing](#)", October 2021.

Has the UK taken the right approach in singling out nuclear as an energy source that needs careful consideration from the outset so as to avoid the difficulties faced by the EU in adding nuclear at the eleventh hour?

We are sceptical on the case for nuclear energy's inclusion in the UK's taxonomy, though we do acknowledge our members have diverse views on this subject in comparison to natural gas's treatment, which investors are more consistently opposed to including.

Our own view is that nuclear power does not qualify as it conflicts with the 'Do No Significant Harm Principle', which states an activity must not have a harmful effect on other environmental goals; specifically, the negative impacts concerning the disposal of nuclear, and the lack of technological solutions to address this, conflicts with DNSH from our view. To date, we have focused our efforts and policymaker engagement to help ensure that natural gas activities will not be included in the UK's taxonomy, and reluctantly accept that nuclear will likely be incorporated.

Are there any broader issues stemming from following the EU lead the APPG should be aware of? Is there a danger that not taking an innovative approach from the outset will deny the UK Taxonomy from meeting its full potential.

One of our final comments would be to highlight the importance of the UK maintaining its commitment to delivering a science-based 'green taxonomy', while ensuring that the valuable work of the GTAG continues at pace.

The taxonomy is a vital component of the UK's future sustainable finance regulatory framework, and further delays to this initiative by the incoming government (or worse its total abandonment) would send precisely the wrong signals to many responsible investors on the UK's leadership on sustainability.

Finally, the UK should be attuned to how its taxonomy interacts with other upcoming sustainable finance regulations, such as the 'Sustainability Disclosure Requirements' regime and International Sustainability Standard Board (ISSB) sustainability reporting standards. This is a key learning from the EU which has experienced considerable sequencing issues in its implementation of its taxonomy and the Sustainable Finance Disclosure Regulation (SFDR). There are close links between the UK's taxonomy and SDR, with taxonomy reporting expected to form one component of the SDR regime, and the market will need to be carefully consulted as both regulations are implemented across the UK economy.¹²

¹²This is a particularly important consideration for policymakers should the UK's SDR regime mandate reporting by all companies on their taxonomy-aligned activities and investments.