Principles for Responsible Investment

PRI STATEMENT: EU SUSTAINABLE TAXONOMY CLIMATE DELEGATED ACT COVERING GAS AND NUCLEAR ENERGY

London, 4 February 2022

The European Commission has adopted the EU Sustainable Taxonomy complementary climate delegated act (complementary climate DA). The complementary climate DA, which is now subject to a 4-to-6 month scrutiny period by the European Council and European Parliament, includes technical screening criteria (TSC) covering gas-fired power/cogeneration/district heating and cooling (henceforth 'gas') [1] and the construction/operation/life extension of nuclear power plants (henceforth 'nuclear energy') [2]. If adopted by the Parliament, the EU Sustainable Taxonomy can no longer be considered the gold standard for a sustainability performance benchmark. This will push an additional burden onto investors who will need to carefully review the disclosures to ensure that their taxonomy-aligned investments reflect criteria that are science-based.

Economic activities can only be labelled sustainable under the EU Sustainable Taxonomy if they substantially contribute to one of the six environmental goals included in the Taxonomy Regulation, while not doing significant harm to any of the other five environmental goals. The TSC for gas and nuclear energy marks a deviation from an environmental science-based assessment of economic activity and performance aligned with the Paris agreement in favour of political and energy market considerations. The suggested approach also moves the instrument away from its initial objective of defining sustainable economic activities on a technology neutral basis, which for the power sector is set within the 100g CO2e/kWh performance threshold.[3]

In addition to deviating from the initial approach of the Taxonomy Regulation, the disclosure requirement proposed in the complementary climate DA would create additional implementation challenges for investors. The disclosure rules will allow investors to distinguish and identify to some extent their exposure to gas and nuclear energy, but also contain major weaknesses:

[1] Unless otherwise specified, the use of the term 'gas' in this statement refers to 'methane gas' – historically also referred to as 'natural gas'.
[2] The European Commission proposed complementary climate DA includes gas and nuclear energy as 'transitional activities', which for gas implies that the 'significant contribution' TSC for the power sector of 100gr CO2e/kWh was loosened. Gas-fired power/cogeneration/district heating and cooling that performs below the 100gr CO2e/kWh threshold, which with currently available technologies and under present market conditions is not feasible, will in any circumstance be accepted as an economic activity that significantly contributes to climate change. More broadly, the grounds for including gas and nuclear energy as 'transitional activities' has been questioned by the Platform on Sustainable Finance because it would deviate from the definition of such activities as per article 10(2) of the Taxonomy Regulation.
[3] The Platform on Sustainable Finance has undertaken a detailed analysis of the TSC that were included in the first version (of 31 December 2021) of the complementary climate DA, which remains a good basis given that the TSC in the final proposal from the European Commission have not changed materially.

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- Exposures to taxonomy-aligned gas and nuclear activities can be reported using all three KPIs (i.e. turnover/Capex/Opex). However, as a backward-looking metric, turnover should not be recognised as taxonomy-aligned before the activity has reached sustainable performance levels; and Capex can only be recognised if it ensures that an activity reaches sustainable performance levels;
- It remains uncertain how reporting requirements will apply to financial products (i.e., article 5 and 6 of the Taxonomy Regulation), and whether they will be coherent with the currently proposed requirements for corporate and financial entities (i.e. article 8 of the Taxonomy Regulation).[4]

The current disclosure requirements will therefore not allow investors to easily compare credible taxonomy ratios with and without gas and nuclear energy, risk rendering the disclosures ineffective, and may lead to (unintended) greenwashing.

The European institutions still have an opportunity to develop a framework that recognises gas and nuclear energy as transition activities towards reaching net-zero emissions by 2050 outside of the EU Sustainable Taxonomy. Two main options are available to drive this forward:

- **Extending the EU Sustainable Taxonomy as per the provisions in article 26(1)f of the EU Taxonomy Regulation.** As indicated by a draft report of the Platform on Sustainable Finance, the potential extension of the EU Taxonomy would allow the recognition of intermediate economic activities and transition pathways, such as gas-fired power that operates below the 'significant harm' threshold of 270g CO2/kWh.
- **Developing a legislative proposal on transition sectors under the decarbonisation financing** initiative. This legislation should be separate from the EU Sustainable Taxonomy to ensure it does not undermine the EU's sustainability objectives or lead to the lock-in of carbon intensive activities – as suggested in the European Commission's recent sustainable finance strategy.

Margarita Pirovska, Director of Policy at the PRI comments: "*Nearly 400 PRI signatories already use the EU Sustainable Taxonomy to measure sustainability outcomes in 2021. This underlines the massive potential of the instrument to drive investment decisions towards sustainability goals. However, the proposed criteria for gas and nuclear energy are likely to weaken the Taxonomy's credibility and implementation. The addition of gas and nuclear have caused a rift among policymakers and market participants. We are facing an execution divide, between investors that will include these criteria and those who will remain committed to the initial intention of the instrument, with a stricter implementation of the Taxonomy's tenet.*"

The PRI will continue to work with its signatories and policy makers to shape taxonomy developments in the EU and around the world, building on our extensive work undertaken over the past few years. In 2019, the PRI organised a Taxonomy Practitioners Group in which investors, both EU and non-EU based, shared tools and experiences to help understand and overcome barriers to implementation of the Taxonomy. PRI published a report summarising the findings of 35 case studies in September 2020, including recommendations from the group to policy makers and supervisors who would oversee the implementation and development of the Taxonomy. PRI is currently working on a follow-up report that is due to be published in March 2022.

[4] In pre-amble (15) of the complementary climate DA, the European Commission states the following: '*In order to provide a high degree of transparency to investors in financial products referred to in Article 5 and Article 6 of Regulation (EU) 2020/852 concerning exposures to fossil gas and nuclear energy activities, for which technical screening criteria are laid down, the Commission will amend or propose to amend the disclosure framework pertaining to those financial products as appropriate to provide for full transparency over the whole life of those financial products. To ensure that such information is clearly identified by end investors, the Commission will consider amending the requirements on the financial and insurance advice given by distributors*.'

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading proponent of responsible investment. Supported by the United Nations, it works to understand the investment implications of environmental, social and governance (ESG) factors and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole. Launched in New York in 2006, the PRI has grown to more than 4,600 signatories, managing over $121 trillion AUM.