DEVELOPING A GREEN TAXONOMY FOR AOTEAROA NEW ZEALAND

Key design recommendations prepared for the Minister of Climate Change by an independent technical advisory group

Exposure draft - April 2024

List of acronyms

Acronym	Full name
A&R	Adaptation and Resilience
ANZSIC	Australian and New Zealand Standard Industrial Classification
APAC	Asia Pacific Region
ASEAN	Association of Southeast Asian Nations
CGT	Common Ground Taxonomy
CSF	Centre for Sustainable Finance
CWG	Climate Working Group
DEFRA	Department for Environment, Food and Rural Affairs
DNSH	Do No Significant Harm
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFI	Green Finance Institute
GHG	Greenhouse Gas
ISIC	International Standard Industrial Classification
ITAG	Independent Technical Advisory Group
MAS	Monetary Authority of Singapore
MfE	Ministry for the Environment
MSS	Minimum Social Safeguard
PSF	Platform for Sustainable Finance
TAG	Technical Advisory Group
TOR	Terms of Reference
TEG	Technical Expert Group
TSC	Technical Screening Criteria
TTEG	Taxonomy Technical Expert Group
TWG	Technical Working Group
UK	United Kingdom

Executive Summary

The Centre for Sustainable Finance (CSF) is an independently governed charitable trust dedicated to an equitable, inclusive and sustainable financial system. A core component of this is a robust sustainable finance market that enables capital flows to sustainable economic activities.

The Centre has been tasked by the Ministry for the Environment (MfE) of Aotearoa New Zealand to develop a recommendations report to inform the future design and development of the country's Taxonomy. This report builds on the initial scoping and stakeholder engagement undertaken to assess the applicability of the Australian Sustainable Finance Taxonomy for the context of Aotearoa New Zealand.

This report provides a set of recommendations for the design and development of a Taxonomy for Aotearoa New Zealand developed by an Independent Technical Advisory Group (ITAG) convened by the CSF. The Climate Bonds Initiative (Climate Bonds) served as a delivery partner for the project and provided technical assistance to the ITAG for the formulation of the recommendations based on the organisation's experience with other benchmark taxonomies (Australia, EU, Singapore, UK etc).

The recommendations set forward by the ITAG for the MfE were developed through a series of online consultation meetings from January to April 2024 and cover the following 10 main topics: principles, purpose, objectives, sector prioritisation, definitions, usability, application, eligibility, transition and governance.

This paper is structured around 4 main sections:
1) an introduction to the background of this work
2) a description of the role of the different stakeholders involved (ITAG, CSF, Climate Bonds)
3) a summary of the recommendations
4) detailed sections for each of the ten topics included for recommendations

Introduction

Climate change is one of the most pressing global issues and its impact on the planet can be felt in the form of rising temperatures, melting glaciers, rising sea levels, and more frequent natural disasters. The continued burning of fossil fuels and other human activities have caused the global mean surface temperature by 1.1. degrees Celsius in 2022 compared to pre-industrial levels (1850-1900)[1].

Aotearoa New Zealand is very vulnerable to climate change as the country is experiencing changes in rainfall patterns, rising sea levels, and more frequent extreme weather events. For instance, over the last 60 years, sea levels in certain parts of the country have risen twice as fast as they did in the previous century whilst the changing climate is also posing severe risks to its unique biodiversity with vast die-offs of animals both in the country's oceans and in its lands[2].

It is also vulnerable to the changing requirements of international capital providers, customers and consumers. Key trading partners, including the UK, EU, Australia, Singapore and others, are positioning themselves to benefit from a global reallocation of capital as humanity seeks to secure a low-emissions and resilient future in line with the goals of the Paris Agreement to keep global temperature well below the 2-degree threshold, and pursue efforts to limit warming to 1.5 degrees .

In this context, sustainable finance can play a key role in mobilising capitals and to shift them towards investments and infrastructure needed to achieve this future. For capital markets and investors to be able to make rational choices about their climate-aligned investment, they need tools that can help them screen economic activities and their underlying assets according to evidence-based environmental performance – for instance, the degree to which those economies activities and assets ensure greenhouse gas emissions reductions or the degree to which they help built infrastructure that is adapted to a changing climate.

A sustainable finance taxonomy is a standardised framework for classifying economic activities according to their environmental performance. This classification system can allow investors to identify and invest in activities that are generating greenhouse gas emissions reductions while avoiding those that cause significant harm to the environment. It helps to align investment decisions with sustainabilityobjectives and to avoid assets that are not aligned with the goals of the Paris Agreement. It can also direct capital flows towards new green technologies and increase the overall transparency of the financial sector through more transparent reporting.

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[1] IPCC, Sixth Assessment Report (AR6), 2022
[2] New Zealand Ministry for the Environment: "Our Atmosphere and Climate", (2023).

In 2021, in line with international developments in sustainable finance, the voluntary, industry-led Aotearoa New Zealand Sustainable Finance Forum published a 2030 Roadmap (SFF Roadmap) to advance a financial system that is more resilient, inclusive, robust and agile through the incorporation of environmental, social and economic considerations in financial decisions.

The Sustainable Finance Forum recommended:

a) Sustainable standards (for both social and environmental factors) be created for the purposes of providing objective definitions of sustainable activities in Aotearoa New Zealand for investment, lending and insurance.
b) Sustainable standards be harmonised to leading international standards in the finance sector, including the EU Taxonomy and the Climate Bonds Standards, but differ where appropriate for the Aotearoa New Zealand context. This should be expanded on to provide a comprehensive standard that aligns with leading practice in Aotearoa New Zealand, particularly with certain fundamental social aspects.

In 2022 the Government included action 5.14 in the National Adaptation Plan (Chapter 5)[3] to "[…] *support the development of a 'green' taxonomy to identify a common definition of climate and nature-positive investments. This could help guide businesses that are investing in both adaptation and mitigation to protect against greenwashing. If aligned with best practice, it could support greater international investment in Aotearoa New Zealand's climate-resilient projects, including nature-based solutions*". This should be designed and developed in collaboration with industry, academic organisations, Iwi/Māori, industry and the scientific community.

In 2024, following initial scoping and stakeholder engagement facilitated by the Centre for Sustainable Finance (CSF) and Ministry for the Environment (MfE), the Minister of Climate Change invited CSF to provide recommendations on the key design considerations for an Aotearoa New Zealand Green taxonomy. Prime Ministers of Australia and New Zealand have committed to a Trans-Tasman Roadmap to 2025, which features climate as a priority for alignment between the two countries particularly in terms of sustainable finance frameworks and of positioning the region as an attractive green finance hub.

Therefore, this report provides recommendations based on the assumption that the future Taxonomy of Aotearoa New Zealand will feature a high degree of interoperability with the Taxonomy of Australia. The design and development of the Aotearoa New Zealand Taxonomy is articulated into three sequential phases:

Phase 1 (complete)
- Set out terms of reference and establishment documents for an independent technical advisory group (ITAG) and frame the future taxonomy work.

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[3] Aotearoa New Zealand's first national adaptation plan, Chapter 5, August 2022.

Phase 2 (current phase)
- Convene the Independent Technical Advisory Group (ITAG) independent led by CSF through an invitation process.
- Deliver a set of clear recommendations report (this report) for the design of the Taxonomy

Phase 3 (future phase)
- Design and establish the taxonomy governance structure to include Independent Board/Governance group, sector-specific technical advisory groups and iwi/Māori groups.
- Engage delivery partners to support the design of the Taxonomy
- Publish the draft Taxonomy document for public consultations and the integration of feedback into a final Taxonomy document

The proposed approach for the development of the Taxonomy aims to be pragmatic, align with international standards and best practices, be relevant domestically and secure industry buy-in.

The Independent Technical Advisory Group (ITAG)

Role of the ITAG

The interim Independent Technical Advisory Group or "ITAG" was established as an independent non-binding expert technical group to advise the Minister for Climate Change, through the Ministry for the Environment ("the Ministry"), on the design of a green taxonomy that is fit for purpose for the New Zealand market. The ITAG is made up of technical experts, subject matter experts and financial market participants.

Remit of the ITAG

The ITAG is a formal decision-making group, and its role and composition may be reviewed for the future phases of the New Zealand Taxonomy. It has been established as an interim group for the second phase of the taxonomy project. Its role is confined to this phase and its advice covers key aspects of taxonomy design, development and application, including but not limited to:

- The most appropriate structural components (e.g. purpose statement, objectives, scope, framework, alignment and core guiding principles) for a New Zealand green taxonomy;
- How to harmonise and ensure international credibility and interoperability with emerging international taxonomies (including the rationale, implications and recommendations for any deviations from existing international frameworks or taxonomies);
- How the taxonomy can effectively be utilised as a market tool to mobilise financial flows and facilitate New Zealand's transition to a net zero and resilient economy in line with Government policy objectives;
- How the taxonomy could be used to align and accelerate the delivery of wider New Zealand climate and environmental policy and targets, and the Australia-New Zealand

2+2 Climate and Finance Dialogue commitment[4] to enhance a robust green finance market across the Tasman (Trans-Tasman commitment).

Membership of the ITAG

Members have been identified and invited to be part of the ITAG by CSF. Potential members were agreed by the Ministry and CSF in advance. The ITAG is composed of a pool of approximately 15-20 experts and market participants. They were selected to represent expertise from a cross section of the potential users of the taxonomy (financial and non-financial), taxonomy and data experts, Māori finance expertise, subject matter experts drawn from academia and non-governmental organisations. More specifically, members were selected based on:

- The experience and knowledge of individual members and/or their organisations, of the development or application of sustainable finance taxonomies or other similar sustainable finance policy, regulation, and tools;
- The ability of members to draw on the institutional knowledge and expertise of their organisations and professional networks; and,
- The balanced representation from different parts of the financial system to ensure diversity within the group.

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[4] https://ministers.treasury.gov.au/ministers/jim-chalmers-2022/media-releases/inaugural-australia-new-zealand-22-climate-and-finance

ITAG members

1. **Pip Best**, Partner - Climate Change and Sustainability Services, EY Oceania
2. **Jono Broome**, Associate Director - Head of APAC Client Advisory, Morningstar Sustainalytics
3. **Antonia Burbidge,** Head of Climate and Nature, Sustainable Business Council of New Zealand
4. **Adam Coxhead,** Head of Sustainable Finance, Bank of New Zealand
5. **Sebastian Gehricke**, Director - Climate and Energy Finance Group (CEFGroup), University of Otago
6. **David Hall,** Policy Lead, Toha NZ
7. **Temuera Hall**, Portfolio Manager, Tahito Ltd; Chair, Te Kakano Holdings Ltd; Chair, Tupu Angitu Ltd
8. **Jaclyn Margules,** Director - Large Corporates and Sustainability, HSBC New Zealand
9. **Gavin Marshall**, Sustainability Manager, Rabobank New Zealand
10. **June McCabe,** Independent Director, Pou Tahua representative, National Iwi Chairs Forum
11. **Fonteyn Moses Te Kani,** Pou Tiaki - Director Māori Strategy and Indigenous Inclusion, Westpac NZ
12. **Greg Munford,** Senior Investment Strategist, Sustainable Investment, NZ Super Fund
13. **James Paterson**, Head of Sustainable Finance, ASB
14. **Caroline Poujol,** Director - Sustainable Finance (NZ), ANZ
15. **Andy Reisinger,** Independent climate change expert
16. **Joanna Silver**, Head of Sustainable Finance, Westpac New Zealand
17. **Frances Sweetman**, Head of Sustainable Investment and Portfolio manager, Milford Asset Management
18. **Jorge Waayman,** Manager - ESG Research, Harbour Asset Management
19. **Sue Walker**, Senior Manager - Responsible Investment, Bank of New Zealand

Role of the Centre for Sustainable Finance: Toitū Tahua (CSF)

CSF is an independently governed charitable trust, established in 2021 by leading financial institutions and philanthropies to advance progress toward the recommendations of the Sustainable Finance Forum. The ITAG was set up and convened by (CSF which has provided secretariat services to the ITAG to enable them to consider, review, provide input, prepare, and endorse the ITAG technical advice and recommendations.

CSF is ultimately responsible for delivery of the ITAG recommendations report and for engaging technical partners, including the Climate Bonds Initiative, to support its development. CSF provides transparency of the project, the ITAG, and a taxonomy sub-committee of the CSF board reviews the final ITAG advice and report.

Role of the Climate Bonds Initiative (Climate Bonds)

The Climate Bonds Initiative (Climate Bonds) is an international organisation working to mobilise global capital for climate action. The mission is to help drive down the cost of capital for large-scale climate and infrastructure projects and to support governments seeking increased access to capital markets to meet climate and greenhouse gas (GHG) emission reduction goals.

Borne out of a need for independent, science-driven guidance on the assets and activities that are consistent with a transition to a low-carbon economy, Climate Bonds carries out market analysis, policy research, market development; advises governments and regulators; and administers the global Climate Bonds Standard and Certification Scheme. Climate Bonds has grown since into a 100+-strong global team of passionate individuals working at the fore front of climate finance including a Taxonomy Team directly focused on developing and contributing to sustainable taxonomies around the world.

Climate Bonds' role and extensive experience with taxonomy development such as with the EU Taxonomy, Common Ground Taxonomy (CGT), Australia as well as a host of other countries and regions (e.g., Cambodia, Canada, Chile China, Columbia, Malaysia, Mexico, Peru, Rwanda, Singapore, Sri Lanka, Thailand Phase I and Phase II, the United Kingdom).

The Climate Bonds Initiative was therefore selected by CSF to provide technical support to the second phase of the development of the Taxonomy of Aotearoa New Zealand in order to:

- Support the development of non-binding ITAG design advice ("ITAG Report") on the taxonomy's design in accordance with the Partnership Agreement between the Ministry for the Environment and CSF
- Prepare and facilitate ITAG meetings and related papers and resources to enable the ITAG to align on its advice
- Advise on trans-Tasman alignment between the emerging Australian and New Zealand taxonomies and other key considerations for international interoperability

Summary of recommendations

Topic	ITAG Recommendations
Principles	**ITAG Recommendation 1** The Principles of the Taxonomy of Aotearoa New Zealand should be: • Credibility – Mana • Usability - Whakamahi • Interoperability – Tuhono • Culture – Ahurea • Prioritisation - Whakarite
Purpose	**ITAG Recommendation 2** The purpose statement of the Taxonomy of Aotearoa New Zealand is: "The sustainable Taxonomy of Aotearoa New Zealand is a classification system for mobilising and directing capital flows to build a low-emissions, Paris-aligned future, restore nature and uphold the rights and interests of indigenous people of the land." **ITAG Recommendation 3** There is formal and increasing international recognition of the contribution and rights of indigenous peoples and local communities as custodians of biodiversity and as partners in its conservation, restoration and sustainable use. To reflect the culture of Aotearoa New Zealand, the ITAG recommends that the rights and knowledge of iwi/Māori are embedded into the design of the Taxonomy.
Objectives	**ITAG Recommendation 4** In line with international best practices, the environmental objectives of Aotearoa New Zealand will include iwi/Māori understanding and knowledge related to each objective and be (not in order of priority): • Climate Change Mitigation • Climate Change Adaptation • Sustainable Use and Protection of Water Resources and Marine Resources • Protection and Restoration of Biodiversity and Ecosystems • Pollution Prevention and Control • Transition to a Circular Economy *-- Iwi/Māori knowledge --*
Sector Prioritisation	**ITAG Recommendation 5** A survey was organised amongst the members of the ITAG, which resulted in the following key priority sectors for the Taxonomy. The sectors have been ranked according to the % of respondents that selected the sectors as priority: • Agriculture, Forestry & Fishery • Transport • Construction & Real Estate activities • Energy • Industrial Manufacturing
Definitions	**ITAG Recommendation 6** The Taxonomy of Aotearoa New Zealand should adopt ANZSIC as its classification system in order to align with other benchmark taxonomies such as Australia and the European Union's. When ANZSIC codes are not available at the granular activity-level, the ITAG recommends the Taxonomy to build *ad hoc* activity-specific codes.

Usability	**ITAG Recommendation 7** To enhance usability in New Zealand, it is important to connect to existing data, national and international labels and criteria while also growing relevant capacity and increasing the availability of new information over time. **ITAG Recommendation 8** The Taxonomy also needs to be linked to existing disclosure requirements – e.g. Aotearoa New Zealand Climate Standards. **ITAG Recommendations 9** The Taxonomy developers should ensure that the Taxonomy is fit-for-purpose across a range of key stakeholders in New Zealand including regulatory agencies, the public sector, iwi/Māori, and capital market stakeholders.
Application	**ITAG Recommendation 10** It would not be expected to mandate the use of the Taxonomy in its initial phase, but it could become mandatory over time following a phase-in approach or grace period. **ITAG recommendations 11** The Taxonomy of Aotearoa New Zealand should be designed for a broad range of applications, not just debt markets. **ITAG Recommendation 12** Following the example of benchmark taxonomies such as the ASEAN, Australian and Singaporean taxonomies, the Taxonomy should have a role in facilitating transition finance.
Eligibility	**ITAG recommendation 13** The Taxonomy of Aotearoa New Zealand should adopt an alignment approach based on technical screening criteria that are binary, credible and internationally-recognised. **ITAG Recommendation 14** The technical screening criteria can be complemented by whitelists (technologies or measures) where deemed necessary.
Transition	**ITAG Recommendation 15** The Taxonomy of Aotearoa New Zealand should focus on defining 1.5 degree aligned 'green' activities as a priority but consider the use of a separate transition category. The category should encourage substantial movements towards a 1.5-degree pathway for a defined and limited list of sectors/activities that are material and relevant to Aotearoa New Zealand. This transition category should be for activities within a predetermined period of time. **ITAG Recommendation 16** The Taxonomy of Aotearoa New Zealand should consider adopting a traffic light system to label transitioning activities that is based on *a robust methodology to ensure that any transition category or label is used to drive material step changes to emissions beyond business as usual.*

Governance	**ITAG Recommendation 17** The Taxonomy of Aotearoa New Zealand should adopt a three-tiered governance structure to ensure the transparency and credibility of its development process and with formal roles for iwi/Māori across all tiers. This would include: - Tier 1 - An overseeing body responsible for the endorsement of the Taxonomy and for the provision of strategic direction to it - Tier 2 - A coordinating group consisting of members with relevant expertise from within government, industry and civil society responsible for coordinating the design and development of the Taxonomy - Tier 3 - A group or set of technical working groups responsible for the design or co-design of the content of the Taxonomy **ITAG Recommendation 18** As an integrity safeguard, government funding for the Taxonomy should be provided from a different agency/source than the government oversight group (Tier 1).

ITAG Recommendations

Principles

The Taxonomy of Aotearoa New Zealand should be based on 5 core guiding principles:

Credibility – Mana. Applying an evidence-based approach together with international best practices and standards to attract and direct the flow of international capital towards green solutions. The Taxonomy needs to be transparent in its governance structure, especially in how the Technical Screening Criteria (TSC) are designed to give effect to the Taxonomy's purpose. Strong safeguards need to be in place to ensure political and industry influence is limited.

Usability - Whakamahi. The Taxonomy should be easy to use and fit-for-purpose. The TSC need to be easily understood by a spectrum of different end users and promote data and metrics that are easy to report against.

Interoperability - Tuhono. As much as possible, the Taxonomy should align with international standards and best practices for the design of its structure, components TSC, Do No Significant Harm (DNSH) and Minimum Social Safeguards (MSS). It should promote interoperability with Australia (Trans-Tasman) as well as with New Zealand's main trading partners EU, UK and other benchmark taxonomies in the APAC region such as Singapore.

Culture – Ahurea. Human society depends on nature, and nature is not seen simply in monetary terms. Indigenous culture and rights are a core principle underlying the entire Taxonomy. Iwi and Māori leaders will be represented in all governance tiers and their views of nature integrated in the design of the Technical Screening Criteria.

Prioritisation - Whakarite. Prioritisation should determine both the selection of environmental objectives the Taxonomy should focus on at first and the sequencing of the design of the TSC based on what sectors of the economy are a priority for New Zealand.

ITAG Recommendation 1

The Principles of the Taxonomy of Aotearoa New Zealand should be:
- Credibility – Mana
- Usability - Whakamahi
- Interoperability – Tuhono
- Culture – Ahurea
- Prioritisation - Whakarite

Purpose

The ITAG recommends the following purpose statement for the Taxonomy of Aotearoa New Zealand:

"The sustainable Taxonomy of Aotearoa New Zealand is a classification system for mobilising and directing capital flows to build a low-emissions, Paris-aligned future, restore nature and uphold the rights and interests of indigenous people of the land"

The main drivers for the development of the Taxonomy of Aotearoa New Zealand are:
1. Mobilising and directing international and domestic capital flows to build the type of infrastructure, systems, products and services required for a low-emissions future with nature at the center of the economy
2. Alignment with the goals of the Paris Agreement to keep temperature well below 2-degrees and pursue efforts to limit warming to 1.5 degrees – with a focus on climate mitigation and adaptation and resilience as per Agreement

ITAG Recommendation 2
The purpose statement of the Taxonomy of Aotearoa New Zealand is:
"The sustainable Taxonomy of Aotearoa New Zealand is a classification system for mobilising and directing capital flows to build a low-emissions, Paris-aligned future, restore nature and uphold the rights and interests of indigenous people of the land".

ITAG Recommendation 3
There is formal and increasing international recognition of the contribution and rights of indigenous peoples and local communities as custodians of biodiversity and as partners in its conservation, restoration and sustainable use. To reflect the culture of Aotearoa New Zealand, the ITAG recommends that the rights and knowledge of iwi/Māori are embedded into the design of the Taxonomy.

Objectives

A taxonomy's objectives are a key part of its interoperability with other benchmark taxonomies. Climate change mitigation is generally the most common environmental objective because it is easier to determine the substantial contribution economic activities make to it (i.e. existing best practices, interoperable criteria and thresholds, robust and credible approach).

Adaptation and Resilience (A&R) is a key priority objective for Aotearoa New Zealand, but there is still lack of international consensus around what substantial contribution to A&R means given its highly contextualised nature. Therefore, prioritisation and sequencing of work will be important as the development of criteria for some environmental objectives will run to different timelines due to lack of clear, applicable international precedents and other complexities.

Regarding social objectives, the Aotearoa New Zealand Taxonomy should not include social components as there is no mandate to develop a social taxonomy at the moment under this project, but it should address social standards through the development of Minimum Social Safeguards (MSS). Some taxonomies (such as Mexico) have sought to include social objectives, but they are considered at the entity-level rather than at the activity level, which is not the current focus of the proposed Aotearoa New Zealand Taxonomy.

The Aotearoa New Zealand Taxonomy should also include broader environmental objectives as risk mitigants through the development of the Do No Significant Harm (DNSH) component. More specifically, the DNSH makes sure the design of substantial contribution criteria to one environmental objective does not cause harm to other environmental objectives. In addition, based on the experience of the EU with the development of DNSH criteria, this component of the Taxonomy should be designed in an implementable way in order to avoid ambiguity and lack of applicability.

ITAG Recommendation 4
In line with international best practices, the environmental objectives of Aotearoa New Zealand will include iwi/Māori understanding and knowledge related to each objective and be (not in order of priority):

- Climate Change Mitigation
- Climate Change Adaptation
- Sustainable Use and Protection of Water Resources and Marine Resources
- Protection and Restoration of Biodiversity and Ecosystems
- Pollution Prevention and Control
- Transition to a Circular Economy

-- Iwi/Māori knowledge --

Sector prioritisation

The coverage or boundaries of the Taxonomy is the sectors and subsectors for which TSC will be developed and proposed. While a taxonomy can, in principle, cover any number or types of sectors, most countries prioritise sectors that are most relevant to their economy based on a range of factors, such as:
- Relevance to the economy as measured by GDP or other metrics
- Materiality of sector to GHG emissions – e.g. % of emissions represented by sector
- Relevance to jobs/employment statistics
- Proportion of FDI/trade
- Ease of developing criteria measured by appearance of in other taxonomies
- Importance to green bond issuance as measured by green bond issuance statistics
- Potential for innovation – presence in a future economy
- Importance sector for Māori empowerment and/or needs for capital flows to promote growth

- Other New Zealand specific factors/features
- Importance of external capital to the sector and its value chain

ITAG Recommendation 5

A survey was organised amongst the members of the ITAG, which resulted in the following key priority sectors for the Taxonomy. The sectors have been ranked according to the % of respondents that selected the sectors as priority:

- Agriculture, Forestry & Fishery
- Transport
- Construction & Real Estate activities
- Energy
- Industrial Manufacturing

Definitions

Categorisation framework – ANZSIC

The Australian and New Zealand Standard Industrial Classification has been developed for use in the compilation and analysis of industry statistics in Australia and New Zealand. It is the primary classification system used by the government, financial institutions, and corporations for collecting, analysing, and reporting economic activity data.
ANZIC is comparable internationally by aligning the classification, as far as possible, with the International Standard Industrial Classification of All Economic Activities (ISIC).

ITAG Recommendation 6

The Taxonomy of Aotearoa New Zealand should adopt ANZSIC as its classification system in order to align with other benchmark taxonomies such as Australia and the European Union's. When ANZSIC codes are not available at the granular activity-level, the ITAG recommends the Taxonomy to build *ad hoc* activity-specific codes.

Usability

Usability is the phrase used to define how well a taxonomy can be applied and integrated into a market. Given that a taxonomy can be both a technical document/tool as well as a policy tool, usability refers to the ability of a taxonomy to be used as both or either of these tools – i.e. how practical the criteria are to measure and report on (as a technical tool) as well as how practical the reporting requirements are (as a policy tool).

Usability is a major topic of discussion around the world, but it is epitomised in the EU where the regulated nature of the Taxonomy has meant that usability remains a challenge that is in the process of being resolved. To revolve usability issues and challenges, the EU Platform of Sustainable Finance (PSF) has put forward an extensive paper which provides a set of recommendations to improve the usability of criteria, DNSH tests and the Taxonomy regulation and how it is applied.

The technical and regulatory usability of a taxonomy are heavily interlinked - e.g. if a taxonomy is not in regulation, then other features of usability become less critical because they do not 'have' to be met or measured. As in many jurisdictions where taxonomy use will not be mandated, the design aspects are even more critical as the simplicity and technical usability of the taxonomy become key drivers of its take-up.

<u>Interoperability</u> is the term used to describe the ability for the taxonomy to be used and understood across borders. If taxonomies differ substantially from each other and interoperability is low, this will negatively impact the ability for the taxonomy to be used as a tool to facilitate cross border capital flows.

ITAG Recommendation 7

To enhance usability in New Zealand, it is important to connect to existing data, national and international labels and criteria while also growing relevant capacity and increasing the availability of new information over time.

ITAG Recommendation 8

The Taxonomy also needs to be linked to existing disclosure requirements – e.g. Aotearoa New Zealand Climate Standards.

ITAG Recommendation 9

The Taxonomy developers should ensure that the Taxonomy is fit-for-purpose across a range of key stakeholders in New Zealand including regulatory agencies, the public sector, iwi/Māori, and capital market stakeholders.

Application

The application of a taxonomy refers to how the taxonomy is used within a market. In particular:
- Who should use it? e.g. corporates and borrowers, banks, investors, governments etc.
- What should it be used for? e.g. classifying bonds, consistency in corporate disclosures and transparent reporting, etc.
- Is it mandatory or voluntary?

This is the 'ruleset' around the taxonomy and goes beyond the taxonomy as a technical document and into its uses within the market.

Voluntary or Mandatory application

The decision over whether or not the Taxonomy will be voluntary, or mandatory is beyond the remit of the ITAG. Despite this, the relative merits and pitfalls of voluntary or mandatory use of the Taxonomy was discussed at length by the ITAG.

The merits of mandating the Taxonomy included that it would create comprehensive data that could be a decision-making tool useful for a range of stakeholders. It would also create a level playing field across users and ensure consistent take-up of the Taxonomy among the core user groups.

The downsides of mandating it included that it may be costly to comply, particularly in the short term, and that mandating is a means to an end that could be achieved with other solutions. Furthermore, there are advantages to putting the Taxonomy out for implementation by users and allowing time to assess its usability before it is mandated.

Moreover, in recent years there has been a noticeable lack of New Zealand companies listing on the stock exchange and a trend towards some opting to list in other countries instead. The cost of taxonomy regulation, whether perceived or actual, may further exacerbate this problem and, therefore, it might be more beneficial to design a phased-in approach with limited mandatory requirements for companies with sufficient size and resources to undertake the necessary measurement and reporting of data against the Taxonomy.

ITAG Recommendation 10
It would not be expected to mandate the use of the Taxonomy in its initial phase, but it could become mandatory over time following a phase-in approach or grace period.

Use cases: debt markets, corporate disclosure or other uses

A taxonomy is, at its core, a technical document that could be applied across a range of uses including:
- Green bonds as a document defining what is exactly included in a green bond (its underlying projects and assets) i.e. beyond the broad Green Bond Principles
- Investment Fund alignment demonstrating how investment funds such as Kiwisaver are invested in taxonomy activities
- Corporate disclosures as a document defining how corporate define green business lines
- Green labels - helping to evidence the green/sustainability labels of financial products, fund etc.
- Policy tool to define which types of activities receive incentives relating to green growth etc.

While the Taxonomy can be used across a range of applications, the development process can be facilitated by knowing what the intended use of the Taxonomy will be.

ITAG recommendation 11
The Taxonomy of Aotearoa New Zealand should be designed for a broad range of applications, not just debt markets.

ITAG Recommendation 12
Following the example of benchmark taxonomies such as the ASEAN, Australian and Singaporean taxonomies, the Taxonomy should have a role in facilitating transition finance.

Taxonomy eligibility

As per the EU Taxonomy, there is a difference between taxonomy eligibility, alignment and compliance. Taxonomy eligibility refers to whether an economic activity falls within the scope of the taxonomy i.e. the activity substantially contributes to one of the environmental objectives. By contrast, taxonomy alignment refers to whether an economic activity and its underlying assets (use of proceeds) fulfil the relevant Technical Screening Criteria so that it can be labelled as green. Similarly, taxonomy compliance means that the economic activity and its underlying assets (use of proceeds) fulfil the relevant Technical Screening Criteria as well as the DNSH and MSS components of the taxonomy.

An activity can be aligned with a taxonomy in three different ways:
1. **Substantial contribution** – the activity provides substantial contribution to one of the environmental objectives of the taxonomy
2. **Enabling** –the activity might not substantially contribute to one of the environmental objectives *per se,* but it is critical to enable other activities to substantially contribute to one of the taxonomy's environmental objectives. For instance, the manufacturing of electric batteries has a relatively high level of GHG emissions throughout its lifecycle analysis but, it enables other economic activities to decarbonise, such as private land transport (i.e. electric vehicles). In addition, according to the EU Taxonomy definition, enabling activities "*must not lead to lock in of assets that undermine long-term environmental goals and their environmental impact must be positive over the life cycle (i.e. the benefit that is enabled must be larger than the impact of the enabling activity)*[5]".
3. **Transition** – the an activity for which there is currently no technological or economically feasible low carbon alternative and is therefore not currently **aligned** with the taxonomy's objectives (e.g. climate change mitigation) but can support the transition by being decarbonised along a science-based pathway as technologies are developed. For instance, cement manufacturing is transitional because cement production is a necessary activity and there are no currently available large-scale replacement/alternative material that is net zero (Please see the Transition section below).

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[5] JRC, Techinical Report, page 10: https://publications.jrc.ec.europa.eu/repository/handle/JRC126045

According to the EU Taxonomy[6], the criteria to determine the alignment of an activity under the taxonomy can be subdivided into three main categories:

1. **Technical screening criteria** – they generally refer to numerical thresholds that allow for a simple binary assessment– the activity either meets the threshold or it does not. Thresholds-based criteria are relatively easy to use and allow for very little room for interpretation so that, in practice, they reduce the risk of greenwashing. However, they tend to be more data intensive.
2. **Whitelists** – are lists of automatically aligned technologies or measures that are prescribed by the taxonomy. They tend to be very easy criteria to use when data availability is a hurdle because the deployment of those technologies essentially act as a proxy for decarbonisation. Whilst usable, whitelists do not prescribe how the technologies included in a whitelist need to be used and, therefore, they provide less safeguards against greenwashing compared to the threshold-based approach.
3. **Principles-based** – taxonomies that features principle-based criteria tend to be quite high-level and not very prescriptive. The idea is that the taxonomy is flexible to accommodate a broad spectrum of users. Whilst easy to use, principle-based criteria leave a lot of room for interpretation to the end user and may easily allow for greenwashing and inconsistency of application.

ITAG recommendation 13
The Taxonomy of Aotearoa New Zealand should adopt an alignment approach based on technical screening criteria that are binary, credible and internationally-recognised.

ITAG Recommendation 14
The technical screening criteria can be complemented by whitelists (technologies or measures) where deemed necessary.

Transition

Transition indicates the movement of an economic activity towards minimum emissions aligned with the long-term temperature goal of the Paris Agreement. While it is clearly an aim of transition-related policies, incentives, regulation and taxonomies to support and facilitate ambitious movements towards or below net zero, the key challenge for a taxonomy is how to recognize this movement with criteria or thresholds that are static at a point in time.

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[6] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

According to the EU Taxonomy[7], a transitional activity qualifies as substantially contributing to climate change mitigation if it:

" Supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels, including by phasing out GHG emissions, in particular emissions from solid fossil fuels, and where that activity:
   a. Has greenhouse gas emission levels that correspond to the best performance in the sector or industry;
   b. Does not hamper the development and deployment of low-carbon alternatives; and
   c. Does not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets."

In practice, there are some sectors of the economy that are difficult to rapidly decarbonise with currently available technologies (also called hard-to-abate sectors). Therefore, transition finance label seeks to move capital towards those activities that currently generate substantial emissions but are driving ambitious emissions reductions (towards a Paris-aligned pathway) within a specific period of time. A transition label can facilitate the decarbonisation of high-emission industries such as steel, cement, aviation, agriculture, etc.

While almost all taxonomies include hard to abate sectors and transition concepts in some way, several taxonomies utilise specific transition categories to distinguish these from green/Paris-aligned activities. These include Australia, ASEAN and Singapore while Canada has developed a methodological approach to transition[8]. The most commonly used approach to label transition activities is the traffic light system where activities are subdivided into three categories:

Green: these are activities that currently substantially contribute to one of the environmental objectives of the taxonomy. This does not mean that all green activities are necessarily net zero or below zero now but rather that they are following a science-based pathway aligned with the long-term temperature goal of the Paris Agreement.

Amber: these are activities that currently still operate at substantial emissions and have no low carbon alternative but that are a necessary part of the economy and societal well-being at present and that are:
- Moving rapidly towards a green transition pathway within a predetermined time period (sunset date); or
- In the short-term, encouraging significant GHG emissions reductions within a specific sunset date.

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[7] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN
[8] https://www.canada.ca/en/department-finance/programs/financial-sector-policy/sustainable-finance/sustainable-finance-action-council/taxonomy-roadmap-report.html

Red: these are activities that are not currently compatible with a net zero future in 2050. Generally, the only way for them to be aligned with a 1.5-degree future is for them to be phased out because their GHG emissions cannot be reduced such as in the case of most fossil fuels (including Scope 3 emissions).

An amber label transition cannot last indefinitely. As amber transition activities are not yet aligned with a 1.5-degree trajectory, at some point, they will need to be on a trajectory consistent with the Paris Agreement. To ensure this, most taxonomies propose a sunset date for the amber category whereafter, it ceases to exist, and the activity is either aligned with the green category or it becomes ineligible/excluded. A sunset date is determined at the sector and activity level.

By contrast, the EU Taxonomy does not explicitly label activities as transitional or employ the traffic light system. However, it does use the best-in class approach for activities where low-carbon alternatives are not widely available (for instance, cement manufacturing). This is done by identifying the top 10% or 15% of the best available performers within a sector or activity and then, using their GHG emissions level as a baseline, drawing a trajectory towards zero by a specific sunset date.

ITAG Recommendation 15
The Taxonomy of Aotearoa New Zealand should focus on defining 1.5 degree aligned 'green' activities as a priority but consider the use of a separate transition category. The category should encourage substantial movements towards a 1.5-degree pathway for a defined and limited list of sectors/activities that are material and relevant to Aotearoa New Zealand. This transition category should be for activities within a predetermined period of time.

ITAG Recommendation 16
The Taxonomy of Aotearoa New Zealand should consider adopting a traffic light system to label transitioning activities that is based on *a robust methodology to ensure that any transition category or label is used to drive material step changes to emissions beyond business as usual.*

Governance

A robust governance structure is key to ensure the success and credibility of a taxonomy. It should safeguard the transparency and scientific rigour of the way the TSC, DNSH and MSS are designed as well as ensuring that the taxonomy is maintained and periodically updated. The governance structure and its rules are generally confirmed at the preparatory stage of the taxonomy design phase.

Based on existing models, taxonomies are often developed as a partnership between experts or industry-led groups and the government of a specific country or jurisdiction. In addition, the process of developing a taxonomy should be highly consultative both in terms of how its different components are designed (TSC, DNSH and MSS) as well as in terms of how the general public is involved in the provision of feedback through consultations.

Generally, the governance structure of a taxonomy is focused on the interaction and clear demarcation of responsibilities between different groups. Terms of Reference (ToR) are created in order to clearly describe the tasks and responsibilities of each group whilst their membership is made publicly available. It is therefore crucial that the governance structure is transparent and collaborative in order to ensure effective checks and balances amongst the different groups.

More in detail, taxonomies are usually mandated and overseen by the government or regulator of a country or jurisdiction (for instance, the European Commission or the Hong Kong Monetary Authority). A project execution or coordination body is in charge of the delivery of all the tasks involved in the development of the taxonomy as well as the review and consolidation of technical feedback.

The body is also responsible for creating the first draft of the taxonomy document. Then, a group(s) consisting of scientists, academics, representatives of industry and of the financial sector is responsible for the design of the TSC, DNSH and MSS components of the taxonomy. Safeguards against political intervention should be established to protect the integrity of Tier 2 and Tier 3 groups. As well as minimising conflict of interest to maintain the integrity of the Taxonomy.

For instance, the EU initially set up the Technical Expert Group on Sustainable Finance (TEG) which was then replaced by the Platform on Sustainable Finance (PSF), both responsible to design and develop the Taxonomy whilst coordinating several Technical Working Groups (TWG) mandated to design its TSC, DNSH and MSS. The work of the TEG/PSD is overseen by the European Commission who is responsible for embedding the Taxonomy into EU law, for designing the related regulation such the EU Taxonomy Delegated Act (2021) and for the long-term maintenance and update of the Taxonomy.

In Singapore, the Taxonomy is overseen by the Monetary Authority of Singapore (MAS) and the development of the TSC was undertaken by the so-called Green-Finance Industry Taskforce supported by the Climate Bonds Initiative as an external consultant. In the UK, the British Government mandated the Green Finance Institute (GFI) to coordinate the design and development of the Taxonomy whilst the Department of Food and Agriculture (DEFRA) is designing the TSC in collaboration with sector-specific advisory groups.

In Australia, the Australian Council of Financial Regulators' Climate Working Group (CWG) oversees the development of the Australian Taxonomy and provides the final endorsements. The Taxonomy Technical Expert Group (TTEG) provides strategic direction and technical feedback on the design of the Taxonomy via its 25 members comprising of experts in the fields of finance, climate change, human rights, environmental science and policy amongst others. The TSC, DNSH and MSS are designed in consultations with sector-specific Technical Advisory Groups (TAGs) and supported by the Climate Bonds Initiative as an external consultant.

Following these international examples, it is proposed that the Taxonomy of Aotearoa New Zealand adopts a three-tiered approach to its governance structure:

Tier 1: this represents the owners of the Taxonomy document who oversee its development and update. These stakeholders would be expected to be a government body or a committee consisting of members of different government agencies (such as the Treasury, Ministry for the Environment, the Reserve Bank, etc) and utilize existing mechanisms for Crown-Māori engagement such as the National Iwi Chairs' Forum Pou Tahua. They provide strategic direction to the Taxonomy and endorse its objectives whilst also ensuring it is aligned with the national goals and policy of the country. The Tier 1 group focusses on the process rather than the content of the Taxonomy i.e if the group chooses not to endorse the Taxonomy, they would need to specify in what way the Taxonomy process has not been followed correctly rather than expressing an opinion on the scientific rigour of the content of the Taxonomy.

Tier 2: a body or committee that oversees the design and development of the Taxonomy. The group serves as a coordinating link between Tier 1, who need to be regularly updated on the development of the Taxonomy, and Tier 3 (see below) who co-design its content. The membership of the group can be comprised of a variety of different stakeholders including industry, finance, iwi/Māori, civil society, think-tanks and government agencies depending on their expertise.

Tier 3: members of this group generally design or co-design the different components of the Taxonomy (TSC, DNSH and MSS) and are often supported by an external consultant. They are generally not just one single group but are a collection of sector-specific technical working or advisory groups. For instance, the EU Taxonomy created a series of technical working groups on usability, transition, social components as well as A&R, transport, energy, manufacturing etc.

In this context, the role of the government is crucial to ensure the Taxonomy is endorsed at the political level in order to provide legitimacy to the process and to provide a predictable source of funding to guarantee a stable environment for the development of the Taxonomy. However, the government should not drive the design of the content of the Taxonomy. Industry and political influences should not hinder the independence of the body developing the TSC.

ITAG Recommendation 17
The Taxonomy of Aotearoa New Zealand should adopt a three-tiered governance structure to ensure the transparency and credibility of its development process and with formal roles for iwi/Māori across all tiers. This would include:
- o Tier 1 - An overseeing body responsible for the endorsement of the Taxonomy and for the provision of strategic direction to it
- o Tier 2 - A coordinating group consisting of members with relevant expertise from within government, industry and civil society responsible for coordinating the design and development of the Taxonomy

o   Tier 3 - A group or set of technical working groups responsible for the design or co-design of the content of the Taxonomy

ITAG Recommendation 18
As an integrity safeguard, government funding for the Taxonomy should be provided from a different agency/source than the government oversight group (Tier 1).

This draft document was produced by the Climate Bonds Initiative and the Centre for Sustainable Finance: Toitū Tahua on behalf of the Aotearoa New Zealand Green Taxonomy Independent Technical Advisory Group (Phase 2).

Please submit questions to taxonomy@sustainablefinance.nz