

# EU Taxonomy: expanding beyond carbon

A consideration of nature-related risks

## Introduction

The rapid rate of global biodiversity loss has made the protection of biodiversity a crucial and urgent subject to be addressed by national and international action by both governments and industry. For a while, climate change and biodiversity have been seen and treated as separate issues, but the two are intrinsically linked. Therefore, the key to solving both of these global challenges lies in the need to address them simultaneously rather than individually. The figures on biodiversity loss and nature decline are staggering, with an average global species decline of 69% since the 1970s. Furthermore, estimates suggest that biodiversity loss will have substantial economic damages, as biodiversity accounts for between [€1.7trillion](#) and [€3.9trillion](#) annually (DBN).

It is worth highlighting that the abundance of biodiversity is not the only crucial factor for consideration when discussing biodiversity. The [variety of species and interconnectedness between ecosystems](#) is also of paramount importance ([Responsible Investor, 2023](#)). This is highlighted by the global goal of the [Kunming-Montreal Global Biodiversity Framework](#) resulting from COP15, which not only aims to protect 30% of terrestrial, inland waters, and coastal and marine ecosystems by 2030 (target 2 and target 3), but also on creating and improving the connectivity between ecosystems and areas (target 12), rather than solely achieving the protection target ([CBD, 2022](#)).










The heightened importance of biodiversity goes hand in hand with increased regulatory efforts to address decreasing levels of biodiversity abundance and variety. Furthermore, initiatives and frameworks for financial institutions to help the organisations scope and understand the impacts and dependencies of their activities on biodiversity and nature are continuously increasing in number and focus (see Figure 1).

## The objectives of the EU Taxonomy

As environmental, social and governance (ESG) considerations for investment and lending decisions have gained ground over the past years, this has gone hand in hand with increased regulatory requirements for financial market participants to illustrate and report on their ESG performance. Within the European Union (EU), sustainable finance forms an integral part of the European Green Deal and has become a key area of focus towards the European Union's social and environmental objectives for finance to support economic growth without increasing pressures on the climate and wider environment (European Commission (1), European Commission (2)).



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<b>Regulatory developments</b>			
<b>Description/objective</b>	Classification system for sustainable activities, including biodiversity considerations	Aims to protect nature and reverse degradation of ecosystems by 2030.	Adoption of a new set of international goals for biodiversity: the Kunming-Montreal Global Biodiversity Framework (GBF).
<b>Finance/investor initiatives</b>			
<b>Description/objective</b>	Provides financial institutions with practical guidance on biodiversity impact and dependency assessment.	Initiative for financial institutions to pledge and commit to protect and restore biodiversity through finance activities and investments.	Global investor engagement initiative on biodiversity, focused on engagement with sectors that are systemically important to reversing biodiversity loss.
<b>Frameworks &amp; tools</b>			
<b>Description/objective</b>	Framework for risk management disclosure to report and act on nature-related risks and opportunities.	Guidance on setting science-based targets that integrate not only climate (e.g. carbon) but across Earth systems.	Tool to scope the impacts and dependencies of sectors included in the portfolio on biodiversity and nature.

**Figure 1.** A selection of regulations, initiatives and frameworks focusing on biodiversity and financial market participants. (Sources: CBD, 2022, ENCORE, European Commission (1), European Commission (2), Finance for Biodiversity, Nature Action 100, PBAF, SBTN, TNFD, UNEP, 2022) .

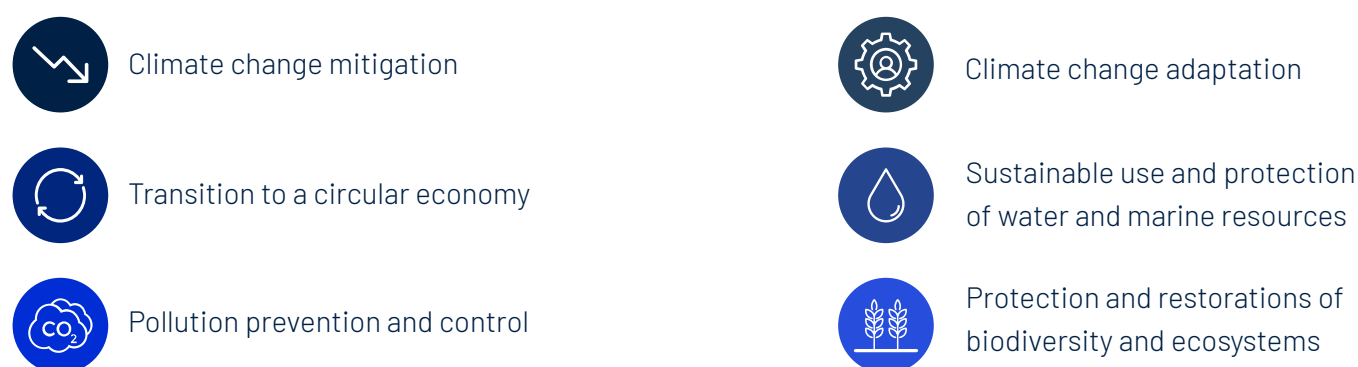
To this end, the European Commission (EC) set up the EU sustainable finance framework, consisting of various regulatory efforts to increase transparency on ESG performance and minimise the negative impacts of the financial sector on the environment. Furthermore, EU sustainable finance regulations are all underpinned by six key environmental criteria (see Figure 2).

In November 2019, the EC published the Sustainable Finance Disclosure Regulation (SFDR). This Regulation lays down harmonised rules for FIs “on transparency regarding the integration of sustainability risks and principal adverse sustainability impacts (PAIs) in their processes and the provision of sustainability-related information concerning financial products” (European Parliament and Council of the European Union, 2019, para.36). Within the mandatory PAIs, FIs will need to report on the share of investments negatively affecting biodiversity sensitive areas, their emissions to water as well as hazardous and radioactive waste. Additional voluntary PAIs include information on land degradation activities and investments in companies without a policy to address deforestation/sustainable oceans/sustainable land practices.

Early 2023, the Corporate Sustainability Reporting Directive (CSRD) entered into force amending the previous rules introduced by the Non-Financial Reporting Directive (NFRD) (European Commission). CSRD is meant to modernise and strengthen the reporting rules regarding ESG information for companies. CSRD will apply to FIs as long as they meet the criteria specified in the scope. Companies subject to the CSRD will have to report according to the European Sustainability Reporting Standards (ESRS). The ESRS provide both obligatory and voluntary reporting requirements. Beyond the general requirements, each company should assess the 'topical standards' (including the climate change standard) in terms of materiality<sup>1</sup> to decide whether to disclose on the impacts or not. Within 'ESRS E4 – Biodiversity and Ecosystems' companies must disclose on their material impacts, risks and opportunities, their processes to identify and assess them, as well as policies, transition plans and metrics related to their mitigation and adaptation actions regarding their impact, risks and opportunities on biodiversity and ecosystems.

The EU Taxonomy (EUT), published in 2020, is a keystone of the EU's sustainable finance framework and an important tool fostering market transparency that helps direct investments to the economic activities most needed for a green transition. The goal of the EUT is to incentivise investments that support the transition towards an economy that is consistent with the EU's environmental objectives by providing a classification system of economic activities with performance criteria to scope and assess an activity's eligibility and alignment with the EUT (see Figure 3).

Until now, the EUT covered only those activities that substantially contribute to climate change mitigation and/or climate change adaptation, focusing largely on carbon emissions. However, in June 2023, the EC published new guidance and documentation, which significantly increases the scope of the EUT across the remaining environmental objectives. This signifies a larger industry trend for the financial sector to increase its environmental considerations beyond carbon to wider nature-related impacts (European Commission).



**Figure 2.** The six environmental objectives of the EU Taxonomy (European Commission, 2023)

<sup>1</sup> CSRD follows a double materiality perspective where the impact of the company on the planet (impact materiality) and the impact of the planet on the company (double materiality) needs to be considered.

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1. Determine eligibility		Is the main activity of the investment one of the <b>eligible activities</b> under the EUT?	✓	✗ no further assessment
2. Assess Alignment	A.	The activity <b>substantially contributes</b> to one of the EUT's environmental objectives based on the technical screening criteria	✓	✗ no further assessment
	B.	The activity showcases it <b>Does No Significant Harm (DNSH)</b> to the other five objectives	✓	✗ no further assessment
	C.	The company complies with the <b>Minimum Social Safeguards</b> to safeguard harm against human and labour rights, bribery, taxation and fair competition		
3. Activity aligned/unaligned		If the previous steps are followed, the activity can be determined <b>aligned or unaligned</b> .	✓ <b>aligned</b> – activity is categorised as sustainable under the EUT	✗ unaligned

**Figure 3.** Approach to the EUT's alignment assessment (Source: European Commission)

## EUT expansion to biodiversity

From its inception, the EUT has been referred to as a 'living document', which will develop over time and increase the scope of activities that it covers. The EUT does not outline a specific timeline to increase the scope of activities covered, focusing on expanding coverage once enough technical guidance and screening criteria is available for specific activities.

After publishing guidance on economic activities contributing to climate change mitigation and adaptation, the EUT published the Environmental Delegated Act which covers the four remaining environmental objectives in June 2023 (European Commission). These delegated acts include new EUT criteria for economic activities that make a substantial contribution to either one of the following objectives: sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and/or protection and restoration of biodiversity and ecosystems. Furthermore, the EUT has increased the scope of activities covered, which further increases the eligibility and alignment criteria for financial market participants.<sup>2</sup>

<sup>2</sup> Not all sectors are included in the current Delegated Acts. Specifically, land use and food production-related activities, such as agriculture, aquaculture and fishing. These high-emitting activities are likely to be included in the EUT at a later stage, as more in-depth assessments and technical criteria are needed to include these activities in the EUT Act. The EC is awaiting the completion of the Common Agriculture Policy to provide further details (European Commission).

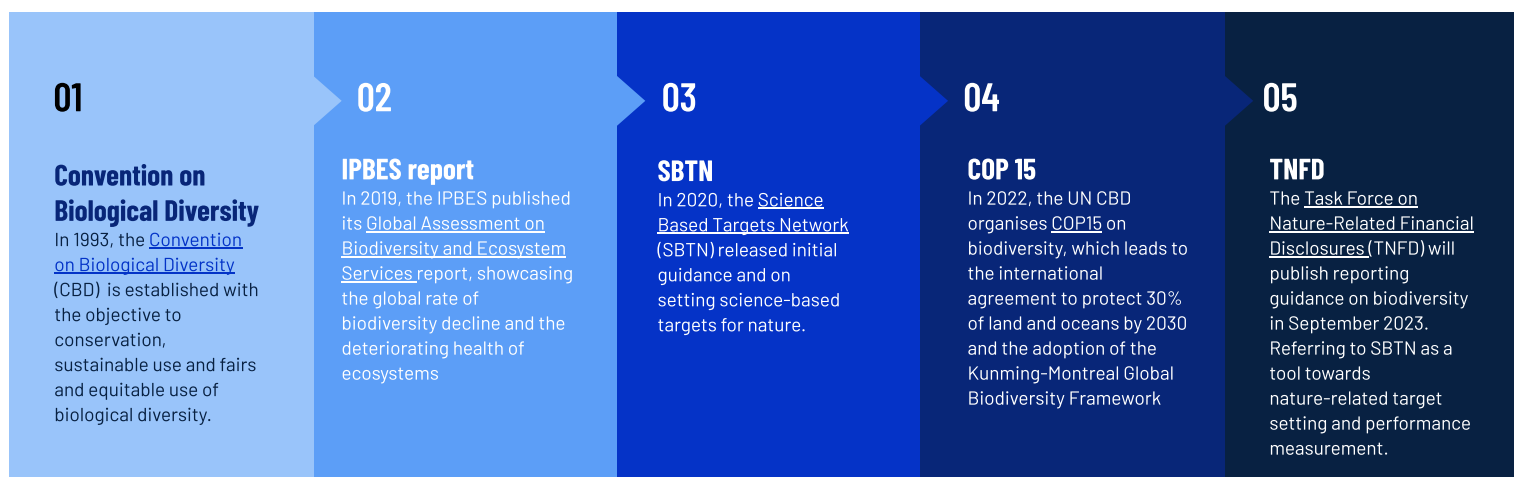
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### What are the new activities encompassed within the four additional objectives?

- **six activities on water and marine resources for four sectors**
- **21 activities on the transition to a circular economy for five sectors**
- **six activities on pollution prevention and control for two sectors**
- **two activities on the protection and restoration of biodiversity and ecosystems for two sectors**

**Figure 4.** Additional activities under the Environmental Delegated Act

The expansion of the Environmental Delegated Act regarding the protection and restoration of biodiversity and ecosystems falls in line with the wider adoption and increased consideration of nature-related risks for FIs. Over the past years, various publications have showcased the alarming rate of biodiversity loss globally, as well as the potential implications on livelihoods and the global economy, such as IPBES Global Assessment on Biodiversity and Ecosystem Services and WWF's Living Planet Report (IPBES, 2019; WWF, 2022). Furthermore, the Convention on Biological Diversity's 15th Conference of the Parties (COP 15), held in Montreal in December 2022, showcased the need to further conserve, protect and restore nature, both to mitigate and adapt to climate change as well as ensure that biodiversity levels do not diminish further, and should even increase (see Figure 5).



**Figure 5.** Key biodiversity initiatives and developments (Sources: CBD; IPBES, 2019; SBTN; TNFD; UNEP, 2022).

<sup>1</sup> Not all sectors are included in the current Delegated Acts. Specifically, land use and food production-related activities, such as agriculture, aquaculture and fishing. These high-emitting activities are likely to be included in the EUT at a later stage, as more in-depth assessments and technical criteria are needed to include these activities in the EUT Act. The EC is awaiting the completion of the Common Agriculture Policy to provide further details.

The EUT Environmental Delegated Act for the protection and restoration of biodiversity and ecosystems provides the technical screening criteria and activities that can be considered under this environmental objective for two activities: 1) **environmental protection and restoration activities**<sup>3</sup> and 2) **accommodation activities**<sup>3</sup> (European Commission). Therefore, the delegated act on biodiversity and ecosystem protection does not currently include a wide variety of activities and provides a relatively limited scope. For the activity 'environmental protection and restoration activities', the EC documentation provides guidance that largely follows the technical screening criteria of forestry-related activities, where the description of the area under consideration, its management, an audit and guarantee of permanence need to be showcased. In addition, following the Do No Significant Harm (DNSH) criteria, the activity should have water management/conservation and pesticide control in place, along with scoping potential physical risks and not damage any high carbon stocks to be considerate of carbon sequestration potential in the conservation area.

## A practitioner's view

The Taxonomy's consideration and inclusion of biodiversity and ecosystem conservation and restoration is a positive development to foster knowledge beyond carbon. However, the current considerations encompassed by the EUT fall short of providing guidance and recommendations that enable FIs to understand the scope and extent of the impacts of their activities on nature and biodiversity.

- In addition to the additional guidance on environmental preservation and restoration activities, throughout the EUT, the protection and restoration of biodiversity and ecosystems is included to a degree within the DNSH criteria for other eligible activities. DNSH criteria generally involve a three-step assessment: 1) the activity has completed an Environmental Impact Assessment (EIA) in line with EU regulations or equivalent applicable national law or international standards, 2) where an EIA has been carried out, the required mitigation and compensation measures for environmental protection are implemented, and 3) for sites/operations near biodiversity-sensitive areas an appropriate assessment is carried out and necessary mitigation measures implemented.
- Although the DNSH criteria require a high-level assessment of environmental impact, they fall short of outlining detailed guidance to assess and more accurately measure the impact of activities on biodiversity and the quality of actions taken towards the protection of nature. Furthermore, the EUT does not provide guidance or support financial market participants to scope the dependencies of their investments on biodiversity and nature. Therefore, FIs might be more inclined to start scoping their dependencies and impact on nature and biodiversity through other upcoming frameworks and initiatives.
- The scope of activities included is a first step in identifying aligned activities but due to the limited scope, the ability of the EUT to catalyse financial flows towards biodiversity conservation and restoration at the scale required is likely to be limited, particularly given that investment in conservation-related

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<sup>3</sup> Restoration activities are also mandated under the Kunming Montreal GBF under target 2 (CBD, 2022).

activities is not currently seen as an attractive investment opportunity for most FIs. Instead, financial flows earmarked as sustainability-focused are largely directed towards climate mitigation or adaptation, and even in such cases they represent a small portion of most investment strategies.

- Accommodation activities is likely to be a more attractive investment activity for FIs to seek alignment towards, but it is worth highlighting that this activity exhibits a lower level of dependency and impact on biodiversity and nature compared to other sectors.

Although the EUT has now taken steps to encompass biodiversity within its considerations, it is important to highlight the vital importance of carrying out a thorough biodiversity impact and dependency assessment as a first step taken by an FI to develop an initial understanding of the impacts and dependencies of investment and allocation strategies on biodiversity.

This said, conducting such an assessment can represent a complex endeavour for financial institutions due to the fact that conducting an accurate supply chain-wide assessment of impact and dependencies across thousands of holdings and assets in a portfolio or strategy requires tools and frameworks that can conduct this assessment at scale and with accuracy. Therefore, the first step for a FI could be to conduct a high-level biodiversity assessment guided by some of the tools and frameworks available and developed for this purpose.

## Frameworks and tools to build internal knowledge on nature

Below, we outline three frameworks and tools available to FIs that can be useful as a first step in exploring and understanding of biodiversity and nature considerations for FIs. It is important to note that this is not an exhaustive list and there are additional options and/or approaches available.<sup>4</sup>

- TNFD is emerging as the leading framework for nature-related disclosures and it is recommended that FIs become familiar with its recommendations, particularly as the Task Force on Climate-Related Financial Disclosures (TCFD) has already established itself as the guiding framework for both industry and regulatory requirements on climate-related disclosures, and it is likely that a similar level of adoption of TNFD will be evidenced in the near future.
- The Taskforce on Nature-related Financial Disclosures (TNFD) provides a framework for risk management disclosure to report and act on nature-related risks and opportunities. The objective of the framework is to direct financial flows away from harmful practices, and towards nature-positive outcomes. The framework is structured in a similar manner to TCFD, and requires organisations to provide information regarding nature across governance, strategy, and risk management metrics and targets. TNFD recommendations help FIs to understand the areas where nature-related information should be considered to integrate nature into the wider business strategy. Furthermore, TNFD has developed an integrated assessment process, LEAP, which refers to Locate, Evaluate, Assess and Prepare. The approach sets out guidance required to understand the interaction and impacts on

<sup>4</sup> South Pole does not endorse nor have any specific alliance, connection or contractual agreement with any of the frameworks or tools mentioned. This list represents examples of tools with a notable degree of adoption in the market and it's meant for illustrative purposes. Institutions should explore those that are best suited to their needs.



nature from initial information requirements up to reporting guidance, and a LEAP approach is outlined specifically for FIs – LEAP-FI.

– Another form of assessment to initiate the inclusion of biodiversity and nature into the overall strategy is to increase understanding and assess the level of impact/dependency of a strategy on biodiversity and nature through various publicly available tools. The WWF Risk Filter provides an overview of sectors, and their related dependencies and impacts, rating the risks on a scale from 1 to 5 (WWF). The tool also provides a dashboard with sector-deepdives, where users can find detailed information on biodiversity impacts and dependencies per sector. Similarly, the ENCORE tool, developed by the Natural Capital Finance Alliance, provides the opportunity to map the dependencies and impacts on natural resources of various sectors and sub-industries (ENCORE).

Lastly, FIs can scope their initial biodiversity considerations through the Carbon Disclosure Project's (CDP) biodiversity module. In its climate questionnaire, CDP has included a biodiversity module that includes questions regarding the governance oversight on biodiversity, whether a biodiversity-risk assessment has been conducted and whether public disclosure on biodiversity performance is available (Weiss, 2022). Similar to TNFD, CDP showcases the types of topics that FIs need to start to assess and understand to act upon biodiversity-related risks and opportunities, and can help identify existing gaps. So far, organisations are increasingly disclosing information through the biodiversity module, but these findings have yet to materialise as commitments to action to build resilience against biodiversity risks (O'Connell, 2022).

As practitioners, our invitation is for financial institutions to review the frameworks and tools available, as well as the information available through many initiatives on biodiversity loss, dependencies and impact, and identify a framework that suits the institution's strategy and strive to develop an understanding of the impact and dependency of its strategy on nature.

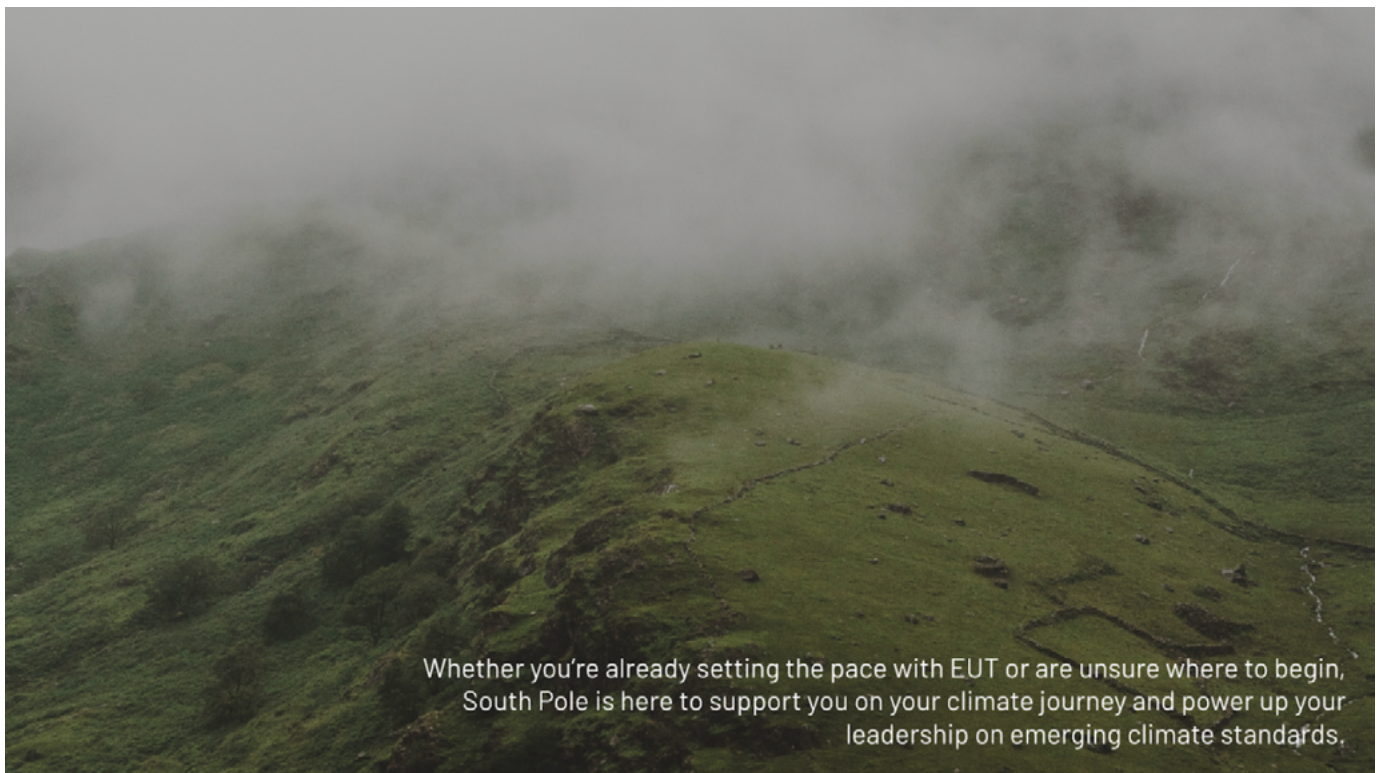


## Concluding remarks

Financial institutions can play a fundamental role in catalysing action towards meeting our nature conservation and restoration objectives. As investors, lenders or service providers, financial institutions have the potential to engage investees and borrowers and steer them towards identifying and evaluating their nature-related impacts and dependencies, define strategies and goals, and implement actions to prevent biodiversity loss. At the same time, acting as investors, lenders and service providers, financial institutions can actively direct financial flows towards activities that improve environmental preservation and restoration.

The inclusion of biodiversity in the EUT, as expressed throughout this paper, is strongly welcomed as it provides an initial guide for a set of activities to investors and lenders to direct investment and lending towards. Furthermore, it emphasises the need to expand sustainability knowledge and action beyond climate mitigation and adaptation. As evidenced by the discussion in this paper, understanding biodiversity loss, impact and dependency, can represent complex and novel themes within sustainability for a number of financial institutions. The EUT's inclusion of biodiversity protection and restoration as an activity therefore is a positive step towards nature-related action as it sheds light on the topic, provides guidance on some of the activities that can drive a positive impact, and potentially direct investment and capital flows towards these.

Having said this, a greater level of understanding and exploration of the double materiality that exists between the impact and dependency of business activities on nature needs to be adopted with a sense of urgency by financial institutions. In addition to the assessment of DNSH and the assessment of eligibility of environmental protection and restoration, financial institutions should be encouraged to conduct a high level biodiversity assessment guided by some of the available tools and frameworks. This will foster understanding of impacts and dependencies on the natural environment and drive further action.



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