

The ASEAN Taxonomy: The Need for Further Enhancements to Attract Sustainable Finance

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Executive Summary

In November 2021 ASEAN published its first edition of an ASEAN Taxonomy^[i] for Sustainable finance which was developed “to serve as a common building block that enables an orderly transition and fosters sustainable finance adoption by ASEAN Member States”. This Version 1 of the ASEAN Taxonomy is an admirable first step for the region as it increasingly and more speedily looks to fund the transition to net-zero carbon economies and to meet the region’s targets under the Paris Agreement and COP26 Accords.

In publishing the ASEAN Taxonomy, the ASEAN Member States made clear that this version was merely a first step as the region looks to tackle climate change, seek international funding for transition projects, and put in place a framework that will allow the region to attract sustainable finance. An ongoing consultation process is now underway to further develop and refine the ASEAN Taxonomy. This paper is the EU-ASEAN Business Council’s contribution to that consultation exercise.

As ASEAN continues to grow economically, plot its recovery from turmoil of COVID-19, and develop socially, it is clear that it needs to do so in a more sustainable way: ensuring that recovery is greener, cleaner and more cognisant of the need to protect the environment, whilst still ensuring more equitable economic growth, alleviating poverty, providing better jobs, housing, education, healthcare but still ensuring that the basic building blocks for economic and social development can be maintained, including the provision of more power generation to support its manufacturing and urbanisation needs. Achieving such a “just transition” and securing the funds to support it is no easy task, particularly in a World that is presently facing rising inflation and interest rates, potential issues around energy prices and energy security driven by the conflict in the Ukraine, and other geopolitical issues.

However, having a Taxonomy in place, which will provide a framework and guideline for the region, will begin to allow ASEAN to compete for sustainable finance funds on the global stage.

A taxonomy will need to be built on **sound data and effective disclosure**. This reporting system should incorporate relevant metrics. Without effective disclosure of a recognised set of non-financial data, it will be impossible to make an effective assessment or to compare alignment across more than one taxonomy. It is also important that **taxonomies are seen as part of a wider regulatory ecosystem or toolkit incorporating other approaches and standards**, for example for sustainable bonds or loans.

It is estimated that at least US\$200 billion per annum is needed in ASEAN for green investments.^[ii] In competing for these funds, ASEAN needs to ensure that it both has investible or bankable projects and a mechanism in place that allows investors to measure the sustainability of those projects. By not having a suitable Taxonomy in place, ASEAN would run the risk of losing out on Sustainable finance funds to other regions and countries that do have clear ESG measurements and standards, as investors increasingly need to demonstrate and measure the degree of sustainability associated with their investments.

Why a Taxonomy?

Sustainable finance is essential to support the transition to more sustainable economic development. The Monetary Authority of Singapore defines sustainable finance as “the practice of integrating environmental, social and governance (ESG) criteria into financial services to bring about sustainable development outcomes, including mitigating and adapting to the adverse impacts of climate change”.^[iii]

The key purpose of a taxonomy is help mobilise all forms of finance to support the achievement of sustainable development (including transition to net-zero carbon economies, and the achievement of broader UN Sustainable Development Goals) and to prevent “greenwashing” of investment funds by establishing a clear set of criteria and a common language by which the degree of sustainability of a project or investment can be measured.

Clear guidance around the degree of sustainability of a project is necessary to accommodate clear and fast decision-making process. Lack of clarity leads to delays, or investor’s inability to compare investment opportunities, which always leads to increased cost of transaction and lowered efficiency.

In the global context, this would mean that investors (be they Multilateral Development Banks, Asset Owners or Managers, Commercial Banks, Pension Funds etc.), who are increasingly only willing to invest in sustainable projects, will only place their funds in those jurisdictions where suitable guidance and criteria to assess the sustainability of projects exists. No taxonomy, or at least comparable direction, will, effectively, mean no sustainable finance funds.

“A taxonomy for sustainable finance is a set of criteria that provide the basis for an evaluation of whether and to what extent a financial asset will support given sustainability goals. Its purpose is to provide a strong signal to investors, and other stakeholders, and assist their decision making – by identifying the type of information needed to assess the sustainability benefits of an asset and to classify an asset based on its support for given sustainability goals.”

BIS Papers No.118 – A Taxonomy of Sustainable finance Taxonomies – October 2021, Bank of International Settlements

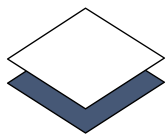
State of Play in ASEAN

Environmental Objectives of ASEAN Taxonomy:



ASEAN published its Version 1 of a regional wide Taxonomy in November 2021. It was developed to “serve as a common building block that enables an orderly transition and fosters sustainable finance adoption by AMS”[iv]. Given the differing levels of economic development and situations concerning the establishment of sustainable finance regimes and approaches across the ASEAN region, the ASEAN Taxonomy itself sets out multi-tiered framework covering a “Foundation Framework” which should be applicable to all ASEAN Member States and a “Plus Standard” which contains metrics and

thresholds to allow has a a deeper benchmarking of eligible green activities and investments. Importantly, the ASEAN Taxonomy does not just focus on the financing of Net-Zero Carbon projects, but also those transitional projects that can help economies to eventually achieve net-zero targets, something that the tiered approach is designed specifically to help achieve. This is important for a region that is both still growing economically, and which in many cases is unable to move directly to a net-zero carbon position.



Tier 1: Foundation Framework (FF)



Environmental objectives and essential criteria

Environmental Objectives

- EO1: Climate change mitigation
- EO2: Climate change adaptation
- EO3: Protection of healthy ecosystem & biodiversity
- EO4: Promote resource resilience & transition to circular economy

Essential Criteria

- EC1: Do no significant harm
- EC2: Remedial efforts to transition

Classification System

Green - FF

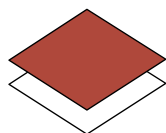
Meets one or more of the environmental objectives, and does no significant harm

Amber - FF

Meets one or more of the climate and environmental principles but causing harm. Nevertheless, making efforts to remediate

Red - FF

Causing harm and no efforts to remediate



Tier 2: Plus Standard (PS)*



Figure 1: ASEAN Taxonomy: Multi-tiered Taxonomy Design[v]

Even in its present early stage, the ASEAN Taxonomy compares favourably with other more established Taxonomies globally (see Table 1 below), but further work is needed in the development of the metrics and thresholds for the “Plus Standard” and on the means of verification for projects and economic activities (see the “What Next” section below).





Table 1: Overview of Sustainable Finance Taxonomies[vi]

		EU Taxonomy	China Taxonomy	CBI Taxonomy	ASEAN Taxonomy
Objective	Alignment with high level policy goals	Activity Level criteria are aligned with the target of net-zero GHG emissions by 2050	The translation of targets set by China's Integrated Reform Plan for Promoting Ecological Progress to activity level is unclear	Project level criteria are aligned with the levels of emission reductions required to meet the 2 °C target set by Paris Agreement	Supports high-level ASEAN commitments towards sustainability including Paris Agreement commitments and Nationally Determined Contributions
	Independence vs Co-dependency	An economic activity must meet principles of "Substantial Contribution" and "Do No Significant Harm" and the minimum social safeguards	Six environmental objectives are interlinked by honouring "Do No Significant Harm" principle	GHG emission screening criteria aiming to achieve climate mitigation	To achieve "green foundation framework" classification a project or activity must meet one or more of set environmental objectives and "Do No Significant Harm". Activity Level "Plus Standards" to be developed.
Scope	Transition & Enabling Activities	Transition and enabling components are included and are subject to review every three years. But it is not very clear how the thresholds of compliance are adjusted over time to accommodate the latest development of climate science and technology innovations.	No transition activities are included	No transition activities are included (separate framework for identifying transition activities published in 2020)	Transition components are included with activity level assessments to be developed
	Industrial Classification	Two level NACE codes	Four-level Chinese Standard Industrial Classification (CSIC)	No reference to industrial classification code. Instead assets are categorised into generation facilities, supply chain facilities and infrastructure.	International Standard Industrial Classification (ISIC)
Target	Unit of Measurement	Activity based metrics with thresholds in line with existing EU regulations and the net-zero target	Activity based metrics with thresholds in line with existing national standards	Asset-based metrics with thresholds in line with the 2 °C target	GHG emissions and Gross Value Added. Metrics only used in Plus Standard.
Output	Data availability & disclosure	Further legislative guidance is required to address data disclosure for different types of financial products	Issuers are required to report use of proceeds whilst environmental impact reporting is encouraged	Issuers are required to report use of proceeds and the environmental objectives of the projects	GHG emissions and Gross Value Added. Metrics only used in Plus Standard.
	Verification	Further legislative guidance is required to address data disclosure for different types of financial products	Independent review of green credentials is encouraged but there is not yet a standardised procedure for providing external review	Climate Bonds Standard & Certification Scheme is the only international third-party certification of green bonds	Further guidance needed
	Granularity	Binary	Binary	Traffic Light System Five distinct categories of transition activities identified in a separate framework	Based on ISIC with added levels using ASEAN Member State NSICs where possible and new categories added if need be. Traffic light system used for both Foundation Framework and Plus Standard

Key Principles of a Successful Taxonomy

The Bank of International Settlements, in its paper *A taxonomy for sustainable finance taxonomies*, set out a number of key principles which the authors of that paper saw as essential for a successful taxonomy. These included alignment with high-level policy objectives; a single objective; ensuring the taxonomy was outcome based with clear KPIs; clear entity information on which activities and projects are covered; and a high degree of granularity to allow for proper assessment of projects. We would add to these principles further ones around interoperability (i.e. there should be an ability to read-across from one taxonomy to another to allow for easier flow of investor funds from one jurisdiction to another), and inclusivity (i.e. the taxonomy should be applicable to as many sectors as possible to allow for as a broad range of economic sectors to benefit from it and to contribute to the achievement of the overall high-level objectives).

Table 2: Assessment of ASEAN Taxonomy Against Key Principles[vii]

Key Principles		Assessment of ASEAN Taxonomy	Notes
Alignment with High-Level Policy Objectives	Clearly defined high-level policy objectives such as meeting Paris Agreement targets		ASEAN Taxonomy is clearly linked to environmental objectives
One Taxonomy, One Objective	No mixing of multiple objectives – single overarching objective		Linked to ASEAN member states commitments at the international, regional, and national levels to work towards a low carbon and sustainable development, including implementation of the SDGs and NDCs flowing from Paris Agreement
Outcome Based with clear KPIs	Clearly set metrics for success. In the case of transition related taxonomies these might include annual targets to GHG reduction		Metrics and Thresholds for the “Plus Standard” still to be determined
Entity Based Information	Entity specific information to identify sectors covered by the Taxonomy		Clear use of the ISIC to identify entities and economic activities
Sufficient Granularity	Clear methodology to allow for the assessment of projects or economy activity and the measurement of their performance against the standards contained in the Taxonomy		Clear decision tree for the “Foundation Framework” set out
Interoperability	Compatibility with other Taxonomies allowing multi-jurisdictional read across through common metrics (e.g. an issuer in Europe investing in a project in ASEAN will need to have a project meeting standards in more than one taxonomy)		The ASEAN Taxonomy has been designed to provide a regional framework approach and to encourage interoperability with national level taxonomies in the region. This was the point of the multi-tiered approach in it. Interoperability with other global taxonomies still to be determined. Covers fewer sectors than the EU Taxonomy
Inclusivity	Covering multiple sectors allowing as many areas as possible to attract sustainable finance products		Covers multiple sectors including: Agriculture; Manufacturing; Electricity; Water Supply; Construction; Transportation; ICT; Financial & Insurance Services; Real Estate; Professional Services

As can be seen in Table 2 above, the ASEAN Taxonomy, even in its Version 1 format, performs relatively well against these key principles. However, it is also clear that further work is needed particularly in the areas of interoperability (which is even more important in a region where individual ASEAN Member States are developing their own national taxonomies and in the development of verification and assessment tools for measuring progress. The latter of these is recognised within the ASEAN Taxonomy with the admission that the metrics and thresholds for the “Plus Standard” are still to be determined and may likely depend on the national taxonomies being developed in the region. For the former, the “Common Ground Taxonomy” (CGT) analysis – a comparison between EU and Chinese taxonomies - constitutes a first step in identifying the need for interoperability of taxonomies, and how this may be further developed in future. With taxonomies being developed by a growing number of jurisdictions, regulatory and market fragmentation is a real risk. It is important that taxonomies are interoperable to facilitate cross-border sustainable finance and lower compliance costs.

What next?

For ASEAN and its Member States, the overarching objective remains to maximise liquidity for brown industries transitioning in ASEAN. The implementation and operation of the Plus Standard Tiers should give comfort to financiers over the credibility of clients' plans based on the ASEAN Plus tiers.

The ultimate goal is a taxonomy that has such a high degree of credibility that financial institutions will accept the tierings and make decisions on that basis. This would accelerate the development of a liquid transition market, taking over from the more ad-hoc provision of SLBs/SLLs products that rely on bespoke KPI assessment and monitoring, constraining the amount of transactions.

Key components of the next phase developments should include:

1. Long-term carbon neutrality targets;
2. Sectoral metrics and milestones that effectively set out a path from the starting point (different for each tier) to short, medium and long term targets;
3. Development of screening criteria and/or alternative means of judging whether an activity or investment is consistent with the pathway set out in a given sector and tier;
4. Flexibility for evolution of the tiers in response to science and external developments;
5. Socialising/communicating the ASEAN approach so that economic actors accommodate it in their thinking.

As noted above, the Version 1 of the ASEAN Taxonomy is making strides in the right direction to accommodate all of the elements mentioned above. The tiered approach allows for tailoring to ASEAN's varied economic development status and for the financing of important transition projects. Its evolution, and importantly the development of the Plus Standards, will be key to improving the attractiveness of the region for sustainable finance funds going forward. Ensuring that the development of the ASEAN Taxonomy includes the elements mentioned above will help position the region better to attract such funds in an increasingly competitive global landscape.

It is also necessary to ensure that ASEAN continues to have a seat at the table in large international forums that are driving transition, to ensure the needs of Asia are taken into consideration by global players. This will include representation in Government-led policy developments forums – for example IPSF (International Platform for Sustainable Finance), G20, APEC, as well as representation by private bodies in industry policy work at global level – for example GFANZ (Glasgow Financial Alliance for Net Zero), NZAOA (Net Zero Asset Owners Alliance) and others.

References

- [i] ASEAN Taxonomy for Sustainable finance, published 1st November 2021 - <https://asean.org/wp-content/uploads/2021/11/ASEAN-Taxonomy.pdf>
- [ii] See: <https://www.mas.gov.sg/development/sustainable-finance>
- [iii] See: <https://www.mas.gov.sg/development/sustainable-finance>
- [iv] ASEAN Taxonomy for Sustainable finance, published 1st November 2021 - <https://asean.org/wp-content/uploads/2021/11/ASEAN-Taxonomy.pdf>, Executive Summary, p.8
- [v] *ASEAN Taxonomy, November 2021, p. 21*
- [vi] After BIS Paper No.118 *A Taxonomy for Sustainable Finance Taxonomies*, Table 1, p.6, EU-ABC assessment of ASEAN Taxonomy added.
- [vii] Key principles drawn from BIS Paper No.118 *A Taxonomy for Sustainable Finance Taxonomies*, EU-ABC assessment of ASEAN Taxonomy added.



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