

Australian sustainable finance taxonomy methodology report

Determining the sustainability objectives and social considerations in the taxonomy

Australian Sustainable
Finance Institute



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Acknowledgement of Country

The Australian Sustainable Finance Institute acknowledges the Traditional Custodians of Country throughout Australia and recognises their continuing connection to land, waters, species and culture. We acknowledge their ongoing status as the First Peoples of Australia and pay our respects to their Ancestors and Elders past, present and emerging.

Release Notice

This report has been prepared by the Australian Sustainable Finance Institute Limited (ASFI) with key technical analysis undertaken by the Climate Bonds Initiative and Ambire Global in their capacity as ASFI's technical partners for the initial development of the Australian sustainable finance taxonomy.



Climate Bonds INITIATIVE



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Executive Summary

Developing a comprehensive Australian sustainable finance taxonomy is a significant and complex undertaking. Like taxonomy development processes globally, the Australian taxonomy will require an iterative and phased approach to the development of criteria across economic sectors and sustainability objectives.

While climate change adaptation and broader environmental and social sustainability objectives are critical in an Australian context, climate change mitigation has been identified as the priority objective in the Australian taxonomy's initial development phase. This is due to the market's urgent need for credible and usable guidance on the types of activities that align with an Australian net zero transition pathway, and to support interoperability with international taxonomies that also prioritise mitigation.

In line with the Australian Government's broader policy ambitions, the taxonomy framework is being designed in a way that provides a platform to incorporate other sustainability-related issues, with a focus on our natural capital and biodiversity, as well as incorporating First Nations perspectives and supporting positive social and economic outcomes for First Nations people.¹

Accordingly, the initial development phase of the Australian taxonomy will cover climate mitigation criteria for up to six priority economic sectors and include the consideration of other environmental objectives and social considerations through the lens of "Do No Significant Harm" (DNSH) and Minimum Social Safeguards (MSS).

This report sets out the approach to determining and defining:

- the environmental objectives to be included in the Australian taxonomy and how the DNSH criteria will be developed; and
- the social objectives and core social pillars to be prioritised by the Australian taxonomy and the approach to developing MSS criteria.

Defining these other objectives upfront is critical to ensuring that the Australian taxonomy can be expanded over time to include economic activities that will drive positive environmental objectives and social outcomes.

Applying the taxonomy design principles of credibility, usability, interoperability and prioritisation, the TTEG has made the below key decisions to determine and define the environmental objectives and core social pillars that will be embedded in the Australian taxonomy.



Approach to Do No Significant Harm

| | |
|--------------------|--|
| DECISION 1: | <p>The following commonly used environmental objectives should be included in the Australian taxonomy:</p> <ul style="list-style-type: none"> • climate change mitigation • climate change adaptation • pollution prevention and control • transition to a circular economy • biodiversity and ecosystem protection • sustainable use and protection of water resources |
| DECISION 2: | <p>That soil protection is an important environmental consideration for Australia and should be included as a consideration in the above environmental objectives (with necessary adaptations as required).</p> |
| DECISION 3: | <ol style="list-style-type: none"> 1. The baseline for defining the environmental objectives should be determined by identifying Australia's national priorities using existing legislation, standards, regulations and policies. 2. The level of ambition of the environmental objectives should be determined by cross-referencing Australia's national priorities with best practice international approaches to shape the draft definitions of the environmental objectives and the DNSH principles for consultation. |
| DECISION 4: | <p>To determine the DNSH criteria for the Australian taxonomy, reference taxonomies should be used as a starting point and then the criteria should be streamlined using the approach taken by the United Kingdom Green Taxonomy Advisory Group (GTAG) as a useful guide.</p> |
| DECISION 5: | <p>The design and development of the DNSH criteria should utilise the following approach:</p> <ul style="list-style-type: none"> • Consistent style to increase clarity and usability. • Prioritise a principle-based approach for generic criteria. • Prioritise a quantitative approach for specific DNSH criteria: with clear references for threshold/process-based criteria that can be objectively measured with detailed pass requirements. • Minimise subjective language: qualitative criteria when used, provide detailed justifications and alignment conditions. • Use adapt/adopt approach to increase interoperability: adapt/adopt and streamline criteria from reference taxonomies. <p>Consideration should also be given to the usability principles, as defined by the Platform on Sustainable Finance in the European Union (EU).</p> |

Approach to Minimum Social Safeguards

| | |
|--------------------|--|
| DECISION 1: | <p>The core social pillars for the Australian taxonomy that will inform the MSS aspects of the taxonomy should be determined and defined as follows:</p> <ul style="list-style-type: none"> • Step A: Identify the priority social objectives and topic areas to be addressed by MSS by mapping Australia's national social priorities with reference to national legislation, standards, policies and strategies and international treaties, frameworks and agreements signed or ratified by Australia. • Step B: Cross-reference the identified priority social objectives and topic areas with disclosure expectations for corporates and investors, including a review of finance and corporate sector environmental, social, and governance policies and risk management systems. • Step C: Align the priority social objectives and topic areas to be considered for inclusion as MSS to international frameworks and standards. • Step D: Define the core social pillars based on overlapping social objectives and topic areas in line with international standards and determine the level of ambition. |
| DECISION 2: | <p>Given the significant challenges with activity-level disclosure, MSS should be applied across entities or assets rather than at an activity level.</p> |

This DNSH criteria and MSS methodology report should be read together with the transition methodology report released alongside it. These reports set out the methodological framework that will be used to determine the green and transition criteria for climate mitigation for the Australian taxonomy, as well as the approach to determining the DNSH criteria and key social safeguards that will be embedded in the Australian taxonomy.

Australian taxonomy scoping phase:

Between early 2022 and July 2023, ASFI undertook taxonomy scoping work. The scoping work was industry funded and led by ASFI, working closely with government and regulators.

ASFI worked with a Technical Advisory Group (TAG) and broader stakeholders to inform the taxonomy scoping deliverables. The TAG comprised 56 members and observers from across the financial services sector, ESG market specialists, academics and international taxonomy experts, including from Circular Australia. The TAG had seven observers, representing the Australian Banking Association, the Financial Services Council, and the Australian Department of Treasury and Council of Financial Regulator agencies (the Reserve Bank of Australia (RBA), the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA)).

The taxonomy scoping work focused on identifying key framework design elements for an Australian sustainable finance taxonomy, including a scoping paper on international taxonomies, which analysed Australia's economic and environmental context, key international taxonomies and implications for taxonomy development in Australia and which, together with feedback from public consultation, informed a framing paper that sets out recommendations on the key design elements for an Australian taxonomy.

The Australian Taxonomy Framing Paper,² published in March 2023, outlined fifteen recommendations for the design of an Australian taxonomy, including that the Australian taxonomy should contain further qualifying criteria assessment of "do no significant harm" and

embed social considerations that meet the unique needs of Australia, including but not limited to standards for First Nations people's rights and heritage and supporting workers and communities in relation to an equitable and just transition.

The Taxonomy Framing Paper also identifies the primary purposes of the Australian taxonomy, which are to:

- **direct capital flows into economic activities that substantially contribute towards sustainability objectives;**
- **facilitate an orderly and just transition to a sustainable economy** by promoting investments that enable the transition to a net zero economy along with broader sustainability attributes and outcomes for social equity; and
- **address greenwashing and promote transparency** by providing regulators and financial institutions with a robust and credible tool for classifying finance, lending, investment, and underwriting activities as having certain sustainability attributes.

This aligns with the Australian Government's sustainable finance objectives,³ which are to ensure Australia's sustainable finance architecture improves financial market transparency and credibility to:

- mobilise the private sector investment needed to support net zero and other sustainability goals;
- ensure Australian entities can access capital to support the transition and are aligned with positive sustainability outcomes; and
- ensure climate and sustainability-related opportunities and risks are well understood and managed.

Australian taxonomy initial development phase:

The Australian Taxonomy Project commenced in July 2023. It is a joint industry-government initiative, led by ASFI in partnership with the Department of the Treasury, to develop an Australian sustainable finance taxonomy. Funding and partnership from the Australian Government reflects shared appetite across government, finance and industry for new frameworks to support sustainable finance markets in Australia.

The project is drawing on the recommendations from ASFI's scoping phase, building on work done on sustainable finance taxonomies internationally and working with a wide range of relevant experts and stakeholders.

The initial taxonomy development phase will run for twelve to eighteen months. It will cover climate mitigation criteria for a minimum of three and up to six priority sectors, and associated technical work on data requirements, a methodology for incorporating transitional activities, Minimum Social Safeguards and a 'Do No Significant Harm' framework.

The six priority sectors are:

- electricity generation and supply (energy)*;
- minerals, mining and metals*;
- construction and the built environment*
- manufacturing/industry;
- transport; and
- agriculture.

(* indicates the first sectors to be developed).

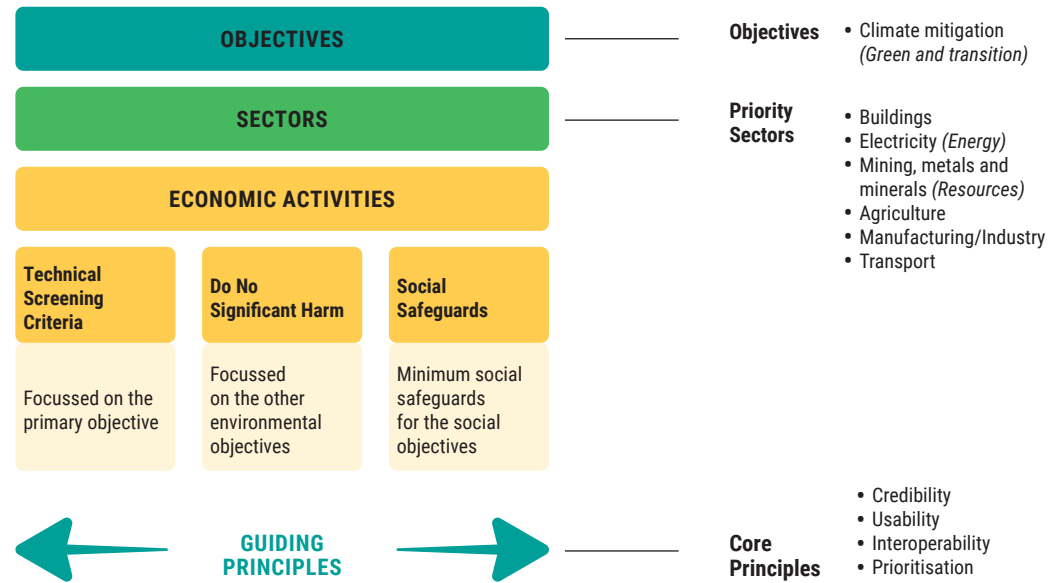
The sector coverage aligns with the six sector decarbonisation plans that the Australian Government is developing for the Australian economy to help mobilise the private sector investment needed to support net zero, invest in Australia's ability to become a renewable energy superpower, and achieve its other sustainability goals.

In accordance with the mandate set by the Australian Government,⁴ there are four key principles to guide the development of the Australian taxonomy:

- the taxonomy should be credible and science-based;
- the taxonomy should be usable for a range of different users;
- the taxonomy should be interoperable and broadly compatible with international approaches to sustainable finance taxonomies; and
- the taxonomy should be tailored to Australian priorities. These include supporting the allocation of capital towards transition activities; aligning with broader Government climate policy objectives; supporting the foundation for broader regulatory frameworks on sustainable finance; and being adaptable to incorporating other climate and sustainability objectives such as nature in the taxonomy.

The Australian Council of Financial Regulators' Climate Working Group (CWG) is overseeing the development phase of the taxonomy project, as part of its role supporting the development and implementation of the Government's Sustainable Finance Strategy.

ASFI, with endorsement from the CWG, has established a Taxonomy Technical Expert Group (TTEG), comprising 25 experts in sustainable finance; whole-of-economy decarbonisation; climate and environmental science and policy; human rights; and Indigenous rights and perspectives. This group is tasked with providing strategic direction over, input into and endorsement of taxonomy products for consideration by Government.



Do No Significant Harm: Methodology

Introduction

In sustainable finance taxonomies, the Do No Significant Harm (DNSH) principle ensures that the defined sustainable finance activities, while substantially contributing to one taxonomy objective, do no significant harm to any of the other taxonomy objectives. This principle also helps to avoid greenwashing, which refers to misleading or unsubstantiated claims of sustainability benefits.

DNSH criteria consider impacts throughout the lifecycle of an asset, activity, or project, and associated impacts across supply chains. DNSH criteria in most taxonomies are defined in two ways: generic or specific. Generic DNSH criteria are defined for each taxonomy objective and apply to all activities of the taxonomy, while specific DNSH criteria are defined at an activity level for each objective by identifying the material impacts of the activity.

DNSH implementation and verification in sustainable finance taxonomies have been a challenge globally, in large part due to the lack of data and capacity to verify DNSH requirements. Another key usability issue of DNSH is the lack of objectivity in language used to define the criteria, especially if the criteria has been linked to national regulations and standards or defined too vaguely.

It is therefore recommended that the Australian taxonomy define DNSH criteria in a clear and consistent structure, finding a balance between local applicability and international interoperability through the integration of existing standards and benchmarks as a reference to support ease of application. This will also help ensure that the generic DNSH criteria at an objective level and the specific DNSH criteria at an activity level are defined in a manner consistent with the taxonomy principles of usability, credibility, prioritisation and interoperability.

Implementation challenges

In the United Kingdom (UK), the Green Technical Advisory Group (GTAG)^F was established in 2021 by the UK Treasury and the Green Finance Institute (GFI) to provide non-binding technical advice on the development and implementation of a green taxonomy for the UK. The GTAG has undertaken significant work to improve the usability of DNSH as it relates to the UK Green Taxonomy, supporting the objective of developing a usable UK Green Taxonomy without compromising the science-based robustness of the criteria, learning from some of the challenges experienced in the EU Taxonomy reporting process. Subsequently, the GFI on behalf of the UK GTAG published a report, "Streamlining and increasing the usability of the DNSH criteria within the UK Green Taxonomy" that contains a summary of DNSH key challenges as well as opportunities and practical steps to streamline and increase the usability of DNSH criteria.

The UK GTAG's DNSH review and recommendations are a useful reference framework for the Australian taxonomy as it designs and develops recommendations for its DNSH criteria. Considering the main challenges of DNSH implementation are with the design and usability of the criteria, the key UK GTAG lessons and recommendations relevant to the Australian taxonomy are:

- the main hurdle of DNSH implementation lies in the design and definition of the EU's DNSH criteria;
- there should be alignment with the EU's classification of environmental objectives; and
- the concept of DNSH criteria is strongly supported by the market, but it needs to be streamlined. The key challenges for end users were classified into the two below categories.

Challenges relating directly to individual DNSH criteria:

- **DNSH criteria can be difficult to understand** due to their complexity, ambiguity, unclear language and the variety of standards they refer to.
- **DNSH criteria can be difficult to measure** due to their qualitative nature and a lack of thresholds and subjectivity, leading to a reliance on estimates and proxies.
- **Evidence of compliance with DNSH criteria is difficult to gather** due to their volume and varying degrees of granularity, which cause data availability issues and a need for estimates.

Challenges relating to the overall DNSH design component of the taxonomy:

- **Inconsistent structure.** The bookends of key variables that determine the composition across all DNSH criteria (length, requirements, guidance, and context) are broad, and many criteria with similar requirements are expressed differently.
- **Inflexible disclosure.** The EU DNSH follows an all-or-nothing approach to disclosure. Under this method, not meeting all DNSH criteria means an entity is not aligned to the EU Taxonomy, even if all substantial contribution (SC) and Minimum Social Safeguard (MSS) requirements are met. This has hindered the development of the market in Europe and contributed to a lack of available data.

The GTAG recommendations suggest using the EU taxonomy as a reference to adopt/adapt DNSH criteria based on a streamlining approach:

- to group similar criteria into defined categories by leveraging the analysis of the EU taxonomy;
- to align DNSH composition with a consistent style of drafting and structuring to increase clarity and usability;
- to include quantitative thresholds aligned to specific regulations and standards to facilitate application; and
- for qualitative criteria, to minimise subjective language and ensure they are clearly referenced and supported by clear guidance.

The EU DNSH implementation challenges in the banking sector were reviewed in the United Nations Environment Programme (UNEP) and the European Banking Federation (EBF)'s report, "Testing the application of the EU Taxonomy to core banking products".⁶ The report is a comprehensive review of the application of the EU taxonomy to core banking products, namely retail banking, Small and Medium Enterprise (SME) lending and corporate banking for trade, export and project finance.

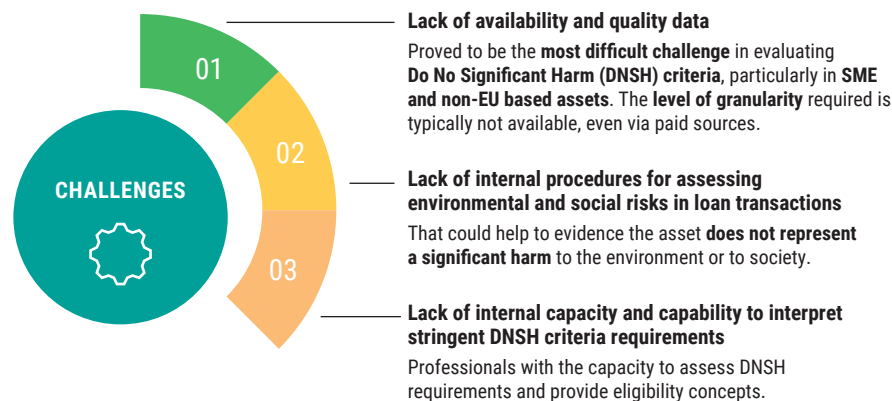
A summary of the challenges faced by the banking sector, including taxonomy implementation challenges in Colombia, is provided below.

FIGURE 1
EU DNSH: Implementation challenges review by UK GTAG



Source: GTAG – Final Report on DNSH, 2023

FIGURE 2
EU DNSH: Implementation challenges of the banking sector



Source: Testing the application of the EU Taxonomy to core banking products, 2023; Final report on the implementation of Colombia's taxonomy in financial entities, 2022

Proposed methodological approach to developing DNSH criteria

Applying a DNSH assessment ensures economic activities that contribute substantially to one environmental objective, in this case climate change mitigation, do not cause significant harm to the other environmental objectives covered by the taxonomy. In practice, this means that in addition to meeting the substantial contribution criteria defined by the

technical screening criteria for climate change mitigation, economic activities in the taxonomy must demonstrate that they meet general and specific compliance requirements for DNSH for each of the other environmental objectives of the taxonomy if applicable.

Figure 3 depicts the methodological approach taken to develop the DNSH criteria in the Australian taxonomy.

FIGURE 3

DNSH methodological approach for the Australian taxonomy

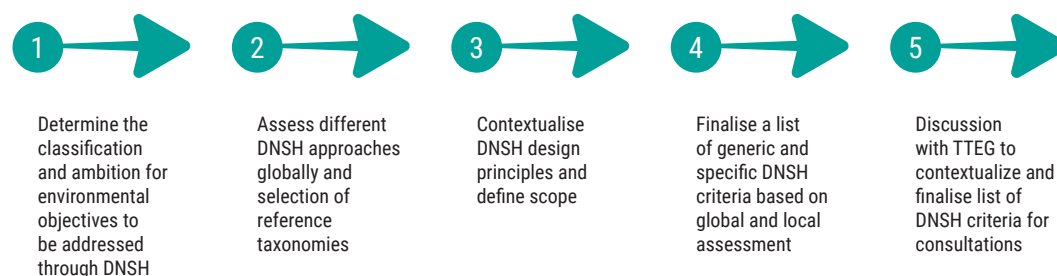


TABLE 1

Substantial Contribution (SC) and DNSH across taxonomies

| OBJECTIVE | EU | ASEAN | South Africa | Colombia | Mexico |
|--|-----------|-----------|--------------|-----------|-----------|
| Climate Change Mitigation | SC + DNSH | SC + DNSH | SC + DNSH | SC + DNSH | SC+DNSH |
| Climate Adaptation and resilience | SC + DNSH | SC + DNSH | SC + DNSH | SC + DNSH | SC + DNSH |
| Circular economy | SC + DNSH | DNSH | DNSH | DNSH | DNSH |
| Pollution prevention | SC + DNSH | DNSH | DNSH | DNSH | DNSH |
| Protection of water resources | SC + DNSH | | DNSH | SC + DNSH | DNSH |
| Biodiversity and ecosystems protection | SC + DNSH | | DNSH | SC + DNSH | DNSH |
| Contribution to gender equality | | | | | SC |
| Soil management | | | | SC | |

Step 1: Determine the classification and ambition for environmental objectives to be addressed through DNSH

The environmental objectives of the Australian taxonomy will be informed by clear goals and targets. This requires an assessment of local commitments and strategies in relation to environmental objectives and an international classification of environmental objectives and ambitions. The classification of environmental objectives should focus on aligning with international standards and frameworks.

Environmental objectives across taxonomies

The following are the environmental (including climate) objectives addressed across different taxonomies, from a “substantial contribution” (SC) and DNSH approach.

Most sustainable finance taxonomies align in giving priority in the early stages of taxonomy development to climate change objectives: mitigation and adaptation and resilience. Broader environmental objectives, such as circular economy, pollution prevention, protection of water resources and biodiversity and ecosystem protection are also addressed in different taxonomies, primarily through DNSH criteria.

Colombia’s taxonomy establishes an additional environmental objective “soil management”, which is primarily addressed for land use sectors (Agriculture, Forestry and Other Land Use).

Note: the contribution to gender equality (see table below) will be included in the Minimum Social Safeguards analysis.

As part of the scoping phase of the Australian taxonomy, stakeholders were asked to rank the order of priority for the development of climate and other environmental objectives in the taxonomy. The results, which are set out in the ASFI report “Designing Australia’s Sustainable Finance Taxonomy”,⁷ show the stakeholder preference for prioritisation of environmental objectives in the taxonomy is as follows:

- climate change mitigation;
- climate change adaptation; and
- environmental management (includes pollution prevention and control, circular economy, biodiversity and ecosystems protection and sustainable use and protection of water resources).

Review of environmental objectives - EU Taxonomy

Of the EU's six environmental objectives, substantial contribution to climate change mitigation is addressed as the main objective for the selection of nine economic sectors in the EU Taxonomy, which include 94 activities/assets.⁸ In terms of substantial contribution to climate change adaptation, the EU Taxonomy addresses the development of this objective for thirteen economic sectors. The other four objectives are addressed through DNSH.⁹

The rationale behind the definition of the four non-climate objectives is linked to environmental strategies and policies in place for each environmental objective specific to the EU. Hence, the environmental objectives defined in the EU taxonomy respond to strategies, policies and regulatory frameworks defined by the EU to support the transformation of the EU economy to meet its European Green Deal objectives, including the 2050 climate neutrality target.

All environment objectives of the EU Taxonomy are interrelated, both in terms of how an objective is achieved and the effect of achieving one objective on another objective. There is also clear overlap between the non-climate objectives and their impact on each other.

Nonetheless, each environmental objective can be clearly defined within an area of focus by setting a headline ambition. Headline ambition level in this context means the aspirational goal linked to each environmental objective.¹⁰

TABLE 2

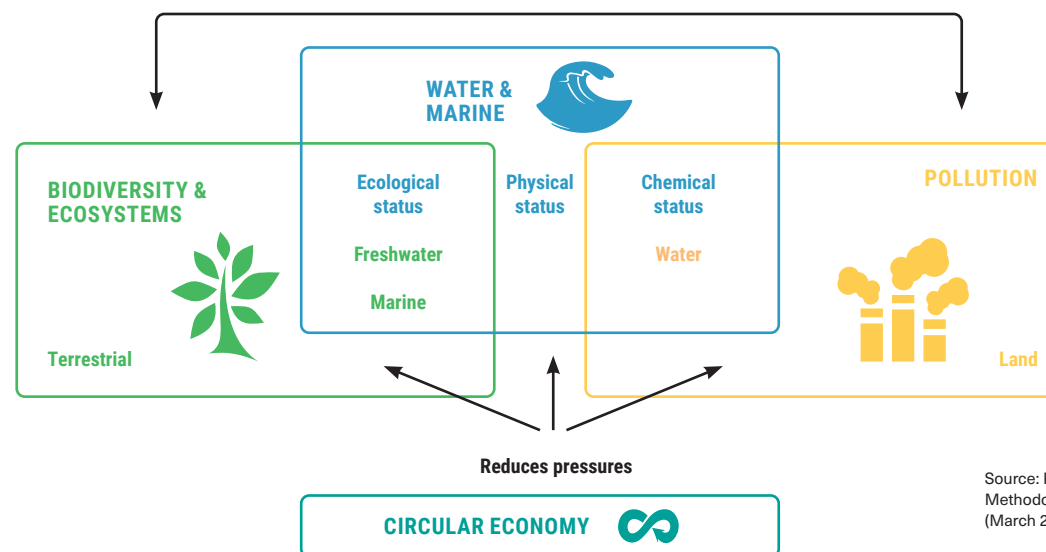
EU's non-climate objectives and links to environmental strategies and policies

| OBJECTIVE | Link to environmental strategies and policies (not exhaustive list) |
|---|--|
| Objective 3: The sustainable use and protection of water and marine resources | <ul style="list-style-type: none"> • Water Framework Directive (WFD) • Urban Wastewater Treatment Directive and the Nitrates Directive • Directive on the Reduction of National Emissions of certain Atmospheric Pollutants |
| Objective 4: The transition to a circular economy | <ul style="list-style-type: none"> • Farm to Fork Strategy. • Commission's 2020 Circular Economy Action Plan |
| Objective 5: Pollution prevention and control | <ul style="list-style-type: none"> • Driver, Pressure, State, Impact, Response (DPSIR) Framework • EU Action Plan: "Towards a Zero Pollution for Air, Water, and Soil" (ZPAP) • EU Chemical Strategy for Sustainability. |
| Objective 6: The protection and restoration of biodiversity and ecosystems | <ul style="list-style-type: none"> • EU Biodiversity Strategy • Transformative post-2020 global biodiversity framework to be adopted at the COP 15 (May 2022) |

Source: Yue Wa Topin, Fabien Cobat (Natixis GSH), based on the PSF TWG Part A: Methodological report (March 2022)

FIGURE 4

Overlap among the different environmental objectives of the taxonomy



Source: PSF TWG Part A: Methodological report (March 2022)

Determining ambition for environmental objectives

After selecting the environmental (including climate) objectives of the taxonomy, it is important to establish the ambition for the achievement of these objectives in Australia before prioritising them to be addressed by DNSH. The principles for setting a headline ambition level for environmental objectives are as follows:

- be based on international environmental and climate agreements that Australia supports (Paris Agreement, the Kunming-Montreal Global Biodiversity Framework);
- be underpinned by science-based information, including alignment to a 1.5°C trajectory;
- be informed by local commitments and strategies on environmental objectives, including Australia's response to international agreements or Australia's leadership on an objective;
- define clear goals and targets, both short and long term where applicable;
- determine timelines to achieve the defined targets;
- assess whether the targets are achievable at the defined levels and timescales

An illustrative example of ambition for the objectives defined in the EU taxonomy is described below:

Review of global frameworks

The following diagram maps different climate and broader environmental objectives addressed in international frameworks, including the International Finance Corporation's Environmental Health and Safety Standards (IFC EHS), the Sustainable Development Goals (SDGs) and the Taskforce on Nature-related Financial Disclosures (TNFD).

Most of the climate and broader environmental objectives that have been defined in these taxonomies are also addressed in different international standards and guidelines associated with environment and social risk management.

FIGURE 5
EU's headline ambition for non-climate objectives

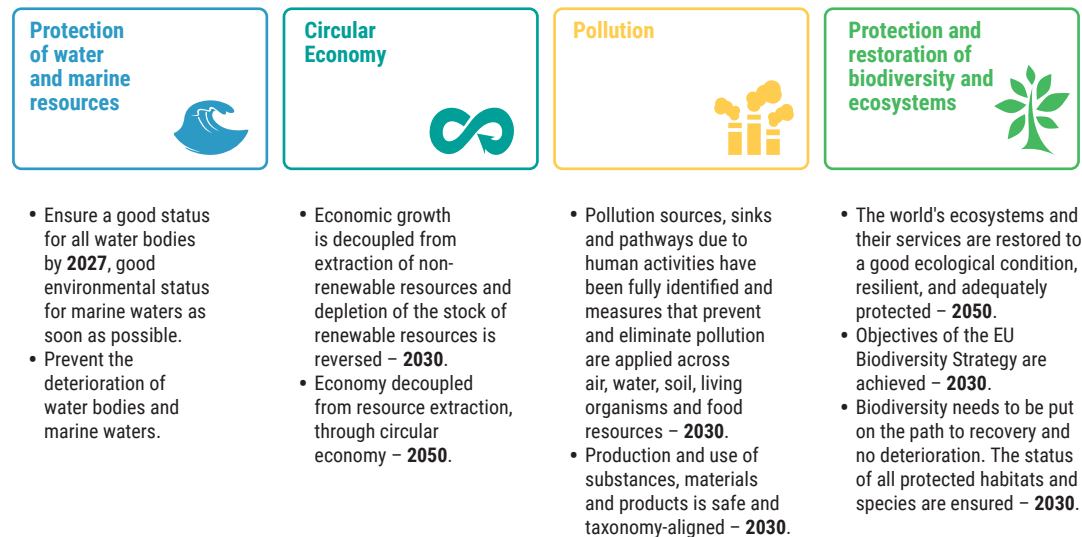


FIGURE 6
Review of global frameworks

| TAXONOMY OBJECTIVES | Reference Frameworks | | | | |
|---|----------------------|-------------------------------|---|----------------------|---|
| | IFC EHS Standards | Sustainable Development Goals | Taskforce on Nature related Financial Disclosures | Planetary Boundaries | |
| Climate Change Mitigation Climate | ● | ● | ● | ● | ● Included ◆ Included as transversal to other components |
| Change Adaptation | ● | ● | ● | ● | |
| Pollution Prevention and Control | ● | ◆ | ◆ | ● | |
| Circular Economy | ● | ◆ | ● | ● | |
| Biodiversity and Ecosystems Protection | ● | ● | ● | ● | |
| Sustainable Use and Protection of Water Resources | ● | ● | ● | ● | |

Recommendations for environmental objectives

Having undertaken the above assessment, the following environmental objectives were recommended to the TTEG for inclusion in the Australian taxonomy:

- climate change mitigation
- climate change adaptation
- pollution prevention and control
- biodiversity and ecosystems protection
- sustainable use and protection of water resources
- circular economy

Justification

The main challenge with DNSH implementation is the streamlining of DNSH criteria rather than the number of environmental objectives or the way in which they have been classified.

There is no visible usability advantage of streamlining the number of environmental objectives or categorising them in a different way.

The proposed environmental objectives can be comprehensively mapped to relevant international standards and aligned to national priorities.

The headline ambition for the environmental objectives can be contextualised to Australia.

There tends to be an overlap with environmental objectives, but usability and interoperability can be ensured by setting up clear boundaries for the definition of criteria.

Decisions

The below decisions were endorsed by the full TTEG on 12 October 2023 in relation to the classification of environmental objectives.

DECISION 1:

The following commonly used environmental objectives should be included in the Australian taxonomy:

- Climate change mitigation
- Climate change adaptation
- Pollution prevention and control
- Transition to a circular economy
- Biodiversity and ecosystem protection
- Sustainable use and protection of water resources

DECISION 2:

That soil protection is an important environmental consideration for Australia and should be included as a consideration in the above environmental objectives (with necessary adaptations as required).

DECISION 3:

The baseline for defining the environmental objectives should be determined by identifying Australia's national priorities using existing legislation, standards, regulations and policies.

The level of ambition of the environmental objectives should be determined by cross-referencing Australia's national priorities with best practice international approaches to shape the draft definitions of the environmental objectives and the DNSH principles for consultation.

The initial list of relevant Australian legislation, standards, and policies considered are compiled in Annexure 1.



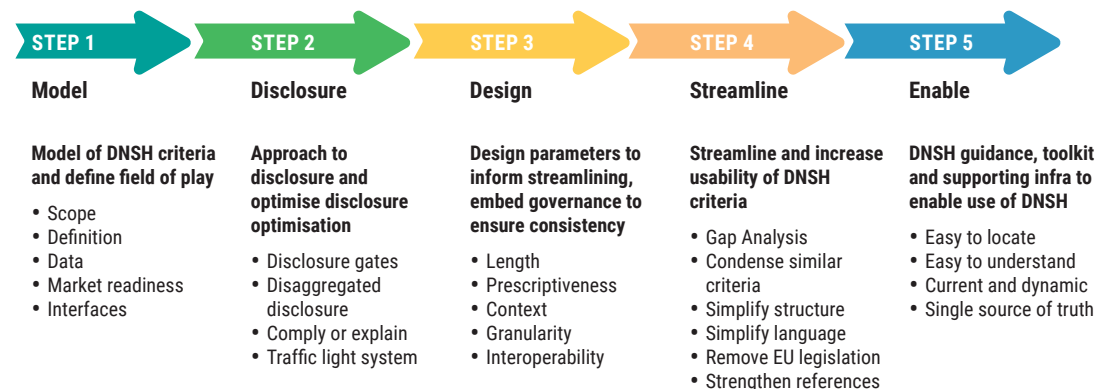
Step 2: Assess DNSH approaches globally and select reference taxonomies

Other sustainable finance taxonomies can provide a starting point to structure the DNSH component of the Australian taxonomy. For this purpose, it is important to conduct a general mapping of DNSH criteria in taxonomies internationally, especially in relation to streamlining approaches to overcome DNSH implementation challenges. This involves the following steps:

1. Evaluate methodologies used to structure DNSH in different taxonomies.
2. Select reference taxonomies and identify the general and specific DNSH criteria for each objective and for the sectors and activities selected, including the identification of key international standards.
3. Formulate a conclusion based on a global assessment, defining the reference taxonomies and the DNSH requirements that can be either adopted or adapted from different international taxonomies.

Based on the process above, the UK GTAG recommendations for DNSH streamlining can be used as a reference point for Australia, considering they seek to overcome the implementation challenges of DNSH for the EU Taxonomy. The steps for streamlining DNSH as recommended by UK GTAG are set out in Figure 7.

FIGURE 7
Recommendations of UK GTAG - Streamlining of DNSH criteria



Recommendations on the selection of reference taxonomies

The first three priority sectors for development under the Australian taxonomy are:

- minerals, mining and metals (resources);
- buildings and construction (the built environment); and
- electricity generation and supply (energy).

The manufacturing/industry, agriculture and potentially transport sectors will be considered directly after those listed above. For the first three sectors, the below global approaches will be drawn on to develop DNSH requirements.

Energy and the built environment: Use the recommendations of UK GTAG for referring to the EU Taxonomy and apply the Adopt/Adapt/New strategy and DNSH criteria streamlining strategy. The focus would be on contextualising the criteria for Australian context.

Resources: There is no reference taxonomy to draw on for this sector. The approach to DNSH in this sector and its activities will need to be designed following the agreed DNSH design principles.

It was further recommended to review other reporting frameworks, including the TNFD and natural capital accounting frameworks while taking into account usability considerations.

Decision

DECISION 4:

To determine the DNSH criteria, reference taxonomies should be used as a starting point and then the criteria should be streamlined using the approach taken by the UK GTAG as a useful guide.

Step 3: Contextualise DNSH criteria design and define principles

The design principles that will inform the development and rationalisation of DNSH criteria will be defined based on international approaches and in consultation with policy and industry experts. The design principles should also be aligned with the Australian taxonomy principles of usability, credibility, interoperability and prioritisation.

To contextualise the DNSH requirements to the Australian taxonomy, the following three steps are proposed.

- **Define general DNSH principles for the Australian taxonomy:** Define DNSH design principles and streamline the opportunities for the Australian taxonomy based on the UK GTAG approach and by reference to other taxonomies.
- **Identify national regulations/strategies/guidelines:** List national regulations, strategies and guidelines that may be aligned with each environmental objective. List general requirements for all activities, as well as specific requirements for each activity.
- **Define the ruleset on disclosure and the usage:** Define the voluntary/mandatory nature of disclosure and the use of DNSH criteria.

Recommendations on DNSH design principles

Consistent style to increase clarity and usability:

Ensure a consistent style of drafting and structuring DNSH content to increase clarity and usability.

Prioritise a principle-based approach for generic criteria:

Principle-based criteria are non-specific for each activity and, therefore, for DNSH, refer to general principles for avoiding harm.

Prioritise quantitative criteria for specific DNSH:

with clear references for threshold/process-based criteria which can be objectively measured with detailed pass requirements.

Minimise subjective language:

Qualitative criteria when used, provide detailed justifications and alignment conditions.

Use adapt/adopt approach to increase interoperability:

Adapt/adopt and streamline criteria from reference taxonomies.

Decision

DECISION 5:

The design and development of the DNSH criteria should utilise the following approach:

- Consistent style to increase clarity and usability.
- Prioritise a principle-based approach for generic criteria.
- Prioritise a quantitative approach for specific DNSH criteria: with clear references for threshold/process-based criteria that can be objectively measured with detailed pass requirements.
- Minimise subjective language: qualitative criteria when used, provide detailed justifications and alignment conditions.
- Use adapt/adopt approach to increase interoperability: adapt/adopt and streamline criteria from reference taxonomies.

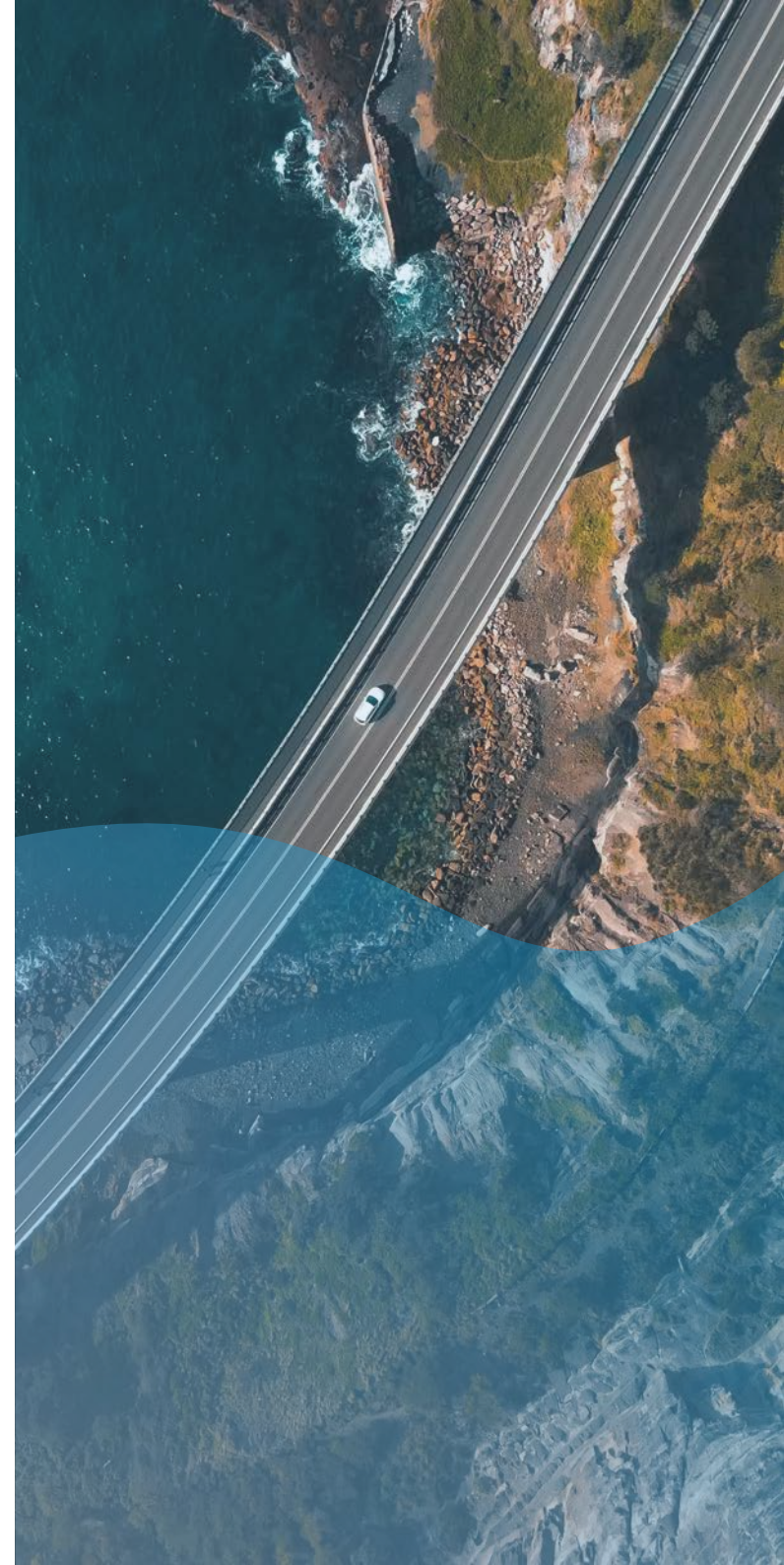
Consideration should also be given to the usability principles, as defined by the Platform on Sustainable Finance in the EU.

Step 4: Finalise DNSH criteria based on global and local assessment

Based on the sectors and activities selected for the Australian taxonomy, the generic and specific DNSH criteria at the objective and activity levels are defined. The review of global standards that may be relevant to DNSH criteria development should be conducted according to the selected activities (for example, the Equator Principles, IFC guidelines, Environmental and Social Risk Systems, among others). Additionally, the review of existing business disclosure frameworks and data availability should be considered within the DNSH criteria development to ensure interoperability and usability.

Step 5: Contextualise criteria for Australia

The DNSH criteria will be developed under the guidance and with input from the TTEG, drawing on consultation and advice from technical advisory groups so that the DNSH criteria are streamlined and reflect the Australian context. The final output of the process is a complete list of DNSH criteria for public consultation. Following consultation, comments and feedback on the content and usability of the DNSH criteria will be discussed with the TTEG's DNSH sub-committee, the DNSH Taxonomy Advisory Group and the full TTEG.



Minimum Social Safeguards: Methodology

Introduction

Sustainable finance taxonomies around the world have addressed social objectives mainly through Minimum Social Safeguards (MSS), which are designed to ensure that activities under a taxonomy do not result in adverse social outcomes by asking entities to comply with certain minimum social safeguards.

MSS in taxonomies tend to expect alignment with various social and responsible business conduct standards relating to core themes or pillars such as governance standards, international human rights (including labour rights) and bribery and corruption. The intention of MSS provisions is that where an entity is not acting in accordance with a MSS, the relevant activity should not be labelled as 'sustainable' as defined by the taxonomy.

The EU Taxonomy's approach to MSS has been a reference point for other international taxonomies. There have also been other approaches globally in defining MSS compliance, which are discussed further in this report.

In the EU Taxonomy, compliance with MSS provision¹¹ is required for activities to be EU Taxonomy aligned. The EU Taxonomy's MSS provision expects an entity to 'ensure alignment' of their economic activities with the following internationally recognised social and responsible business conduct standards:

- OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (OECD Guidelines); and
- UN Guiding Principles on Business and Human Rights (UNGPs)

- Eight fundamental conventions identified by the International Labour Organization (ILO) and the International Bill of Human Rights.¹² (*together, the 'Key International Standards'*).

Accordingly, a set of MSS procedures needs to be implemented by companies to ensure alignment with the Key International Standards outlined above.¹³

In the EU context, the evaluation of MSS compliance is carried out at the company/entity level, and based on the Key International Standards mentioned above. The EU Platform on Sustainable Finance has provided recommendations around the application of the EU Taxonomy's MSS provisions, including by identifying four key social pillars in the relevant standards:

- human rights (including labour and consumer rights);
- bribery, bribe solicitation and extortion;
- taxation; and
- fair competition.¹⁴ (*together, the 'four MSS pillars'*)

The EU Platform on Sustainable Finance has used these four MSS pillars to inform recommended preliminary criteria for compliance with MSS and the procedures entities need to adopt in order to ensure their corporate conduct is aligned with the MSS provision. The two key MSS compliance criteria suggested by the EU Sustainable Finance Platform are:

- the existence of adequate corporate due diligence processes and measures with respect to each of the four MSS pillars; and
- avoidance of negative impacts and legal convictions in relation to the four MSS pillars.¹⁵

Implementation challenges

In the EU, there is still a level of uncertainty regarding implementation of MSS. The preliminary indicators of non-compliance with MSS recommended by the EU Platform on Sustainable Finance include the following:

- Inadequate or non-existent corporate due diligence processes on human rights, including labour rights, bribery, taxation and fair competition.
- Final liability of companies in respect of breaches of any of the four MSS pillars.
- Lack of collaboration with an OECD National Contact Point (NCP), and an assessment of non-compliance with OECD Guidelines by an OECD NCP.
- Non-response to allegations by the Business and Human Rights Resource Centre (BHRRRC), within a certain timeframe.¹⁶

An example of criteria for alignment with the MSS in the EU, specifically for non-EU companies and EU companies until CSRD is fully implemented, is as follows:¹⁷

TABLE 3

Criteria for alignment with the MSS in EU

Non-CSRD companies are considered non-compliant if one of the two criteria apply:

Human rights

1. The company has not implemented adequate Human Rights Due Diligence (HRDD). The HRDD process is set out in the UNGPs. As audit/assurance of these disclosures will be voluntary, additional checks on implementation is necessary. To do this, investors might consider data resources such as the World Benchmark Alliance (WBA) for an assessment.

2. There are signals that the company did not adequately implement HRDD and/or did abuse human rights. These are:

- The company has been finally found in breach of labour law or laws relevant to human rights.
- Lack of collaboration with an OECD NCP or an assessment of non-compliance with the OECD Guidelines by an OECD NCP.
- Non-response to allegations by the Business and Human Rights Resource Centre.

Corruption

1. The company has no anti-corruption processes in place.

2. The company or its senior management, including the senior management of its subsidiaries, has been finally convicted in court of corruption.

Taxation

1. The company does not treat tax governance and compliance as important elements of oversight, and there are no adequate tax risk management strategies and processes in place.

2. The company or its subsidiaries have been finally found in violation of tax laws.

Fair Competition

1. The company does not promote employee awareness of the importance of compliance with all applicable competition laws and regulations.

2. The company or its senior management, including the senior management of its subsidiaries, has been finally found in violation of competition laws.

Further criteria have been developed for:¹⁸

- EU companies in scope of CSRD;
- SMEs;
- Sub-sovereigns;
- Project finance/special purpose vehicles (SPVs); and
- Banks and insurers.

There have been challenges around implementing MSS in the banking sector, as detailed by the UNEP-European Banking Federation (EBF) report, “Testing the application of the EU Taxonomy to core banking products”¹⁹ and based on the implementation pilots of the Colombian Taxonomy:

- **Lack of evidence of alignment, insufficient granularity:** banks have generally struggled to find evidence of alignment with MSS in publicly available data, including evidence of company compliance with the OECD Guidelines. This contrasts with data available to assess technical screening criteria to demonstrate substantial contribution to sustainability objectives, which has been more commonly available.
- **MSS assessments are normally based on assumptions of compliance with relevant legislation by clients and assets:** compliance with MSS standards cannot be verified with the data currently held by banks. Compliance with certain social safeguards is normally assumed based on relevant regulatory obligations, such as exclusion lists, with which the company/asset must comply.
- **Limited implementation of the environmental and social risk management systems in banks and lack of alignment with the taxonomy:** lack of or limited implementation of environmental and social risk systems within the banks to obtain information on environmental and social risks linked to credit lines.

Investors and asset managers would likely face similar issues relating to lack of data and information.

Similarly, some of the challenges relating to gaps in the MSS compliance or alignment criteria suggested by the EU Platform on Sustainable Finance to inform the EU Taxonomy (outlined above) are discussed in the Final Report on Minimum Social Safeguards (October 2022).²⁰ They include, for example, that “victims of severe human rights abuses who have no access to courts, OECD NCP or the BHRRC often are members of the most vulnerable groups in these countries”, and in some countries it may be “difficult, impossible, or even dangerous to address human rights violations and to bring them to court”.

Methodological approach to identifying and developing MSS

The steps for the identification and development of MSS for the Australian taxonomy are illustrated in Figure 8.

Step 1: Assess MSS approaches globally

To develop MSS for the Australian taxonomy, it is important to conduct a general mapping exercise of the MSS in other international taxonomies. This exercise will help inform the development of MSS for the Australian taxonomy, and lessons learned may help mitigate MSS-related implementation challenges faced in other jurisdictions.

Definition of Minimum Social Safeguards

Three international examples of how other jurisdictions have developed MSS are set out below:

Example A: EU Taxonomy. For an economic activity to be considered environmentally sustainable, it must comply with certain principles that ensure alignment with Key International Standards.

As outlined above, the MSS framework in the EU taxonomy is set out in Article 18²¹ of Taxonomy Regulation. The aim is *to prevent* investments from being labelled 'sustainable' when they do not align with the expectations of the Key International Standards.

The regulation specifically clarifies that entities seeking to align their economic activities with the EU Taxonomy must comply with the standards for responsible business conduct mentioned in the:

- OECD Guidelines for Multinational Enterprises on Responsible Business Conduct (OECD Guidelines).
- UN Guiding Principles on Business and Human Rights (UNGPs), including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights.

Analysis of the EU Taxonomy's MSS provisions by the EU Platform on Sustainable Finance (discussed above) suggests in practice this means having procedures in place to avoid negative impacts on human rights including labour rights, corrupt practices, and not being linked to non-compliance with letter or spirit of tax laws or anti-competitive practices.

FIGURE 8
MSS methodological approach for the Australian taxonomy

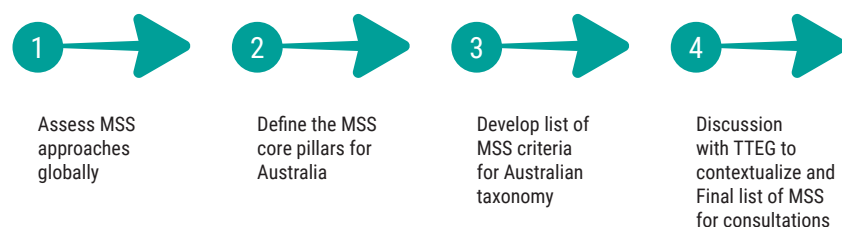


FIGURE 9
MSS approaches globally



In the EU context, the approach taken by the EU Platform for Sustainable Finance to identify suggested criteria for compliance with the EU Taxonomy regulation's MSS provisions in Article 18(1) involved the following steps:

- Analysing and identifying the substantive themes in the Key International Standards referred to in the EU Taxonomy Regulation MSS provision (that is, the four MSS pillars of human rights, corruption, tax and competition).
- Reviewing existing and emerging EU regulation relevant to the substantive themes/pillars identified in the international standards, including consideration of EU regulations topics covered by the MSS and, where necessary, national laws on human rights due diligence.
- Reviewing and analysing existing business and market practices with regards to ensuring and verifying compliance with the EU Taxonomy's MSS (e.g. aligning with the OECD Guidelines).²²

As mentioned previously, the substantive topics in each of the key international standards were reviewed so as to identify the four MSS pillars for compliance: human rights, taxation, bribery and fair competition. The MSS compliance against each of these core pillars is ensured by the following requirements:

- Implementation of due diligence procedures, internal controls and processes, programmes, and strategies.
- Avoidance of negative impacts and legal convictions on any of the substantive topics under the core MSS pillars.

Example B: Colombian Taxonomy. Identifies key social priorities with reference to specific International Financial Corporation (IFC) Social Performance Standards:²³

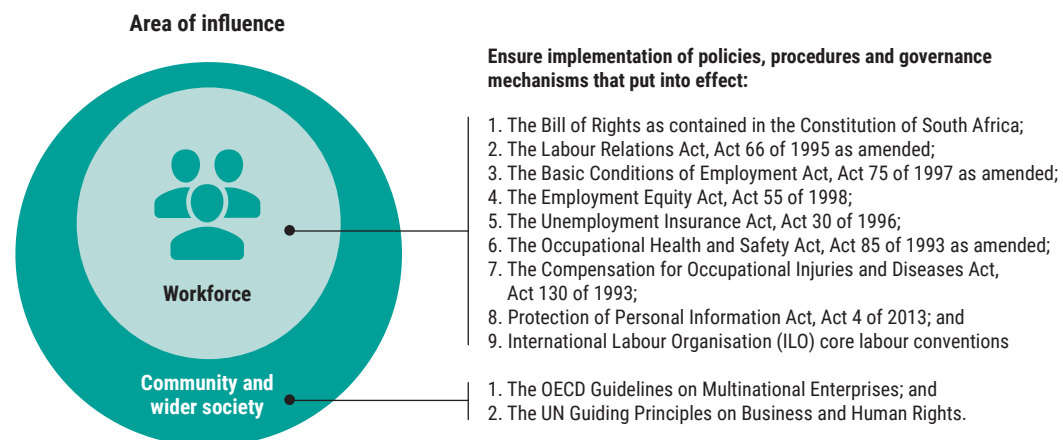
- PS01: Assessment and management of environmental and social risk impacts
- PS02: Labour and working conditions
- PS03: Community health and safety
- PS04: Land acquisition and involuntary resettlement
- PS05: Indigenous rights
- PS06: Cultural heritage

Example C: South African Taxonomy (SA GFT).

All activities must be aligned with both international standards as well as compliance with national standards or regulations.

FIGURE 10

Simplified representation of additional specifications of MSS requirements under the SA GFT, over and above EU Sustainable Finance Taxonomy stipulation²⁴



Step 2: Define the MSS core pillars for Australia

In order to define core social pillars for the Australia taxonomy, we must first identify Australia's priority social objectives and topic areas. Drawing on the various approaches taken globally, the TTEG considered that a useful starting point for identifying the social priorities for Australia is to first map Australia's legal, policy and regulatory landscapes that relate to social outcomes. This entails identifying the international treaties, standards and declarations that have been endorsed, signed or ratified by Australia, and the various legislation, policies, commitments and strategies. A non-exhaustive list currently being mapped for the purpose of identifying Australia's national priorities are set out in **Annexure 2**.

The priority social objectives and topic areas for Australia identified through the mapping process can then be cross-referenced against corporate and finance environmental social and governance (ESG) expectations as evidenced through ESG policies, processes and disclosure frameworks and then aligned to international frameworks and standards.

Decisions

DECISION 1:

The core social pillars for the Australian taxonomy that will inform the MSS aspects of the taxonomy should be determined and defined as follows:

- **Step A:** Identify the priority social objectives and topic areas to be addressed by MSS by mapping Australia's national social priorities with reference to national legislation, standards, policies and strategies and international treaties, frameworks and agreements signed or ratified by Australia.
- **Step B:** Cross-reference the identified priority social objectives and topic areas with disclosure expectations for corporates and investors, including a review of finance and corporate sector environmental, social, and governance policies and risk management systems.

- **Step C:** Align the priority social objectives and topic areas to be considered for inclusion as MSS to international frameworks and standards.
- **Step D:** Define the core social pillars based on overlapping social objectives and topic areas in line with international standards and determine the level of ambition.

DECISION 2:

Given the significant challenges with activity-level disclosure, MSS should be applied across entities or assets rather than at an activity level.

Step 3: Develop list of MSS criteria for the Australian taxonomy

Based on prioritised sectors and activities selected for the Australian taxonomy, the MSS compliance requirement at the entity level for each MSS core pillar will be defined.

Additionally, business disclosure frameworks, corporate expectations and data availability will be considered to ensure alignment to taxonomy principles of interoperability, credibility, prioritisation and usability.

Step 4: Contextualise and finalise list of MSS for consultation

The MSS criteria development will be developed under the guidance and input of the TTEG MSS Committee, drawing on consultation and advice from technical advisory groups and Australian experts.

Public consultation

This DNSH and MSS methodology report sets out the approach to:

- determining the DNSH objectives and how they will be defined; and
- identifying Australia's priority social objectives to inform the core social pillars that will be embedded in the taxonomy.

Once the environmental objectives have been defined and the core social pillars have been identified, draft DNSH and MSS technical criteria can be developed.

ASFI will undertake a period of extensive public consultation on the environmental objectives and social pillars as well as on the technical criteria for the first three priority sectors early in the second quarter of 2024. Information on the public consultation process can be found on the ASFI website at: <https://www.asfi.org.au/taxonomy-public-consultation>.



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24. Tennant Reed, Australian Industry Group
25. Zachary May, IFM Investors

Annexure 1: Australian reference materials used to scope ambition of environmental objectives

Climate mitigation:

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Clean Energy Finance Corporation Act 2012 (Cth) <https://www.legislation.gov.au/Details/C2023C00105>

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Climate change adaption:

DCCEEW, *National Adaptation Plan* (2021) <https://www.dcceew.gov.au/climate-change/policy/adaptation>

DCCEEW, *National Climate Resilience and Adaptation Strategy 2021-25* (2021)

<https://www.dcceew.gov.au/climate-change/policy/adaptation/strategy>

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Department of the Prime Minister and Cabinet, *Net Zero Authority* (2023) <https://www.pmc.gov.au/netzero/net-zero-authority>

Disaster Ready Fund Act 2019, (Cth) <https://www.legislation.gov.au/Details/C2023C00158>

Biodiversity, environmental protection, circular economy:

Water Act 2007 (Cth) <<https://www.legislation.gov.au/Details/C2021C00539>>

Environment Protection and Biodiversity Conservation Act 1999 (EPBC Act) (Cth) <<https://www.legislation.gov.au/Details/C2023C00225>>

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International human rights treaties:

International Covenant on Economic, Social and Cultural Rights, opened for signature 16 December 1966, 993 UNTS 3 (entered into force 3 January 1976)

International Covenant on Economic, Social and Cultural Rights, opened for signature 16 December 1966, 993 UNTS 3 (entered into force 3 January 1976)

International Convention on the Elimination of All Forms of Racial Discrimination, opened for signature 21 December 1965, 660 UNTS 195 (entered into force 4 January 1969)

Convention of the Elimination of All Forms of Discrimination against Women, opened for signature 18 December 1979, 1249 UNTS 13 (entered into force 3 September 1981)

Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, opened for signature 10 December 1984, 1465 UNTS 85 (entered into force 26 June 1987)

Convention on the Rights of the Child, opened for signature 20 November 1989, 1577 UNTS 3 (entered into force 2 September 1990)

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Australian Human Rights Commission Act 1986 (Cth) <<https://www.legislation.gov.au/Details/C2017C00143>>

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Environment Protection and Biodiversity Conservation Act 1999 (Cth) <<https://www.legislation.gov.au/Details/C2021C00182>>

Protection of Movable Cultural Heritage Act 1986 (Cth) <<https://www.legislation.gov.au/Details/C2016C01056>>

Aboriginal Land Rights Act 1976 (NT) <<https://www.legislation.gov.au/Details/C2016C00111>>

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Employment standards and conditions:

Fair Work Act 2009 (Cth) <<https://www.legislation.gov.au/Details/C2017C00323>>

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