

## Frequently Asked Questions: Methodological Design Features of the Australian Taxonomy

### 1) *What is a taxonomy and why does Australia need one?*

A sustainable finance taxonomy is a financial sector tool that classifies economic activities and assets according to their sustainability attributes. A sustainable finance taxonomy helps identify sustainable investment opportunities, create sustainable assets and activities, and guide capital to support the achievement of Australia's climate, environmental and social objectives. It also provides the finance sector with greater confidence in and assurance over sustainability claims, enables comparability between investment products and portfolios, and reduces transaction costs by clearly identifying sustainable assets.

Both the Australian Government and the finance sector have recognised the need for, and support the immediate development of a sustainable finance taxonomy that is internationally credible, interoperable and fit for purpose for Australia. This will help to guide the allocation of capital towards decarbonisation activities in the Australian economy, bolstering Australia's attractiveness as a destination for foreign investment as global capital markets are increasingly pricing..

### 2) *Which economic sectors will be covered by the Australian taxonomy?*

The Australian taxonomy's initial development phase will run for eighteen months, during which climate mitigation criteria will be developed for green and transition activities across three and up to six economic sectors. "Do No Significant Harm" (DNSH) criteria will be developed for the other environmental objectives defined in the taxonomy and "Minimum Social Safeguards" (MSS) will be incorporated to ensure climate mitigation activities do not undermine Australia's other sustainability and social goals.

The six sectors prioritised for initial development under the taxonomy are:

- a) electricity generation and supply (energy)\*;
- b) minerals, mining and metals\*;
- c) construction and the built environment\*
- d) manufacturing/industry;
- e) agriculture; and
- f) transport.

(\* indicates the first sectors to be developed).

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

### **3) Why does the Australian taxonomy need a transition category?**

It is imperative that financial institutions have access to credible and consistent transition criteria that progressively steer economic activities toward taxonomy alignment and assist in mitigating the risk of greenwashing. Transition finance helps mobilise capital toward activities that facilitate the decarbonisation of hard-to-abate sectors. Decarbonising these sectors will play a crucial role in reducing Australia's national emissions, greening financial portfolios, and reducing exposure to systemic transition risk across the Australian economy.

There is a lack of consensus around the purpose, intent, and meaning of transition finance, and global best practice is still emerging. Recognising this, the [Taxonomy Technical Expert Group](#) (TTEG) developed a methodology for defining transition and determining what types of activities should be eligible for the Australian taxonomy's transition category. A credible approach to defining transition activities is key to ensuring the Australian taxonomy achieves its objective of mobilising capital to support Australia's transition to net zero emissions in a transparent and internationally credible manner.

### **4) How are 'green' and 'transition' defined in the Australian taxonomy?**

The green category includes economic activities and assets that are consistent with achieving net zero greenhouse gas emissions in accordance with the Paris Agreement temperature goals. Performance thresholds for these activities will be determined using science-based 1.5 degree scenarios. The transition category includes economic activities and assets that, based on current technological readiness levels:

- a) have a continued role or uses in a net zero post-2050 economy;
- b) do not have low carbon emissions alternatives;
- c) can be decarbonised across scope 1,2 and 3 emissions even if decarbonisation is only economically feasible in the long term; and
- d) the risk of locking in future high carbon assets can be mitigated.

Importantly, the transition period cannot remain indefinitely and sunset dates by which activities will no longer be in transition will be determined for all transition activities.

### **5) What is the purpose of the transition category?**

The TTEG determined that the purpose of the transition category should be to:

- a) recognise those activities that are capable of significant movement towards a 1.5°C trajectory within a defined timeframe;
- b) facilitate decoupling of increasing emissions from increasing production;
- c) facilitate deployment of technologies that catalyse emissions reductions and decoupling;
- d) enable the identification of timeframes for a transition period (e.g. sunset dates by which activities are no longer in transition but need to be 1.5°C aligned).

The TTEG recognises that there will be some activities that remain economically necessary for a period while the economy transitions, but which are ultimately not compatible with a net zero emissions economy. While these activities remain economically important, the taxonomy is

primarily future focused so that it can mobilise capital to where it's needed most to support Australia's transition and become a renewable energy superpower.

**6) *What scenario pathways will activities need to follow to be classified as 'transition' under the taxonomy?***

As a starting point, the International Energy Agency (IEA) Net Zero Emissions and Climateworks Centres' scenarios will be used. While there are many scenarios available, IEA was selected due to its widespread global use, regular updates, coverage and adoption into other sector pathway work (e.g. Transition Pathway initiative utilises IEA NZE scenario). Climateworks Centre's scenarios are the most detailed and up to date scenarios applicable to the Australian context. You can read more about ClimateWorks scenarios [here](#).

**7) *Will gas be included as a transition activity?***

Gas is used in a range of ways in the Australian economy. When assessing whether the use of gas in various forms will be eligible for inclusion under the transition label in the taxonomy, a range of activities and uses will be considered, including:

- extraction, production and processing;
- for use to generate electricity and heat;
- for use in the manufacturing of various activities across the economy; and
- for use as a feedstock in chemical and other processes.

Each of the above will be assessed against the transition methodology using credible science-based scenarios and technology readiness levels to determine whether the above activities/uses:

- are inconsistent with and therefore have a diminished role or use in a net zero future economy;
- have low carbon alternatives currently available, or in advanced stages of development;
- pose a risk of high carbon lock in; and
- have an actual pathway to decarbonise scope 1, 2 and 3 emissions without phase down and/or out.

The TTEG recognises that climate science is evolving and technologies are advancing. Accordingly, the methodology assumes periodic updates to assessing the eligibility of activities for green and transition categorisation based on the latest scientific and technology readiness information.

**8) *Will nuclear power be included in the taxonomy as either green or transition?***

Given that nuclear energy is currently prohibited in Australia by legislation, it will not be considered for inclusion in the taxonomy.

**9) *What will the TTEG do now that the transition methodology has been determined?***

The TTEG is assessing which economic activities across the first three priority sectors will be eligible for inclusion in the taxonomy as either green or transition. It will then determine the relevant performance level for green and transition activities using objective science-based technical screening criteria and credible information on technology readiness levels.

### **10) How aligned is this methodology with other jurisdictions?**

Transition categories, sectors and activities have been incorporated into various taxonomies around the world in different ways. The Australian taxonomy's transition methodology builds on the work that other jurisdictions have done to advance transition methodologies in recent years, including Canada, Singapore and ASEAN.

### **11) Will the definition of transition change?**

No, the definition of transition will not change. However, the TTEG recognises that climate science is evolving, and technologies are advancing. Accordingly, the methodology assumes periodic updates to assessing the eligibility of activities for "green" and "transition" categorisation based on the latest scientific and technology readiness information.

### **12) What is Do No Significant Harm (DNSH)?**

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.

The taxonomy's environmental objectives are: climate change mitigation and adaptation and resilience; sustainable use and protection of water resources; biodiversity and ecosystem protection; pollution prevention and control; and transition to a circular economy. DNSH criteria will be drafted for each of these objectives across the priority sectors for development under the Australian taxonomy.

### **13) What are Minimum Social Safeguards (MSS)?**

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.

The Australian taxonomy's social objectives, and the core social pillars under these objectives, will be informed by assessing Australia's social priorities with reference to current laws and policies, international agreements signed or ratified by Australia and current disclosure expectations. Once defined, these social objectives and pillars will inform the drafting of MSS criteria across the priority sectors for development under the Australian taxonomy.

### **14) What will happen next in the development of the taxonomy?**

Once the activities and sectors that are eligible for transition criteria have been identified, the performance level for green and transition activities using objective technology- and science-based technical screening criteria will be developed.

ASFI will undertake a period of extensive public consultation on the technical screening criteria for all green and transition activities across 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](#).