Green Technical Advisory Group

Treatment of green financial products under an evolving UK Green Taxonomy

September 2023

Contents

Executive Summary

With the emergence of global taxonomies, questions around the impact on and treatment of existing green financial products and investments are of pressing importance. The planned review processes built into taxonomies such as the UK Green Taxonomy also pose questions around the future implications for such products and investments as criteria evolve over time.

The objective of this paper is therefore twofold. Firstly, to provide GTAG's recommendations on how activities previously considered environmentally sustainable, i.e. 'green', are affected when the UK Green Taxonomy is implemented. Secondly, to advise on how taxonomy-aligned activities, products and investments are treated as the taxonomy evolves over time.

Outlining the UK approach to the topic is important so that the market understands how existing 'green' products are affected by the taxonomy, and how financial products developed using the taxonomy will be treated in the future, which will support the use of the taxonomy as a tool, and more broadly a strong UK green finance market.

GTAG is in agreement on the need for clarity on how both existing green products and future green products are treated when the taxonomy is implemented and evolves over time. A well-defined 'grandfathering'[1] clause provides the right balance between supporting the use of the taxonomy to develop green products while minimising the risk of greenwashing as standards change.

The European Commission have considered recommendations from their advisory body, the Platform on Sustainable Finance ('the Platform') on grandfathering and GTAG's advice reflects on those recommendations, as well as the views of stakeholders, which were in part gathered via a market survey.The final EU text on the EU Green Bond Standard (EU GBS) has been published recently[2].

Given the FCA's ongoing work on Sustainability Disclosure Requirements, environmental social and governance (ESG) integration and investment labels, there must be a consistent UK approach to green and sustainability debt instruments and green equity investments, and this should incorporate decisions relating to grandfathering in the UK Taxonomy. In particular, if the UK works towards announcing a voluntary Green Bond Standard that aligns use of proceeds to the UK Green Taxonomy, as recommended by GTAG in previous advice[3].

---

1 Grandfathering refers to a provision whereby an old rule applies in certain cases but a new rule or rules apply to future cases. For the UK Green Taxonomy, including a grandfathering clause would permit and define the conditions by which assets previously considered environmentally sustainable are treated when the standards change – in this instance, the 'technical screening criteria' (TSC).

2 Council of the European Union – EU Green Bond Standard. May 2023. https://data.consilium.europa.eu/doc/document/ST-9074-2023-INIT/en/pdf

3 See GTAG's paper on "policy links", which provides recommendations on the links between the UK Green Taxonomy and other policies here: https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2023/08/GTAG-Final-Report-on-Policy-Links.pdf

Recommendations

GTAG's recommendations are as follows:

1. **HMG must provide clarity prior to the taxonomy's implementation on how existing green products will be treated when the taxonomy comes into effect, and how taxonomy-aligned products will be treated as the taxonomy evolves over time.** Existing green products can still be referred to as such, but if they do not meet the taxonomy's technical screening criteria, they cannot be referred to as taxonomy-aligned. As the taxonomy evolves over time, some products that were previously taxonomy-aligned may no longer meet the criteria. For both equity and debt, implementing a 'grandfathering' clause with clear conditions is necessary to ensure there is certainty in the market about how products will be treated, and reduce potential negative impact on the development and issuance of taxonomy-aligned products.

2. **To support the above, implement a 'grandfathering' clause which provides a set time period for green debt issuers that will enable most green bonds and loans that are "green" or taxonomy-aligned at their time of issuance to remain aligned until maturity, and reduce lock-in risk for longer-term investments, if the criteria they are aligned to change.** The condition will support use of the taxonomy as a guide for sustainable investments, while minimising the opportunity for lock-in of carbon-intensive activity. The clause should apply only to issued debt and not new issuances, which must align with the taxonomy criteria at their time of issuance. The clause will need to outline any exceptions that are necessary, such as long-term infrastructure projects which will require investment but may operate over much longer timeframes and therefore have longer-dated debt, to ensure the risk of greenwashing is minimised. Such exceptions should be considered on a case-by-case basis. There must also be a distinction between allocated and unallocated proceeds.

3. **For equity, GTAG agrees that the grandfathering clause should outline a set time period within which alignment to the Taxonomy's criteria must be met if criteria change.** The time period should include providing an extension for certain projects (such as long-term infrastructure projects) to not limit investment in necessary activities, but GTAG recommends that government consult on whether the market agrees with the timings within the EU's legislation, or if another time limit is more suitable.

4. **If existing green debt is refinanced, assessment should be made against the taxonomy for the latest, current criteria at the time of refinancing.** This would align with the EU's legislation but also recommendation 2 in this paper, as the refinancing is treated as new debt. Therefore, any refinancing of a product would override any existing grandfathering grace period. This will not place additional burden on business as it is to be expected that refinancing would involve review of the conditions, terms, and alignment with any green standards or objectives it is intended to meet.

5. **Government must work closely with the FCA to agree a consistent approach to green and sustainability bonds, including updating FCA guidance to support taxonomy alignment.** Decisions made on grandfathering in relation to the taxonomy should be consistent with the FCA's guidance, which currently involves encouraging issuers of green bonds to consider voluntarily applying or adopting industry standards such as those developed by the International Capital Market Association (ICMA) for green, social and sustainability bonds. GTAG has recommended the announcement of a voluntary Green Bond Standard aligning use of proceeds to the UK Green Taxonomy, building on the green gilt framework[4]. The FCA should update this to the UK Green Taxonomy once it enters law in the UK.

6. **Government should publish additional supporting guidance, including a suggested methodology and detailed case studies, to explain how to assess complex green investments and projects against the UK Green Taxonomy.** Other GTAG recommendations to increase usability of the taxonomy, in particular by streamlining 'do no significant harm' (DNSH) criteria[5] will help, but better guidance in this area will promote the use of the Taxonomy as a tool for bond issuers and therefore the usefulness of the Taxonomy to the market.

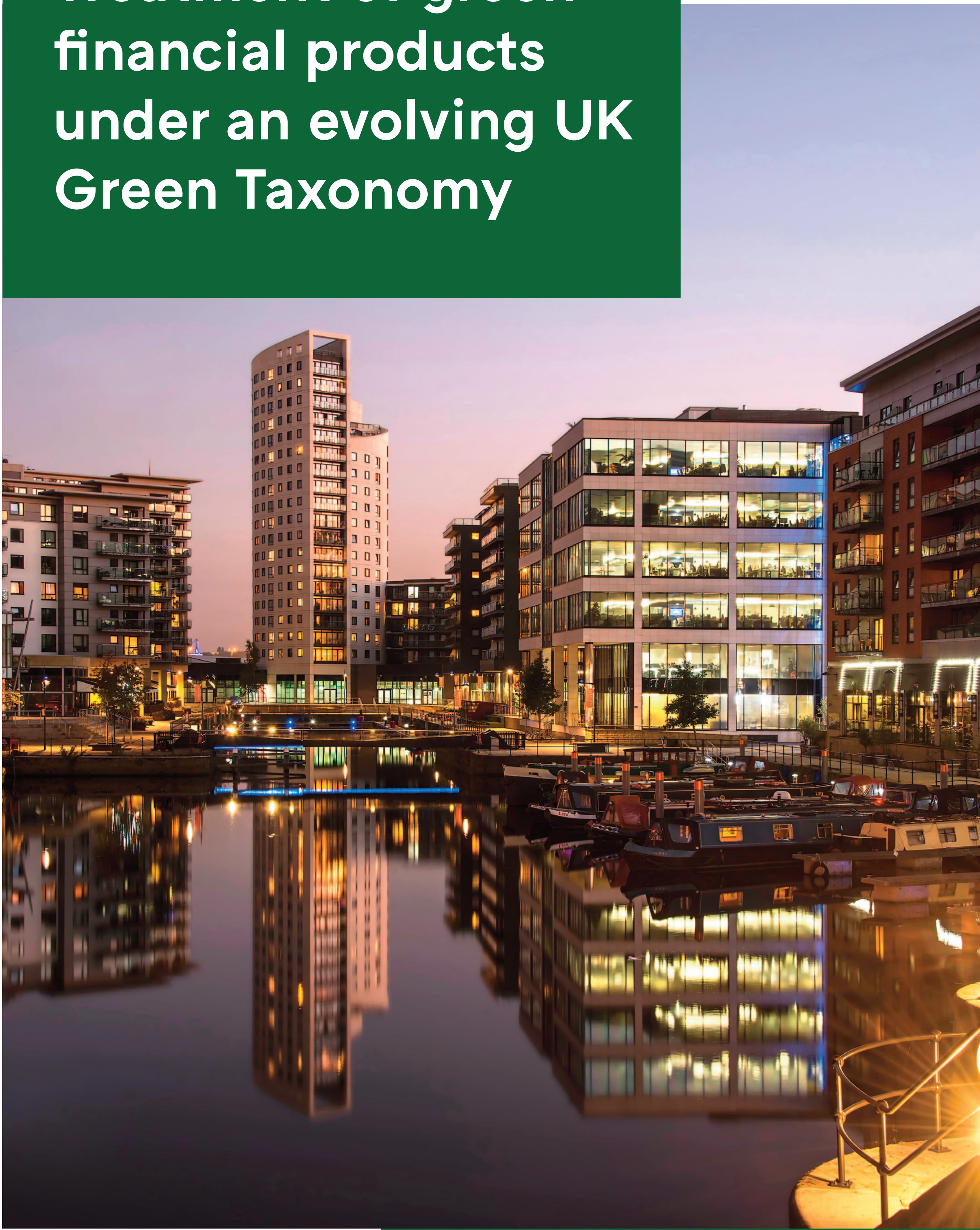
[4] See GTAG's paper on "policy links", which provides recommendations on the links between the UK Green Taxonomy and other policies here: https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2023/08/GTAG-Final-Report-on-Policy-Links.pdf
[5] See recommendations 4 and 5 in GTAG's paper providing advice on DNSH within the UK Green Taxonomy: https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2023/08/GTAG-Final-Report-on-DNSH.pdf"

Table 1: **Summary of recommendations for both debt and equity.**

Situation	Debt	Equity
When the taxonomy is introduced	Must meet TSC to be taxonomy-aligned	Must meet TSC to be taxonomy-aligned
When the investment is made/product created	Meet current TSC	Meet current TSC
When the TSC are updated	Unallocated proceeds must meet new TSC within seven years*. Allocated proceeds fully grandfathered in most cases.	Product must meet new TSC within seven years*
When the product is refinanced (debt), or composition changed (equity)	Must meet latest version of TSC	Must meet latest version of TSC

* time period to be consulted on. EU legislation includes the timeframe specified.

Treatment of green financial products under an evolving UK Green Taxonomy



Introduction

There are two key issues to address:

1. When implemented, the UK Green Taxonomy will become the tool to define what criteria must be met for an economic activity to be considered sustainable. The UK already has a market for green and sustainability-related financial products and the arrival of the Taxonomy will impact that market.

The taxonomy's introduction will meet the market need for definitions of environmentally sustainable economic activity. Reporting against the taxonomy will form part of the UK's Sustainability Disclosure Requirements (SDR) regime and so companies within scope will be required to report[6]. Therefore, **when mandatory reporting is brought in, existing green products will need to assess against the taxonomy to determine their eligibility and alignment to meet their disclosure requirements. Existing green products could therefore meet another voluntary standard, but will not be taxonomy-aligned unless they also meet the taxonomy TSC.** The market will have a clear view of the green credentials of the products, which is in line with the objectives for the taxonomy.

2. The UK taxonomy will evolve over time. The dynamic nature of the taxonomy could cause problems for those issuing green financial products and investors wanting to understand their green credentials.

In Greening Finance: A Roadmap to Sustainable Investing[7], the government committed to reviewing the Taxonomy Regulation's effectiveness every three years, with consideration given to changing the activities covered by the Taxonomy, and the technical screening criteria (TSC) applying to each activity. The Taxonomy needs to be dynamic in this way to ensure it always provides a high standard for 'greenness' that supports the UK's transition to Net Zero.

There is potential for negative impact upon financial products that use taxonomy alignment to demonstrate their green credentials, when the taxonomy criteria change:

a. **Limited issuance** – if the criteria are expected to change over time, issuers of green financial products may be deterred from developing products using the Taxonomy as they will not be able to have confidence their products will remain taxonomy-aligned. This will be particularly problematic for longer-term investments, that are necessary for the UK to reach net zero, e.g. large scale infrastructure projects.

b. **Market instability as reviews approach** – Given the taxonomy will be reviewed every three years, holders of taxonomy-aligned financial products may be incentivised to sell prior to confirmation of any changes to the taxonomy to prevent drop in value of the product if it no longer meets the taxonomy criteria. In addition, issuance will likely reduce as issuers will not want to release a product just before criteria might change.

c. **Greenwashing** – investors could be misled as to the green credentials of financial products. Products aligned to the initial taxonomy criteria could claim to be 'taxonomy-aligned' indefinitely. As the taxonomy is intended to be used for decades, this could have significant consequences over the long term. Even UK government could be at risk of greenwashing for its own investments as the Green Financing Framework[8] was developed to align with the International Capital Market Association (ICMA)'s Green Bond Principles, but also includes references to the UK Taxonomy.

---

[6] HMT – Greening Finance: A Roadmap to Sustainable Investing; October 2021. Page 28. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf

[7] HMT – Greening Finance: A Roadmap to Sustainable Investing; October 2021. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1031805/CCS0821102722-006_Green_Finance_Paper_2021_v6_Web_Accessible.pdf

[8] The Green Financing Framework states at least 50% of net proceeds will be allocated to current and future green expenditures, which include clean transportation and renewable energy products. Source: HM Treasury and United Kingdom Debt Management Office - UK Government Green Financing Framework. June 2021. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1002578/20210630_UK_Government_Green_Financing_Framework.pdf

GTAG therefore recommends that HM Treasury provides clarity on how existing green products will be treated when the taxonomy is implemented, and how products using taxonomy alignment to demonstrate their green credentials will be treated as the taxonomy evolves over time. This will provide the market with the necessary confidence to allow them to develop green financial products that use the UK Green Taxonomy and increase the usefulness of the Taxonomy as a tool overall. This clarity should leverage the other recommendations in this paper.

Complex green debt and project financing

Most green bonds have multiple uses of proceeds, which makes them difficult to assess against the EU Taxonomy. The same issue is seen when assessing projects against taxonomies if the project involves several different economic activities. The Platform point to the example of a construction project illustrated within the 'Do No Significant Harm' (DNSH) Handbook[9] involving 25 different economic activities to highlight how a single project can involve assessment against many criteria[10]. The challenges of assessing against DNSH are also covered – GTAG has separately provided advice on how to improve the usability and usefulness of DNSH for the UK Green Taxonomy[11].

As well as consisting of different economic activities, green projects can contribute to multiple environmental objectives and/or have social components. To support fair assessment of complex projects funded by green and sustainable bonds, the Platform recommended the concept of a 'lead activity or activities'. The lead activity or activities could be determined by comparing the project's components to:

- The issuer's primary green and sustainability objectives
- Amounts allocated (or committed) to underlying project components, and/or cost
- The focus of impact reporting and metrics applied to the project and its components.

GTAG agrees with the Platform's recommendation on the **importance of providing guidance to the market on how to approach taxonomy assessment of complex green projects.** Developing detailed case studies would help, particularly if they include assessment against DNSH criteria. If implemented, GTAG's recommendations to streamline DNSH will likely reduce the complexity of making taxonomy assessments on projects and improve the usability of the taxonomy.

9 Maples Group, Els Europe and Frankfurt School - Do No Significant Harm Handbook. December 2021. https://www.elseurope.eu/files/docs/Do-No-Significant-Harm-Handbook.pdf
10 Platform on Sustainable Finance – Platform Recommendations on Data and Usability. October 2022. https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf
11 For further details on GTAG's DNSH recommendations, see here: https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2023/08/GTAG-Final-Report-on-DNSH.pdf

International approaches

A ‘grandfathering’ clause within the taxonomy (see Figure 1) facilitates greater clarity to the market on how assets will be treated under the taxonomy. Implications of such a provision are explored within this paper.

Figure 1 - What is ‘grandfathering’?
• ‘Grandfathering’ refers to a provision whereby an **old rule applies in some cases, with a new rule or rules applying to future cases.** • For the green taxonomy, including a grandfathering clause would define the conditions by which assets previously considered ‘green’ are treated when the standards change. • For example, if the taxonomy permits ‘grandfathering’, finance deemed to be ‘green’ at the point of issue (by meeting the taxonomy’s substantial contribution technical screening criteria and demonstrating ‘do no significant harm’ criteria and minimum safeguards are met), would be considered ‘green’ for its full lifetime/maturity, even if the taxonomy standards change, and the updated criteria are no longer met. For example, the Finance Act 2017 included grandfathering provisions for overseas pension taxation relief[12].

Including a grandfathering clause within Taxonomy legislation was recommended by both the EU Technical Expert Group (TEG) on Sustainable Finance and the Platform on Sustainable Finance. GTAG’s outreach suggests the wider market is generally supportive of the proposals made by the Platform, recognising the importance of providing certainty to the market while maintaining the integrity of the taxonomy, albeit with some concerns about the potential for greenwashing[13]. **GTAG recommends aligning with the EU and implementing a ‘grandfathering’ clause which provides a set time period for green bond issuers to reallocate proceeds if the taxonomy criteria they are aligned to change.**

From the international perspective, having a similar clause to the EU will support market demand for consistency between taxonomies and promote interoperability. Outside the EU, only the Thailand taxonomy specifically currently references a grandfathering condition, according to GTAG research and as of May 2023. The Thailand taxonomy permits partial grandfathering for loan or bond issuance, whereby the bond/loan is certified under the previous version of the taxonomy as green or amber after the taxonomy’s criteria have changed for up to five years.[14] However, it is GTAG’s view that all taxonomies will have to handle this question as they develop.

The EU Taxonomy approach to grandfathering

The EU’s taxonomy development process considered grandfathering from an early stage, with the EU Technical Expert Group on Sustainable Finance recommending that green bonds issued under earlier TSC be grandfathered for their lifetime, to prevent unacceptable unpredictability for issuers and investors[15]. More recently, the Platform on Sustainable Finance (‘the Platform’) made a series of recommendations to the European Commission in relation to grandfathering within the EU Taxonomy in October 2022[16] (see Figure 2). For the recommendations in full, please see Annex 1: Platform on Sustainable Finance recommendations on grandfathering.

---

12 UK Parliament. Finance Act 2017, Schedule 3 – Overseas Pensions. April 2017. https://bills.parliament.uk/bills/1970
13 Further details are within the next section, with additional information in the Annex ‘PSF Recommendations on grandfathering’.
14 Bank of Thailand - Thailand Taxonomy Paper – Draft for public consultations. December 2022. Page 61. https://www.bot.or.th/Thai/SustainableBanking/Documents/Thailand_Taxonomy_phase_1.pdf
15 EU Technical Expert Group on Sustainable Finance – Usability Guide: EU Green Bond Standard. March 2020. Answer provided to Question 5: https://finance.ec.europa.eu/system/files/2020-06/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf
16 Platform on Sustainable Finance – Platform Recommendations on Data and Usability. October 2022. https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf

Figure 2: Overview of the Platform on Sustainable Finance's recommendations

- **The Platform proposed a grandfathering provision in three areas:**
  - The EU Green Bond Standard (GBS)
  - Reporting under Article 8 of the Taxonomy Regulation (entity level)
  - Reporting under Articles 5 and 6 of the Taxonomy Regulation (product level).
- The Platform **highlight the importance of clarity on the European Commission working towards defining 1.5°C trajectories, with specific time frames and pathways** to ensure there is market understanding of how taxonomy criteria will tighten over time and when transitional activities will expire (sunset clauses).
- The Platform requested **fully grandfathering technical screening criteria (TSC) until maturity for green bonds** whose proceeds are invested in low carbon and enabling activity. Until trajectories for transitional activities are set (for green bonds with use of proceeds in TSC that will tighten over time), **the Platform recommend full grandfathering until maturity for bonds with a lifespan up to 10 years** to minimise lock-in and reputational risks.
- The Platform acknowledged that in some cases (e.g. infrastructure/building projects), a longer lifespan may be required and could be granted by exception.
- The Platform recommended review of application of full TSC grandfathering to allocated and/or committed proceeds for Article 5, 6 and 8 Taxonomy Reporting when:
  - **Taxonomy-alignment is fully reported**
  - **Verification is by a third party registered and supervised by the European Securities and Markets Authority (ESMA)** (or an official authority if non-EU)
  - **Proceeds are invested in low-carbon and enabling activities**

In March 2023, **the European Commission announced that political agreement had been reached between the European Parliament and Council on the Commission's proposal for a European Green Bond Regulation[17].** The regulation establishes a voluntary standard for green bonds, the European green bond standard (EUGBS). The proposals include a seven-year grandfathering period, which is an increase from the initial legislative proposal of a five-year period.

To align with the EUGBS, **issuers must ensure at least 85% of funds raised by the bond are aligned to the EU Taxonomy,** which was a reduced threshold compared to the initial proposal[18] for which all proceeds were required to be taxonomy-aligned. Even with this reduced threshold (likely a response to the Taxonomy criteria for environmental objectives still being developed and challenges in demonstrating taxonomy alignment), there has been some criticism the threshold is still too difficult[19]. GTAG views any comment on the percentage alignment required to meet a future UK green bond standard as outside of the scope of this paper.

The Commission will also publish templates for issuers of other bonds with environmental objectives, even if they do not make use of the EUGBS – use of the templates is voluntary. Bonds must also be registered, and reviewed externally at several points during their life-cycle and this will include assessment of EU Taxonomy alignment.

In the final text for the EU GBS, green bond proceeds are allocated in alignment with the TSC applicable at the time when the bond is issued. Where TSC are amended, unallocated proceeds and proceeds covered by a Capex plan that have not yet met the Taxonomy criteria, must be allocated in alignment with the amended TSC seven years after their entry into application. For any proceeds of a bond that may not align to the new criteria, issuers must draw up, submit for external review and publish a plan for aligning as much as possible and mitigating negative consequences of lack of full alignment. This plan must be published within the seven year time period. Any assets financed that do not align with the amended TSC can continue to be part of the pool of financed assets for at most seven years. If they remain and the bond no longer meets the 85% threshold, the bond could no longer be classified as aligned with the EU GBS.

[17] European Commission – Sustainable Finance: Commission welcomes political agreement on European green bond standard. March 2023. https://ec.europa.eu/commission/presscorner/detail/en/mex_23_1301

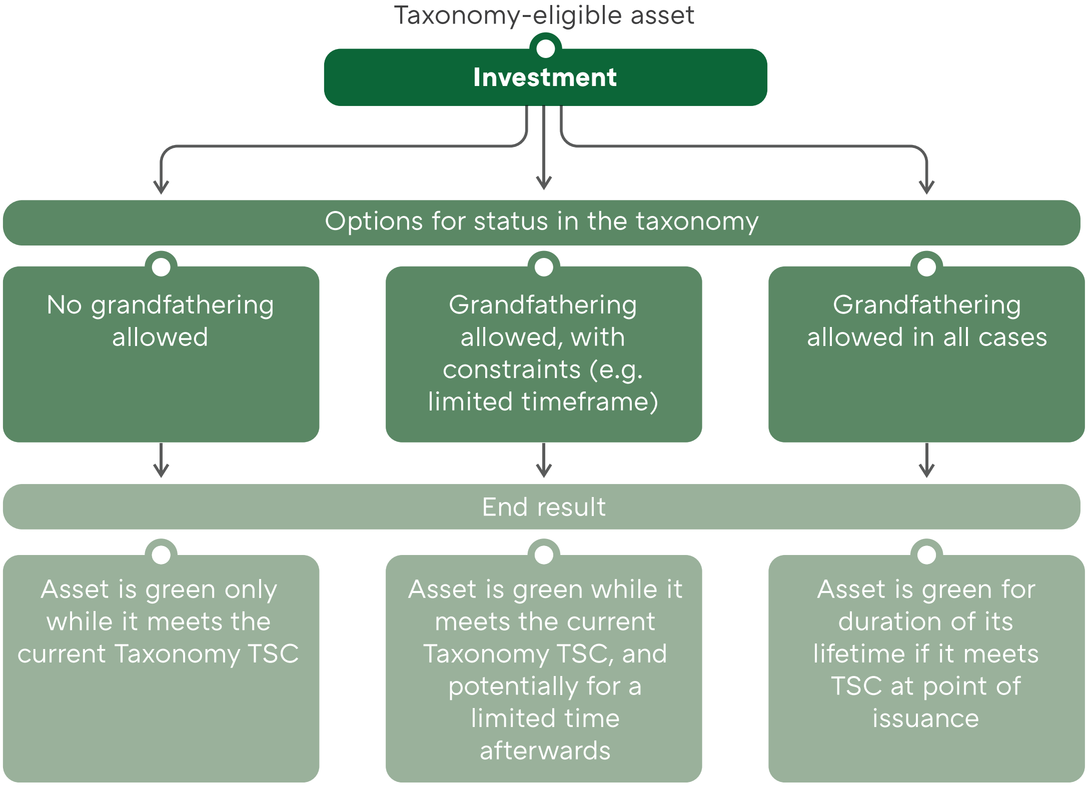
[18] European Commission – Commission puts forward new strategy to make the EU's financial system more sustainable and proposes new European Green Bond Standard. July 2021. https://ec.europa.eu/commission/presscorner/detail/en/ip_21_3405

[19] Official Monetary and Financial Institutions Forum (OMFIF) - EU Green Bond Standard a 'wasted opportunity' for issuers; April 2023 https://www.omfif.org/2023/04/eu-green-bond-standard-a-wasted-opportunity-for-issuers/

Options for grandfathering

There are options with implementation of a grandfathering clause which should be considered (see Figure 3).

Figure 3: **Diagram illustrating the end result in various scenarios, depending on whether 'grandfathering' is permitted in the taxonomy. TSC = technical screening criteria.**



Full grandfathering presents risks and the potential for unintended consequences. While alignment to the initial taxonomy criteria will represent a science-based, robust standard of sustainability, the taxonomy is expected to be updated regularly and so the UK Green Taxonomy of 2030 and beyond may be very different. GTAG's recommendation is instead to permit partial grandfathering, i.e. grandfathering with certain conditions, as outlined below:

1. **Scope – grandfathering should be permitted in relation to allocated proceeds in debt but also partially for equity.** Providing a grandfathering condition for both debt and equity supports a level playing field. There is less potential for 'lock-in' with equity products, and stewardship can play a key role in ensuring those utilising the taxonomy to demonstrate their green credentials by re-allocating holdings to maintain their alignment.

2. **Timing – there should be a limited time period within which unallocated proceeds must be allocated to taxonomy-aligned activities for products to continue to be viewed as aligned.** The European Council proposed full grandfathering for taxonomy-aligned bonds, with partial grandfathering for: financing fixed assets, capital expenditure ('capex'), operating expenditure ('opex'), sovereign expenditures, and equity, with an extension to ten years for financing of debt (see Annex 2: Platform recommendations on grandfathering for further detail). When the EU's legislation was published, the five year period for capex, with extension to ten years – if justified by specific features of the economic activity and investments concern – was confirmed. **GTAG agrees with the provision of a time period for equity products to align to amended TSC, including providing exception for certain projects (such as long-term infrastructure projects)** but recommends HM Treasury consult on whether the market agrees with the timings within the EU's legislation.

3. **Refinancing – if an existing loan is refinanced, assessment should be made against the taxonomy for the latest, current criteria.** This would align with the EU's legislation. Therefore, any refinancing of a product would override any existing grandfathering grace period. This should not place additional burden on business as it is to be expected that refinancing would involve review of the conditions, terms, and alignment with any green standards or objectives it is intended to meet.

Future implications

A grandfathering clause could have implications in the future, if the UK moves towards implementing a voluntary green bond standard underpinned by the taxonomy in the future. This is an option that GTAG outlines in more detail within its paper on "policy links", which provides recommendations on the links between the UK Green Taxonomy and other policies[20]. The FCA is delivering on the UK Sustainability Disclosure Requirements regime, as well as continuing work on environmental, social and governance integration and investment labels. Therefore it is important that decisions made on grandfathering in relation to the taxonomy should be consistent with the FCA's guidance and intended direction, with **HM Treasury working with the FCA to agree a consistent approach to cultivating the UK's green and sustainability bonds market.**

The FCA's guidance currently involves encouraging issuers of green bonds to consider voluntarily applying or adopting industry standards such as those developed by the ICMA for green, social and sustainability bonds. One of the recommendations made by ICMA to improve usability in the EU Taxonomy was to "Grandfather the Taxonomy alignment of the legacy green bond market for Green Asset Ratio/Green Investment Ratio and the SFDR Disclosures".[21]

By having a grandfathering provision, global investors are able to make more informed decision. For example, one investor may decide that a green bond containing investments aligned to the UK Green Taxonomy when first issued is acceptable to them, even after the first taxonomy review takes place and some TSC are changed, such that the investments would no longer be aligned to the new criteria immediately. This market-led approach allows decisions on taxonomy alignment to become an element of investor strategies – if there is demand for products aligned to the latest version of the UK Green Taxonomy, then this should incentivise the creation of new funds designed to meet the current criteria.

A successful UK Green Taxonomy will evolve over time, supporting the UK's transition and progress towards more sustainable activity across the economy. Clearly outlining the UK's approach to treatment of green financial products will ensure the market feels comfortable with the taxonomy as a tool and uses it to guide their development of green financial products in both the short term and the long-term.

[20] GTAG – Applying the UK Green Taxonomy to wider policies: the value case and options. August 2023. https://www.greenfinanceinstitute.co.uk/wp-content/uploads/2023/08/GTAG-Final-Report-on-Policy-Links.pdf

[21] ICMA – Ensuring the usability of the EU Taxonomy; February 2022. https://www.icmagroup.org/assets/documents/Sustainable-finance/Ensuring-the-Usability-of-the-EU-Taxonomy-and-Ensuring-the-Usability-of-the-EU-Taxonomy.pdf?vid=2

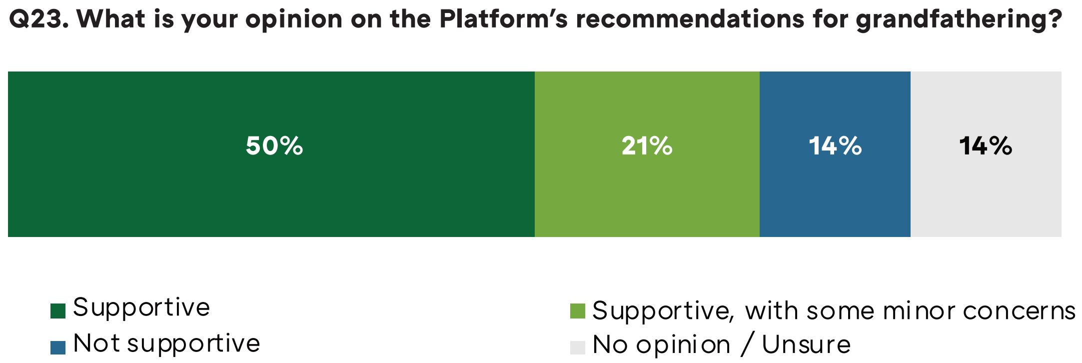
Annex

GTAG Market Survey 2022

GTAG asked the market its view on the Platform's proposals and recommendations in relation to grandfathering as part of a market survey in November/December 2022. A majority of respondents (75%) support the Platform on Sustainable Finance's recommendations in relation to grandfathering (Figure 4). A small proportion (13%) were unsupportive of the Platform's recommendations.

However, responses indicate concerns about the potential for greenwashing, particularly for longer-term issuance as green standards may significantly change over time. If the UK introduces full grandfathering, the regime needs to provide market certainty, be usable and maintain the taxonomy's integrity. As such, reviewing the criteria as part of the taxonomy review process may be necessary. Other priorities for grandfathering include: clear regulation outlining how assets will be treated over time if the standards change, some form of cut-off period for refinancing existing loans, and potentially assessing green credentials on an ad hoc basis.

Figure 4: **Market views on the Platform's recommendations on grandfathering. Total responses to question = 28.**



PSF recommendations on grandfathering

The Platform on Sustainable Finance ('the Platform') made a series of recommendations to the European Commission ('the Commission') in relation to grandfathering within the EU Taxonomy in October 2022[22].

The Platform proposed a grandfathering provision in three areas:

- The EU Green Bond Standard (GBS)
- Reporting under Article 8 of the Taxonomy Regulation (entity level)
- Reporting under Articles 5 and 6 of the Taxonomy Regulation (product level).

The EU Green Bond Standard (GBS)

The Platform acknowledged the European Commission is still negotiating their position on grandfathering for EU Green Bond Standards. The Commission's original Regulation proposal involved a five-year "partial" grandfathering for European green bonds, such that if TSC were to change following issuance of an EU GBS-compliant green bond, issuers would apply the amended TSC within five years of the amended Delegated Act entering application. In April 2022, the European Council opted for full TSC grandfathering whereby Taxonomy status of taxonomy-aligned bonds would be preserved for their entire maturity. However, the partial grandfathering status of five years would remain for: financing fixed assets, capital expenditure ('capex'), operating expenditure ('opex'), sovereign expenditures, and equity, with an extension to ten years for financing of debt.

The Platform noted there is a difference in treatment of capex plans affected by a change in TSC. Capex that upgrades taxonomy-eligible activities to taxonomy alignment should be completed within 5 years in normal circumstances. If the TSC change during the implementation of the capex plan, the non-financial entity can either: (i) restate its Capex KPI by downgrading it, or (ii) use a two year period to re-calibrate the plan to meet the new TSC. The same rules cannot be applied to the EU GBS as these are binary standards without any option to "restate" alignment given the bond is issued with the expectation it is fully aligned to the taxonomy, and there is no possibility to provide extra time given the bond will not exist beyond its date of maturity.

The Platform highlighted the current lack of predictability on how criteria for substantial contribution to an environmental objective will change over time. Although criteria for transitional activities are expected to change, through the three-year review process, there is no clear trajectory towards meeting a specific target. By recommending the Commission consider working towards a 1.5°C trajectory, the Platform set out an approach by which the timeframes and pathways for how criteria will tighten and when transitional activities will expire (sunset clauses) can be clarified. As a result, issuers and investors would be reassured by the forward-looking pathways that allow longer term planning for investments and development of financial instruments.

The Platform requested fully grandfathering technical screening criteria until maturity for green bonds whose proceeds are invested in low carbon and enabling activity. Until trajectories for transitional activities are set (for green bonds with use of proceeds in TSC that will tighten over time), the Platform recommended full grandfathering until maturity for bonds with a lifespan up to 10 years to minimise lock-in and reputational risks. The Platform acknowledged that in some cases (e.g. large infrastructure/building projects), a longer lifespan may be required and could be granted by exception.

[22] Platform on Sustainable Finance – Platform Recommendations on Data and Usability. October 2022. https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf

For Article 5, 6 and 8 Taxonomy Reporting

Under the Article 8 Delegated Act, taxonomy alignment status can be maintained for five years following any changes in the relevant TSC when reporting Green Asset Ratio (GAR) or the Green Investment Ratio (GIR). This applies to the EU GBS and green and sustainability-linked bonds issued with a portion of proceeds aligned to the Taxonomy. However, there is no grandfathering provision within the Sustainable Finance Disclosure Regulation (SFDR), so the Platform suggested it is implied that investors would need to restate their taxonomy alignment in subsequent annual reporting. Without the certainty provided by grandfathering within the taxonomy's framework, there may be the unintended consequence of issuers being encouraged to focus on shorter term financial instruments that are less ambitious and have a more limited positive impact.

The Platform propose that the TSC grandfathering rules within Article 7 of the Commission's proposal for the EU Green Bond Regulation should serve as guidance:

- TSC at time of creation of debt apply when allocating proceeds to debt
- TSC at time of issuance apply for other types of use of proceeds.

The Platform noted there are not specific answers on how TSC apply over a bond's lifetime when an issuer finances a portfolio of green projects. An overview of the Platform's' recommendations can be seen in Figure 5.

The Platform recommended review of application of full TSC grandfathering to allocated and/or committed proceeds for Article 5, 6 and 8 Taxonomy Reporting when:

- Taxonomy-alignment is fully reported
- Verification is by a third party registered and supervised by the European Securities and Markets Authority (ESMA) (or an official authority if non-EU)
- Proceeds are invested in low-carbon and enabling activities

Figure 5: **Overview of the Platform's recommendations from an investment reporting perspective, as adapted from pages 91-92 of the Platform's 'Recommendations on Data and Usability' report[23].**

Issuance of green bonds to finance different types of use of proceeds

	Financing types under Green Bond Framework	*Which TSC to apply?*	*Sample status when TSC change (e.g. 36 months after issuance)*	*Recommended treatment*
Corporate-issued €1bn 10 year green bond for funding both existing and future green projects	Existing asset refinancing	TSC of the time of issuance	Allocated proceeds	Full grandfathering
	Signed-off capex investment or ongoing green project	TSC of the time of issuance	Allocated proceeds	Full grandfathering
	Future green projects to be finance on a dynamic basis	TSC of the time of financing of each project	Un-allocated proceeds	Latest TSC should be applied

Issuance of green bonds by financial institutions to finance different types of use of proceeds

	Financing types under Green Bond Framework	*Which TSC to apply?*	*Sample status when TSC change (e.g. 36 months after issuance)*	*Recommended treatment*
Financial institution-issued €1bn 10 year green bond for funding both existing and future loans	Refinancing of existing loans	TSC of the time of the loan's creation	Allocated proceeds	Full grandfathering
	Future green loans to be added to the pool on a dynamic basis	TSC at the time of the loan's creation	Un-allocated proceeds	Latest TSC should be applied

[23] Platform on Sustainable Finance – Platform Recommendations on Data and Usability. October 2022. https://finance.ec.europa.eu/system/files/2022-10/221011-sustainable-finance-platform-finance-report-usability_en_1.pdf

GTAG Members

Chair: Ingrid Holmes, Green Finance Institute

Users of the taxonomy – Financial Services

- **Faith Ward,** Institutional Investors Group on Climate Change
- **James Alexander,** UK Sustainable Investment and Finance Association
- **Elizabeth Gillam**, International Regulatory Strategy Group

Users of the taxonomy – Non-Financial Services

- **Nick Molho,** (June 2021 – June 2023), Aldersgate Group
- **Rain Newton-Smith,** (June 2021 – January 2023), **Flora Hamilton** (January 2023 – May 2023), Confederation of British Industry

Taxonomy & Data Experts

- **Mike Thompson** (June 2021 – January 2023), **Bea Natzler** (January 2023 – present), Committee on Climate Change
- **Alyssa Heath** (June 2021 – August 2021), **Olivia Mooney** (August 2021 – February 2022), **Margarita Pirovska** (February 2022 – July 2022), **Eliette Riera** (July 2022 – present), Principles for Responsible Investment
- **Prashant Vaze** (June 2021 – March 2022), **Anna Creed** (March 2022 – January 2023), **Matteo Bigoni** (January 2023 – present), Climate Bonds Initiative
- **Lily Dai,** FTSE Russell, London Stock Exchange Group
- **Nadia Humphreys,** Bloomberg
- **Anna Bond** (June 2021 – January 2022), **Katie Spooner** (January 2022 – present), Environment Agency

Academia & Subject Matter Experts

- **Paul Fisher,** Cambridge Institute for Sustainability Leadership
- **Ben Caldecott** (June 2021 – August 2022), **Nicola Ranger** (August 2022 – present), Centre for Greening Finance and Investment and Oxford Sustainable Finance Group / University of Oxford
- **Nick Robins,** Grantham Institute / London School of Economics
- **Theodor Cojoianu,** Queen's University / University of Edinburgh
- **Rhian-Mari Thomas,** Taskforce on Nature-Related Financial Disclosures (TNFD)

NGOs

- **Kate Levick,** E3G
- **Karen Ellis,** WWF

Ad-hoc Members

- **Rachel Barrett** (August 2022 – present), Linklaters
- **Mark O'Sullivan** (August 2022 – present), PwC
- **Amanda Swaffield** (August 2022 – present), Deloitte
- **Jeffrey Twentyman** (August 2022 – present), Slaughter and May

Observer Group

- HM Treasury
- Department for Energy Security and Net Zero
- Department for Business and Trade
- Financial Conduct Authority
- Bank of England
- Other relevant HMG departments and regulators

Acknowledgements

The GTAG Chair and Secretariat would like to thank all the GTAG members and deputies for their time, effort and dedication to the work of the GTAG. Special thanks go to **Lily Dai**, who led this workstream. The GTAG Secretariat is led by **Ryan Jude,** working with **Adam Standage, Sandie-Gene Muir, Jonathan Heybrock, Amy Allan, Blanche de Biolley** and **Victoria Spiteri.**

Glossary

DNSH	Do No Significant Harm
ESG	Environmental Social and Governance
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
GAR	Green Asset Ratio
GBS	Green Bond Standard
GIR	Green Investment Ratio
GTAG	Green Technical Advisory Group
HMG	His Majesty’s Government
ICMA	International Capital Market Association
PSF	Platform on Sustainable Finance
SDR	Sustainability Disclosure Requirements
SFDR	Sustainable Finance Disclosure Regulation
TSC	Technical Screening Criteria
TEG	Technical Expert Group