What's in a Name? ASEAN Taxonomy Version 2 Released

May 2, 2023

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On March 27, the Association of Southeast Asian Nations (ASEAN) Taxonomy Board (ATB), representing ASEAN finance sectoral bodies, released **Version 2** of the ASEAN Taxonomy for Sustainable Finance. This follows **Version 1**, which was released in November 2021. The Taxonomy is "designed to enable a just transition towards sustainable finance adoption by ASEAN Member States" by articulating underlying principles to "harmonise the classification of sustainable activities and assets across ASEAN."

The ASEAN Taxonomy is based on four Environmental Objectives (EOs): Climate Change Mitigation, Climate Change Adaptation, Protection of Healthy Ecosystems and Biodiversity, and Resource Resilience and the Transition to a Circular Economy. "To be classified under the ASEAN Taxonomy, any Activity must demonstrate that it contributes to at least one of these EOs and does not have any adverse effects to other EOs" (i.e., a "do no harm" approach). In addition to satisfying DNH, to be classified as sustainable an activity also must satisfy Remedial Measures to Transition, "which ensures that any significant harm is either removed or rendered insignificant," and a Social Aspects criteria, which "focuses on social aspects that could be harmed by an Activity, such as human rights, labour rights, and impact on people living close to the investments."

To promote achieving these EOs, the Taxonomy articulates five core principles and two assessment approaches, the Foundation Framework comprising "detailed methodologies for assessing economic activities," and a more granular Plus Standard which applies to six "Focus Sectors" and three "Enabling Sectors" that have been identified as particularly important for sustainable development in the region."

Activities are classified as "Green," "Amber" or "Red." To be classified as "Green" or "Amber," an activity "must result in a positive benefit to one or more environmental objectives; or create[s] some form of utility whilst displacing another provider of that utility which detracts from an environmental objective." A "Red" classification means that an activity is "not aligned with the ASEAN Taxonomy." Guiding questions are included for each environmental activity to help assess whether an activity is "Green," "Amber" or "Red." The Taxonomy utilizes Technical Screening Criteria to assess and classify activities according to this stoplight approach.

Phasing out Coal

The Taxonomy addresses the region's specific circumstances and the initiatives already being developed that aim to "promote the phase-out of coal-fired power plants in Asia." **Version 2** introduces coal phase-out as an activity which may be classified as "Green" or "Amber" under the Plus Standard framework – "a global first for a regional taxonomy."

The ATB will now hold targeted consultations with key stakeholders on the Plus Standard and the proposed technical screening criteria for the energy sector. The goal is to finalize these standards in early 2024. Subsequent versions of the ASEAN Taxonomy will expand the Plus Standard and criteria to cover the other five focus sectors (agriculture, forestry and fishing; manufacturing; transportation and storage; water supply, sewerage and waste management; and construction and real estate). The ASEAN Taxonomy is currently scheduled to be finalized by 2025.

Taking the Temperature: The tiered-framework of the ASEAN Taxonomy has been designed to align with other key taxonomies such as the EU Taxonomy and Singapore Taxonomy. The traffic light classification system is similar to the approach adopted by the Singapore Taxonomy, both of which recognize an "Amber" classification of activities, which are those that are either transitioning towards "Green" within a certain time frame or enabling significant emissions reductions in the short term. The taxonomy proposal by Canada's Department of Finance likewise recognizes a transition classification, whereas the proposed UK and enacted EU taxonomies do not have that category. While seemingly minor, these differences in taxonomies across countries is potentially significant in terms of capital allocation. Taxonomies are essential in allowing investors and companies to understand what industries, businesses and projects will be considered sustainable. The development of regional taxonomies with varying approaches and rubrics underscores not only the difficulty in defining a sustainable activity or project, but also increases the regulatory and practical burdens investors and financial market participants will likely face in making investment decisions.