Hong Kong Taxonomy for Sustainable Finance: Supplemental Guidance

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1. Introduction

The Hong Kong Monetary Authority (HKMA) commissioned Climate Bonds Initiative (Climate Bonds) to develop a green classification framework for adoption in the local market.

In May 2023, we published a discussion paper on "Prototype of a Green Classification Framework for Hong Kong". Apart from outlining our thinking on the development of a local green classification framework including the background, potential benefits and core principles, the paper also proposes the structure and core elements of a prototype framework. Based on the paper, a market consultation was conducted to gather feedback from stakeholders on the development and application of the framework.

A range of stakeholders including financial sector participants, industry associations, academia, think tanks and non-government organisations (NGOs), were invited to participate in the consultation and relevant outreach sessions. From the consultation, there were some requests for more illustrations and clarifications about the Taxonomy. Thus, we have prepared this Supplemental Guidance to facilitate the use of the Hong Kong Taxonomy for Sustainable Finance (Hong Kong Taxonomy). It does not provide regulatory advice but aims to help users develop an understanding on the applicability of the Taxonomy. It also provides some background about the Taxonomy based on the discussion paper, and responses to some frequently asked questions.

2. Taxonomy design and structure

The Hong Kong Taxonomy has three layers of depth to provide green definitions of different degrees of preciseness, taking into account the complexity of the activities and their applicability in Hong Kong circumstances.

1. Mapping to standardised industrial codes. The first layer is intended to map activities to standardised industrial classification codes and categorise them according to whether they could be considered either:

1. Automatically eligible and adopted immediately for Hong Kong because they are universally considered green based on existing taxonomies without any major refinement (such as solar and wind); or
2. Potentially green, i.e. activities that are considered green subject to meeting specific technical screening criteria (such as building).

Specifically, standardised industrial classification codes (such as the International Standard Industrial Classification of All Economic Activities (ISIC) and Hong Kong Standard Industrial Classification (HSIC)) are used to form the structure of the Taxonomy and as the basis for its mapping at the granular level. The Common Ground Taxonomy (CGT), the European Union (EU) Taxonomy, the Mainland China Taxonomy, the ASEAN Taxonomy, the Climate Bonds Taxonomy (CBT) and others are then referenced to assess whether an activity can be seen as green without any further refinement.

2. Key metrics. The second layer identifies the key metrics for the Taxonomy, based on the review of existing global guidance and other national/regional taxonomies so as to establish whether:

1. any existing metrics can readily be applied for an activity;

2. the metrics are relevant in the local context; and
3. they are usable for adoption by financial institutions in Hong Kong.

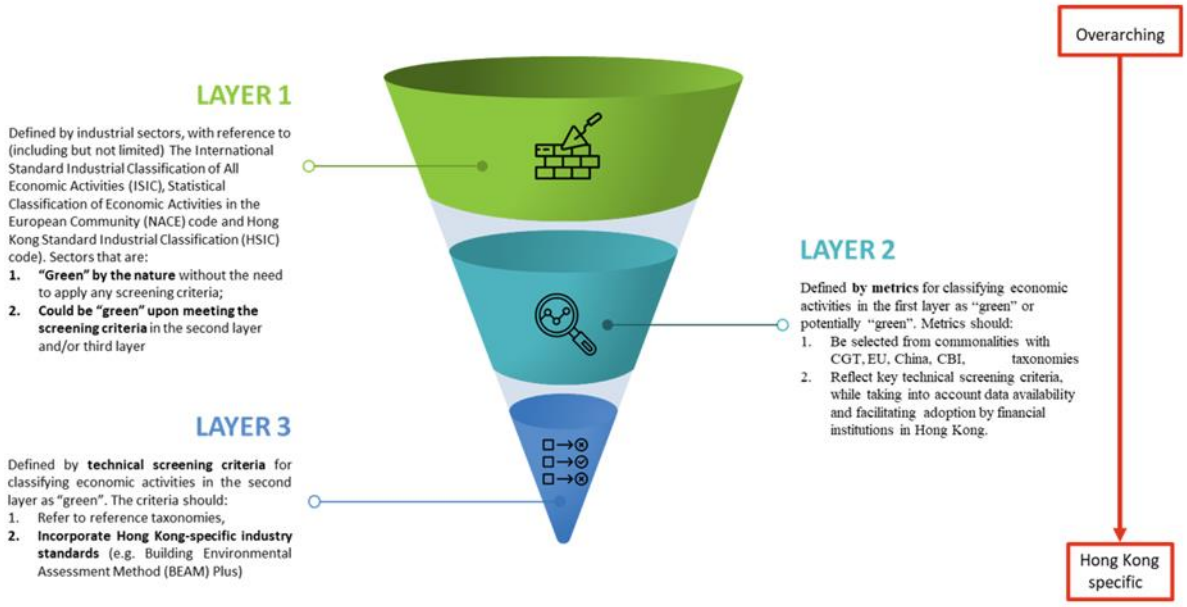
The metrics identified in this layer could be included in investor reports or annual reports as a standing item for disclosure. They can also be considered as a guide for bond issuers and financial institutions to better understand what type of data to gather and disclose to prove eligibility against the Taxonomy.

3. Substantial contribution criteria. This layer aims to propose technical screening criteria. Specifically, existing global guidance and other national/regional taxonomies mentioned above have been reviewed to propose:

- technical screening criteria from existing taxonomies that can be readily applied to an activity;
- adaptations to either the metric or ambition level of an existing screening criteria for it to be applied locally; and
- new metrics and criteria required to be usable in the Hong Kong context.

As much as possible, technical screening criteria have been proposed in consultation with industry experts. This may be the case particularly for sectors or activities where there is limited or no existing guidance in existing taxonomies - for instance shipping. Thresholds have been based on thorough research by the technical experts of the best available science and best available local data to demonstrate a pathway towards zero over time. Where data or scientific pathways are not available, the threshold may have been set based on current best practices with the intention to strengthen this over time following a pathway to zero.

Figure 1: Taxonomy layers scheme



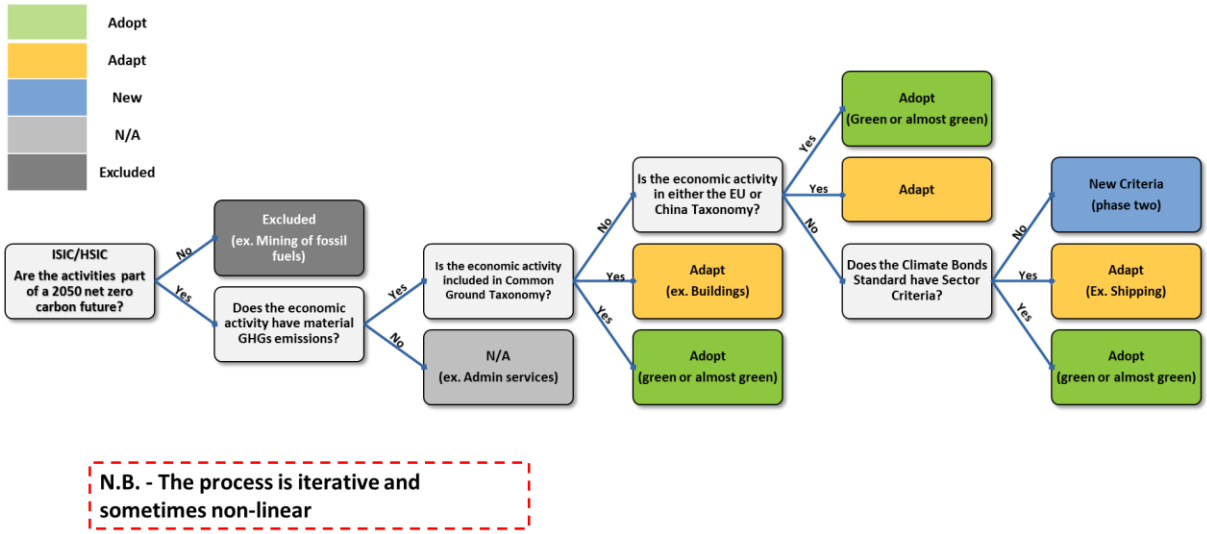
Source: *Climate Bonds Initiative*

In some instances, to cater for the local circumstances and activities in Hong Kong, some metrics or thresholds have not been previously featured in any other taxonomies. For example, the "*Construction of New Buildings*" criteria reference **Hong Kong-specific industry standards** such as Building Environmental Assessment Method (BEAM) Plus. In such instances, the Taxonomy endeavours to draw an equivalence in ambition between this scheme and those used in international taxonomies.

2.1. Decision Tree

In order to build a robust taxonomy and to clearly understand its potential scope of decarbonisation, the thought process was based on a sequence of decision points that have been summarised in the decision tree below **(Figure 2)**. As a preamble, the decision-making process included an in-depth preparatory assessment of all economic activities as defined by the ISIC[1] and the HSIC (V.2.0)[2].

Figure 2: Taxonomy criteria decision tree



N.B. - The process is iterative and sometimes non-linear

2.2. Key references

The development of the Hong Kong Taxonomy has made reference to a number of taxonomies and frameworks. The major ones include the following:

1) The major taxonomy referenced is the **CGT**. It was developed by the International Platform on Sustainable Finance (IPSF)[3] as a bridge between the Mainland China and the EU taxonomies. In July 2020, the EU and Mainland China convened a Working Group with the objective of undertaking a comprehensive assessment of existing taxonomies for environmentally sustainable investments, including identifying the commonalities and differences in their respective approaches and outcomes.

2) **The EU taxonomy**[4] is a cornerstone of the EU's sustainable finance framework and an important market transparency tool. The Taxonomy Regulation[5] entered into force on 12 July 2020. It establishes the basis for the EU taxonomy by setting out the four overarching conditions that an economic activity has to meet in order to qualify as environmentally sustainable. The EU Taxonomy consists of advanced technical screening criteria and activity thresholds as well as an extensive set of supplementary documents related to the issuance of

[1] https://unstats.un.org/unsd/publication/seriesm/seriesm_4rev4e.pdf
[2] https://www.censtatd.gov.hk/en/index_hsic2_code.html
[3] https://finance.ec.europa.eu/sustainable-finance/international-platform-sustainable-finance_en
[4] EU Taxonomy Compass (europa.eu)
[5] https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en#legislation

financial instruments, disclosures, sectoral operational principles, etc. It is also at the centre of the IPSF efforts to build the CGT.

3) In Mainland China, regulators responsible for the green bond market jointly released the **Green Bond Endorsed Projects Catalogue**[6] for consultation in May 2020. The 2021 version of the Catalogue is used as a reference and referred to as Mainland China Taxonomy in this document.

4) **ASEAN Taxonomy** was first published in November 2021[7]. Its second version with the first batch of criteria was published in March 2023[8]. This is a multilayer "traffic lights system" taxonomy which allows different ASEAN states to choose different decarbonisation criteria baselines depending on their economic capabilities.

5) **The CBT** [9] is the oldest and one of the most developed taxonomies used as a reference for the Hong Kong Taxonomy. At the heart of the CBT lies a suite of sector-specific eligibility criteria determined through a multi-stakeholder engagement process convened and managed by Climate Bonds and are subject to public consultation and revised as needed as a result of that feedback. They are reviewed and approved by the Climate Bonds Standard Board.

2.3. Thresholds and criteria development

In order to be eligible as contributing to the environmental objective of climate change mitigation, the activity must be compliant with specific technical screening criteria and related thresholds. These criteria are developed on the basis of technical work conducted for the CGT, Mainland China taxonomy, EU taxonomy and CBT, having regard to the applicability in Hong Kong.

Criteria can be either generic (postulating a general principle) or based on an absolute threshold. For this Taxonomy, concrete criteria are usually constructed in one of the following manners:

- **Upper boundary based**. These are the most common types of criteria. This criterion usually utilises emission metric of some kind, expressed as emission of greenhouse gas (GHG) in CO_2 equivalent per unit of production specific to this industry.
    - Example*: "Lifecycle emission of the installation must not exceed 100gCo_2e/kWh"*

- **Percentage change**. If the retrofitting or modernisation of a facility is discussed, a fixed percentage change may be an excellent way to establish a threshold.
    - Example: "*New Buildings must be at least 25% more emissions-efficient than their peers according to a constructed baseline*"

[6] http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4342400/2021091617180089879.pdf
[7] https://asean.org/wp-content/uploads/2022/06/ASEAN_Taxonomy_V1_final_310522.pdf
[8] https://asean.org/wp-content/uploads/2023/03/ASEAN-Taxonomy-Version-2.pdf
[9] https://www.climatebonds.net/standard/sector-criteria

3. Illustrative use cases

The Hong Kong Taxonomy serves as a market infrastructure by providing a framework for classifying green and sustainable activities for voluntary use by the industry. It provides a foundation to support and complement specific applications. Some examples[10] are set out in this section to illustrate how the Taxonomy could be applied with the necessary instruments and external set of principles such as the Climate Bonds Standard[11], International Capital Market Association Green Bond Principles (GBP) [12] and the Loan Markets Association Green Loan Principles (GLP)[13].

3.1. Basic steps

The basic unit of the Taxonomy is the economic activity. To assess whether an entity, asset, or project (or some of their components) is aligned with the Taxonomy, the following steps should be followed:

1. **Break down into activity level**

An entity, asset, or project is first broken down at the activity level, e.g. according to the industry codes (HSIC/ISIC) provided in the Taxonomy. Expenditures such as capital expenditure (CapEx) and operating expense (OpEx) or revenue/turnover can then be tagged against each identified activity.

2. **Check the coverage**

An activity listed in the breakdown can be compared against the activity descriptions provided in the relevant Activity Card to verify if they are covered in the Taxonomy.

3. **Assess eligibility against the technical screening criteria**

Information including granular data should then be collected and processed so as to determine the eligibility of the identified activities against the technical screening criteria. A combination of data provided by third-party together with in-house research may support the process.

4. **Conclude the evaluation**

If an activity is eligible under the Taxonomy, the expenditure (CapEx or OpEx) or revenue/turnover linked to the implementation of the activity can be considered green. The eligible expenditure could then form the basis of the underlying use of proceeds of a potential green financial instrument - for instance, a green bond or a loan[14].

If 100% of the activities of a company are aligned with the screening criteria of the taxonomy, the company in its entirety may be considered green. However, if only a portion of the activities of the

[10] These examples are intended to illustrate how the Taxonomy could be applied. In actual implementation, the eligibility of the application under the Taxonomy and other standards/principles should be assessed taking into account the specific circumstances.

[11] https://www.climatebonds.net/files/files/climate-bonds-standard-v3-20191210.pdf

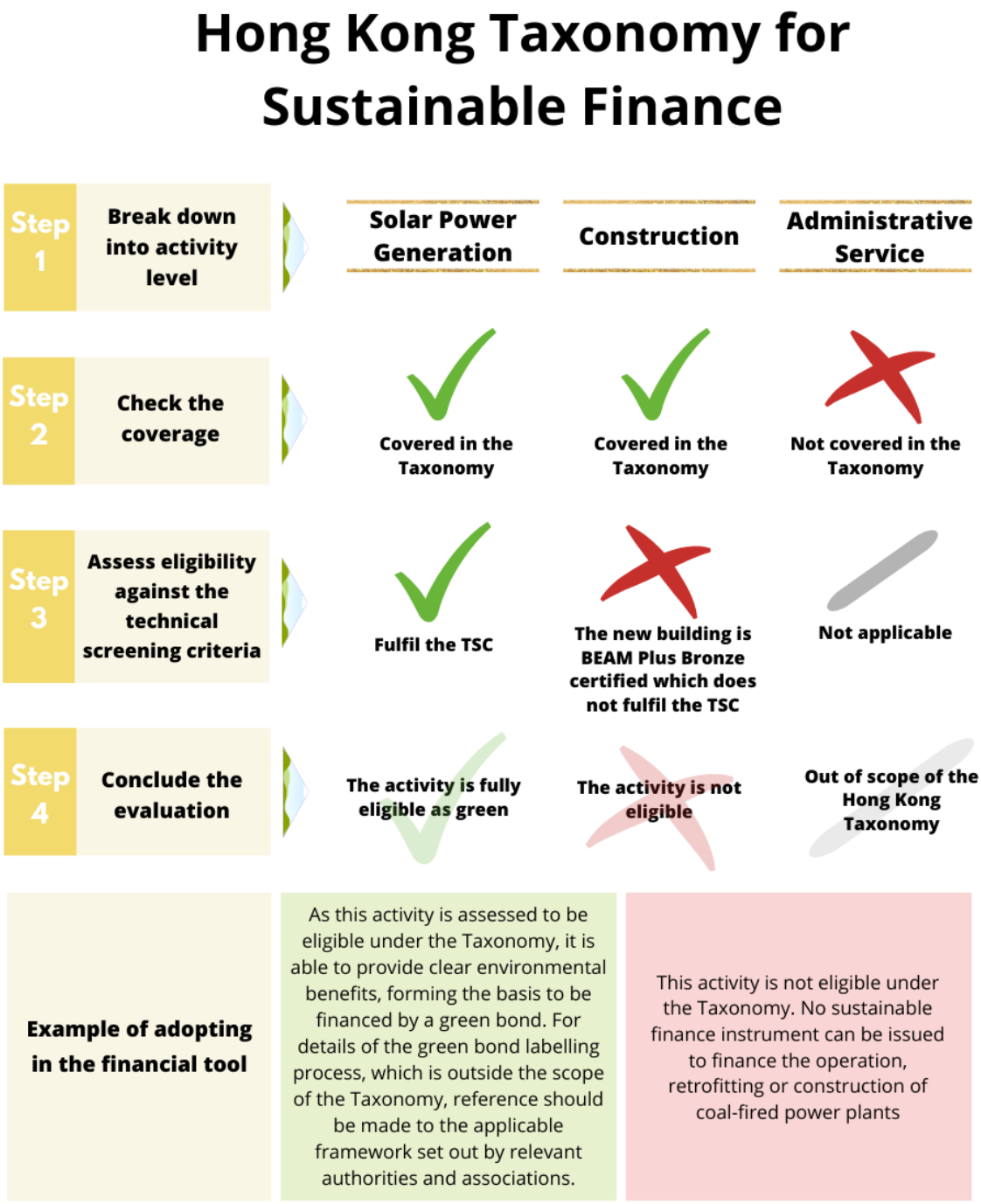
[12] https://www.icmagroup.org/assets/documents/Sustainable-finance/2022-updates/Green-Bond-Principles_June-2022-280622.pdf

[13] https://www.lsta.org/content/green-loan-principles/

[14] In order to operationalise the bond or loan labelling process, an external set of principles (e.g. GBP) or a standard (the Climate Bonds Standard) are required, which are both separate frameworks independent of this taxonomy.

company is aligned with the criteria, then only the relevant expenditure, turnover or revenue of the activities of the company could be considered eligible as green, depending on the referenced rules and frameworks.

Figure 3: Basic steps of adopting Hong Kong Taxonomy



3.2. Example 1: Construction of a portfolio of new buildings

The GBP consist of a set of voluntary process guidelines (around Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting) in relation to green bond issuance that recommend transparency and promote integrity in the development of the green bond market. The GBP recommend a clear process and disclosure for issuers, which investors, banks, underwriters, arrangers, placement agents and others may use to understand the characteristics of any given green bond. As the GBP do not have specific threshold-based criteria for the selection of projects and assets, the Taxonomy could be a useful tool to assess their environmental performance for inclusion in the labelled financial instruments. In practice, the criteria of the Taxonomy could assist the selection of projects and assets using the thresholds as a filtering tool to assess eligibility. The use of the Taxonomy as a selection tool could then be referenced in the "Process for Project Evaluation and Selection" section of a bond's Green Bond/Sustainability Framework.

For example, a bank may assist a company in issuing a green bond to finance the construction of multiple commercial buildings in Hong Kong, Mainland China and the EU. As different locations are involved, the relevant technical screening criteria in the Taxonomy could be applied when assessing the environmental performance benefits of projects and assets. Under the Hong Kong Taxonomy, for those located in Hong Kong, buildings are required to have at least BEAM Plus (either gold or above) designed to certify as such, *and* the Energy Use component of BEAM Plus Certification must meet at least a minimum of 10 credits under EU2 (Reduction of CO_2 Emissions) *and* a minimum score of 70% in Energy Use category *and* certified under BEAM Plus 2.0, with 20% energy saving against BEC 2021 baseline. Alternatively, issuers may reference the HKGBC Zero-Carbon Ready Building Certification Scheme. Those buildings in Mainland China should be rated to the third-level of Mainland China's Three Star System. For buildings in the EU, their primary energy demand needs to be at least 10% lower than the threshold set for the nearly zero-energy building requirements in national measures implementing Directive 2010/31/EU of the European Parliament and of the Council.

In accordance with the GBP, a green/sustainability bond framework could then be established which, among other things, explains how the Taxonomy is used in the process of the selection of eligible projects and assets.

3.3. Example 2: Financing for electric vehicles

Similarly, the Taxonomy could also be applied with the GLP in respect of green loans.

For example, a bank could make reference to the Taxonomy when developing green loan products. Under the Hong Kong Taxonomy, the "*selling, purchasing, financing, leasing, renting and operation of personal transport devices*" are considered green if the emissions of the vehicles are zero tailpipe. The bank may thus provide green loans by financing companies which operate combustion engine vehicles to migrate to electric vehicles.

To label a loan as green using Hong Kong Taxonomy, the bank may use GLP as the framework to guide the loan's labelling process, which is very similar to that for bonds as it is also centred around the same four components (Use of Proceeds, Process for Project Evaluation and Selection, Management of Proceeds, and Reporting). Specifically, the positive environmental performance of the project funded by the loan, as well as the process by which the project is assessed against the Hong Kong Taxonomy, should be clearly articulated.

3.4. Example 3: Wind farm project

Apart from labelling financial products, the Hong Kong Taxonomy could also be a reference tool to support disclosure. In preparing for climate-related disclosures, there could be a need to assess the alignment of assets or portfolios with climate goals and commitments, and this is where a taxonomy may come in.

For example, a bank may wish to disclose climate-related opportunities and relevant targets in accordance with the recommendations of the Task Force on Climate-related Financial Disclosures. It could refer to the Hong Kong Taxonomy in assessing the alignment of its financed projects. If, for instance, there are any projects supporting the construction and operation of a wind farm, and since such projects are considered as eligible under the Hong Kong Taxonomy, the bank can leverage this information in its reporting and disclosure practices. This facilitates better communication and understanding of a bank's green initiatives, allowing investors and other stakeholders to be better informed.

4. Frequently Asked Questions

1. What is a sustainable finance taxonomy?

A sustainable finance taxonomy can be considered as a classification system that identifies activities or investments that deliver on environmental objectives, helping drive capital more efficiently towards sustainable projects. As a consequence, taxonomies can help banks and other financial institutions originate and structure green products (e.g. loans, credits, and guarantees). They can also help investors identify opportunities that comply with sustainability criteria for impact investments.

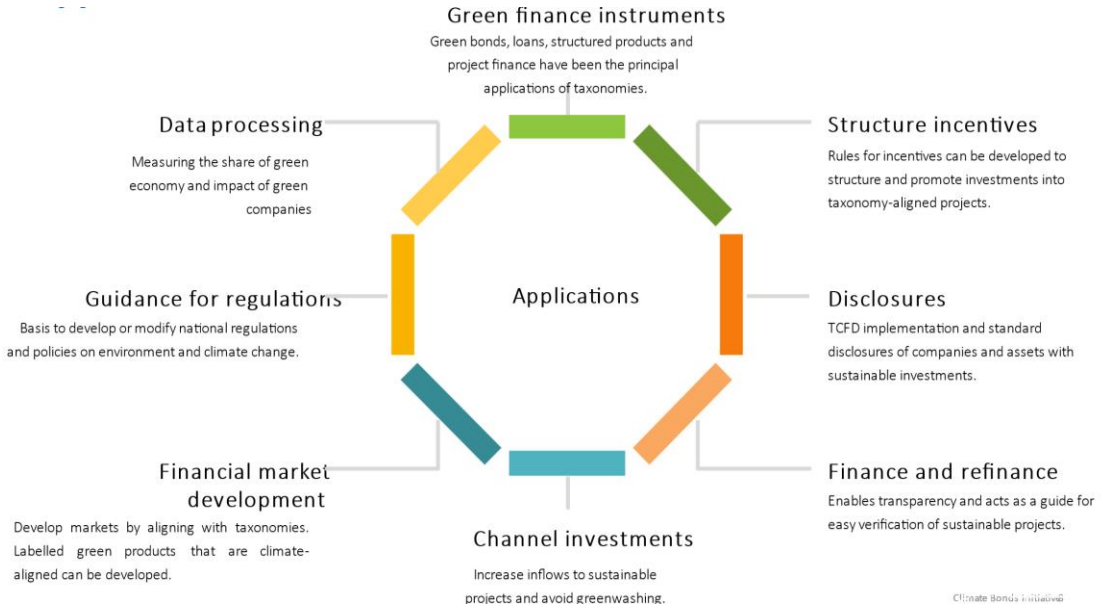
By contrast, a taxonomy is not:

- **A list of "good" and "bad" activities.** A taxonomy does not preclude anyone from investing in any specific activities because it simply helps to define what is sustainable and what is not.
- **A self-sufficient mechanism** that can single-handedly trigger the green transformation of the economy. Whilst a taxonomy is the heart of this transformation, additional tools and frameworks are required to apply it in practice (such as reporting and disclosure requirements).
- **A document frozen in time**. Taxonomies would evolve with climate science to regularly reflect all changes and all new technologies.

2. What are the possible applications of a taxonomy?

A taxonomy may be used for a variety of different purposes associated with confronting climate change as well as shifting the economy towards a more sustainable model (please see figure 4 below). It is important to note that, whilst a taxonomy is the "engine" or "soul" of a green finance system, for any systematic and consistent applications, a taxonomy should be used with additional instruments such as supplementary frameworks and instructions.

Figure 4: Possible taxonomy applications

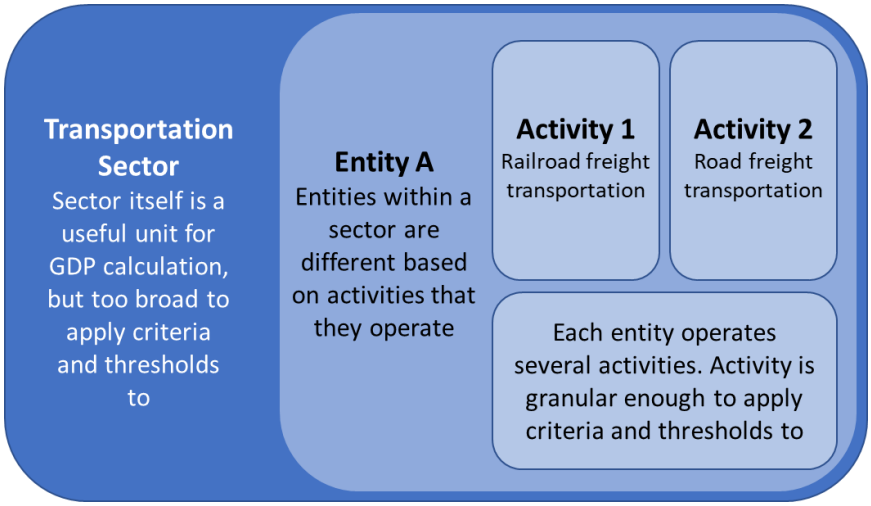


***Source**: Climate Bonds Initiative*

3. Why does the Hong Kong Taxonomy operate on the activity level? How can I assess my entity or portfolio with it?

Activities are the basic units to which specific criteria and screening thresholds are applied within this taxonomy. This is in line with other major international taxonomies which consider activities as operational taxonomical units and do not consider entities. This is optimal because an activity is, on the one hand, large enough to be the object of a bond or loan issuance and, on the other hand, granular enough to be separated from similar activities. On the contrary, an entity comprises different activities, some of which can be decarbonised with significant emission reduction benefits (e.g. steelmaking, battery production, power generation, etc.), while the effect of others on climate is negligible (e.g. management, accounting, etc.).

Figure 5: Example of the relationship between sectors, entities and activities



***Source**: Climate Bonds*

To assess the alignment of an entire entity or portfolio against a taxonomy, a common approach is to ascertain the percentage of green activities of an entity that align with the taxonomy. A specific set of guidelines may also be developed for systematic and consistent assessment.

4. How are technical screening criteria and thresholds in the Hong Kong Taxonomy formulated?

As described above in the taxonomy design section, criteria and thresholds for certain activities in the Hong Kong Taxonomy have been formulated by referencing certain national/regional taxonomies and frameworks such as the CGT, EU Taxonomy, Mainland China Taxonomy, and the CBT. More information about how these taxonomies are developed, such as the involvement of technical expert groups, the different stages of development and public consultation, can be found on the relevant websites. In addition, the Taxonomy has considered the local context and incorporated Hong Kong-specific industry standards (e.g. BEAM Plus).

5. How does the Hong Kong Taxonomy align with other taxonomies?

As the Hong Kong Taxonomy was developed with the aim to operationalising the CGT, it is interoperable with the EU Taxonomy and the Mainland China Taxonomy. It is also compliant with the majority of other threshold-based taxonomies in terms of key criteria and thresholds (but not in mechanisms or objectives which are country-specific). It may not be practical to achieve full interoperability among jurisdictional taxonomies because of the different legal systems and sectoral standards that are referred to by the legislation.

6. How should I calculate my emissions for the purpose of using the Hong Kong Taxonomy? What scope should I consider for this?

Emissions should be calculated using internationally acceptable tools and standards, such as GHG protocols. The scope of the emissions that needs to be considered is usually indicated in the sectoral activity card - specifically in the “Activity scope” section.

The default scopes are 1 and 2 (direct emissions plus emissions from electricity, water, heating and steam consumed) unless stated otherwise. Other options:

- Only Scope 1 emissions (e.g., direct tailpipe emissions of the car in case of transportation activities)
- Lifecycle emission (Scopes 1+2+3), e.g., in the case of energy.

Annex 1: List of Abbreviations

ASEAN	The Association of Southeast Asian Nations
BEAM	Building Environmental Assessment Method
CapEx	Capital expenditure
CBT	Climate Bonds Taxonomy
CGT	Common Ground Taxonomy
Climate Bonds	Climate Bonds Initiative
EDGE	Excellence in Design for Greater Efficiencies
EU	European Union
GBP	Green Bond Principles
GHG	Greenhouse Gas
GLP	Green Loan Principles
HK-GBC	Hong Kong Green Building Council
HKMA	Hong Kong Monetary Authority
HSIC	Hong Kong Standard Industrial Classification
IFC	International Finance Corporation
IPSF	International Platform on Sustainable Finance
ISIC	International Standard Industrial Classification of All Economic Activities
NABERS	National Australian Built Environment Rating System
NGO	Non-Governmental Organisation
OpEx	Operating expense