

WESTPAC BANKING CORPORATION
ABN 33 007 457 141

Developing our Sustainable Finance Taxonomy Discussion Paper

DECEMBER 2022

 **estpac** GROUP

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Executive summary

Current landscape

The development of a sustainable finance taxonomy is an important enabler for financial institutions to help the transition to net-zero by 2050 and support a more sustainable and climate resilient economy. A taxonomy is a set of criteria and transparent, credible and comparable standards that together support action to align capital allocation and investments to meet sustainable goals.

Westpac aims to play its part in financing and facilitating activities that contribute to climate, environmental and social outcomes. Our aim is to set a sustainable finance target that aligns with our Sustainability Strategy and commitments. To do this, we are working to develop a Westpac Sustainable Finance Taxonomy ('our taxonomy') that is tailored to our business, and which will underpin and inform a new Westpac sustainable finance target. It will support us to make responsible decisions about how and what we finance – and provide a classification tool to measure progress against the target we set.

The purpose of this discussion paper is to set out our initial views, challenges and considerations in developing a taxonomy. We are inviting feedback on stakeholder expectations of a company-level taxonomy.

We welcome and acknowledge the Australian Government's support and close engagement with industry on the national taxonomy development project. We are a member of the Australian Sustainable Finance Institute, which is managing the Taxonomy Project, an industry-led initiative, working closely with Government and regulators to develop a national taxonomy.

Strong coordination between Government, regulators and industry will be critical to develop a national taxonomy that is fit for purpose. It should also promote consistency and complementary interaction with other regulations and policies, such as disclosure standards. Ultimately, ownership of the national taxonomy should reside with the Australian Government.

We acknowledge a national taxonomy will take time for industry and Government to work together to formulate and design. In the interim, our aim is to progress with developing a taxonomy that is complementary to the work already underway and seeks to be consistent and aligned.

This discussion paper is divided into two key sections. Section A outlines our development approach to how we might define and measure sustainable activities, taking into consideration the external sustainable finance landscape. It sets out our taxonomy blueprint which summarises the key attributes that we expect will be covered and defined. In section B, we share the challenges we are working through and areas where we invite specific feedback from stakeholders.

Given the complexities of developing taxonomies, we anticipate the process will be iterative. We expect to take a stepped approach and will seek to prioritise certain sectors for criteria development and publication.

Westpac Sustainable Finance Taxonomy and a national taxonomy: how do they fit together?

Westpac

To support our Sustainability Strategy and commitments, our aim is to:

- set a new sustainable finance target; and
- develop a taxonomy that will underpin our sustainable finance target.

National

A national taxonomy is needed to support and facilitate capital allocation and investments to meet Australia's 2030 and 2050 climate goals. The national taxonomy is at early-stage development.

How we envisage they will fit together

Taxonomies need to be dynamic and fit-for-purpose. We will aim to align our taxonomy with the national taxonomy as it is developed. Developing our taxonomy will also support our contribution to the national process and will provide an open and transparent framework for Westpac's customers, investors and other stakeholders until such time a national taxonomy is agreed.

2023



Our taxonomy

Tailored to our business; supporting new sustainable finance target

Our taxonomy blueprint

The table below sets out how we envisage the key attributes and elements of a taxonomy.

TAXONOMY ATTRIBUTES	DESCRIPTION
Purpose	<p>Our taxonomy aims to help provide the classifications and criteria for us to:</p> <ul style="list-style-type: none"> – develop sustainable finance products and services that align with our business strategy and net-zero commitments – support customers’ transition by providing capital toward economic activities delivering sustainable outcomes – support the efforts for sustainable finance to be more accessible for a broader range of customers over time, including small businesses and retail customers.
Principles	<p>Our principles to develop a taxonomy are:</p> <ul style="list-style-type: none"> – Credible - science-based performance thresholds and consideration of leading industry practice – Transparent - clear criteria that supports measurement and tracking against a sustainable finance target – Useable - can be practically applied to customers and easy to implement – Inter-operable - to tailor to Westpac, Australian and New Zealand contexts but is flexible to evolve and change as national taxonomies and emerging standards develop.
Classification	<ul style="list-style-type: none"> – Green finance – Transition finance – Social finance
Objectives	<ul style="list-style-type: none"> – Climate change mitigation and adaptation – Sustainable use and protection of water resources – Circular economy, waste prevention, recycling – Transition towards a low carbon economy – Improved living standards and wellbeing – Inclusive and sustainable society and communities
Criteria	<p>Quantitative and qualitative (principles-based) criteria for classifying economic activities that substantially contribute to the above objectives.</p>
Sectors	<p>The intention is for our taxonomy to apply to and prioritise sectors where we:</p> <ul style="list-style-type: none"> – have material exposures – have material financed emissions exposures – see anticipated growth in sustainable activity.

Key challenges and considerations

In starting to develop our taxonomy we have encountered six key challenges. We welcome views on how we might best work through these.

1. Intersections of climate, environmental and social objectives

- *Challenge:* when working to create a positive impact, actions that may address one goal may result in other complex impacts. How can taxonomies and screening criteria address and support practical assessments of the complex intersections between climate, environmental and social objectives?
- *Consideration:* our initial view is to assess eligibility of the economic activity and its contribution to each sustainable objective independent of each other as a practical starting point. This can be supported by a screen for climate, environmental and social risks against our position statements, policies and frameworks for institutional and business financing portfolios prior to financing.

2. Setting the standard for net-zero 1.5°C and well below 2°C pathways

- *Challenge:* activities for 1.5°C aligned performance are different to those which are well below 2°C aligned, with limited guidance and frameworks outlining these differences in existing taxonomies. How do we develop a taxonomy that supports a 1.5°C performance or pathway, and supports emissions-intensive customers to transition?
- *Consideration:* our initial classification seeks to define green as activities or entities that are consistent with a 1.5°C pathway and transition financing as consistent with a well below 2°C pathway.

3. Defining sustainability thresholds for general corporate purpose lending

- *Challenge:* there is no settled consensus on what constitutes a ‘sustainable’ entity or how to measure this for general corporate purpose lending, which makes up a significant proportion of our overall corporate financing portfolio. What should be the appropriate threshold to classify an entity as sustainable and how should we differentiate classification between green and transition?
- *Consideration:* we are working through a range of options, including how we might classify an entity or activity applying the appropriate threshold level and performance standards to classify as green or transition and overlaying 1.5°C or well below 2°C pathway commitment requirements at the entity and activity levels.

4. Defining social impact as social taxonomies are still in development

- *Challenge:* social taxonomies that provide the classifications to help direct capital to economic activities considered to make a significant contribution towards social impact and human rights outcomes are still in development. What are the priority areas to drive financing to support achievement of these outcomes?

- *Consideration:* we are aiming to align our taxonomy to social outcomes and target populations (such as marginalised/underserved populations and/or communities) recognised in international social financing principles. This includes our initial views to classify, as social economic activities, eligible healthcare and education services provided by the private sector, where government funding enables social benefits to be provided to target populations.

5. Driving change and alignment in a world of evolving standards

- *Challenge:* there is a challenge to ensure taxonomy development remains flexible and considers interaction with emerging taxonomies, government policies, and regulatory and disclosure standards, while supporting customers to meet their climate, environmental and social objectives. How might we best adapt to international standards – and support the inter-operability principle – while responding to regional circumstances of the Australian and New Zealand economies, as national taxonomies are in the early phases of development?
- *Consideration:* we will continue to consult with standard-setting bodies and industry stakeholders and establish a process to regularly revise our criteria and thresholds to stay aligned with the latest developments as appropriate.

6. Data and implementation challenge

- *Challenge:* as taxonomies, standards and regulations develop, there is an increasing need to address data availability relating to our customers’ sustainable performance. Given the data and implementation challenges how might we balance setting minimum requirements while supporting customers to transition and meet their sustainability goals?
- *Consideration:* we need to take into account balancing the minimum standards required for measurement, with the realities of data availability and developing the right capabilities (processes, frameworks and systems) to practically implement the taxonomy. We will aim to factor in improvement efforts, revising criteria as data methodologies and availability mature.

Looking ahead

We recognise the complexities and challenges in developing and applying a sustainable finance taxonomy. While we develop our taxonomy, we will engage and seek feedback from stakeholders including on the key topics and challenges raised in this discussion paper. This is to progress and support our work as well as the work being undertaken on the national taxonomy. It will be important that what we develop interacts and is informed by evolving standards. It must be flexible and dynamic, so it is able to evolve as science, technologies and regulation change.

We welcome feedback, comments and questions, which can be addressed to sustainability@westpac.com.au.

SECTION A

Current landscape and our development approach

Building a sustainable future

Financing sustainable development

Significant investment is required to help transform all sectors of the economy to deliver on the climate, environmental and social goals of the Paris Agreement (including a goal of net-zero emissions by 2050) and the UN Sustainable Development Goals (UN SDGs)¹.

Collaboration and collective action are needed to support the development of a common set of sustainable finance standards to facilitate capital allocation and investments.

National taxonomies development

Developing sustainable finance taxonomies are a significant endeavour and while good progress has been made internationally, there are some complexities and challenges associated with adopting taxonomies. These include:

- limitations in the comparability and alignment of thresholds and performances across jurisdictions as taxonomies have been developed to meet local or regional requirements
- extending taxonomies beyond climate to consider other environmental and social objectives, which are currently less mature
- limited availability of methodologies and data to measure the impact of activities toward thresholds and performance metrics
- maintaining relevance in taxonomies if sustainable products and services are defined using static, out-of-date or less mature taxonomies. This may impact sustainability claims, result in pricing implications, lower demand for products and services or even divestment.

We welcome the progress already underway in Australia to develop a national sustainable finance taxonomy relevant for local contexts, taking into consideration:

- **National taxonomies to incentivise investment are needed to help scale up sustainable finance**
 - Efficient allocation of capital and investments are required across the economy to decarbonise and meet Australia's and New Zealand's target of carbon reductions by 2030 and net-zero by 2050. A common language and set of standards can help support this collective action. While investments are required across the economy to decarbonise, climate scenarios indicate that government policies that incentivise and support the transition should lead to improved economic growth and resilience.
 - To meet the growing demand for sustainable products, taking a science-based approach to taxonomy development is important. Improved classification will help build understanding of sustainable activities and bring global legitimacy to the market, increase uptake by market participants and promote interoperability across the regions for global capital markets.
- **Governance of the national taxonomy is important to ensure credible and transparent standards**
 - A national taxonomy is expected to help support useability and transparency across the finance industry, as well as promote consistency and complementary interaction with other regulations and policies such as disclosure standards. There is likely to be a role for Government and regulators to help drive adoption across the economy.
 - Consistent data, reporting and standardisation is expected to support the real economy and the finance sectors to work towards a common goal.

Westpac will seek to engage constructively and contribute to this process through industry consultations with the Australian Sustainable Finance Initiative (ASFI)² and engagement with Government, regulators and industry bodies such as the Australian Banking Association. This discussion paper is intended to complement the existing work already underway.

We recognise that New Zealand has developed the Sustainable Agriculture Finance Initiative (SAFI)³ guidelines. We will further engage with relevant stakeholders where a national sustainable finance taxonomy is being developed.

1. See for example, McKinsey: The net-zero transition: What it would cost, what it could bring, January 2022. Available at <https://www.mckinsey.com/capabilities/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring>.

2. Available at <https://www.asfi.org.au/taxonomy>.

3. Sustainable Agriculture Finance Initiative (SAFI) created voluntary guidelines for developing sustainable finance products for farmers, growers and other agribusiness. SAFI was set up by The Aotearoa Circle in 2021 to drive further investment and support for sustainable agriculture in Aotearoa. ANZ, ASB, BNZ, Westpac and Rabobank collaborated with the Ministry for Primary Industries (MPI).

Role of our taxonomy

Westpac has a long history of acting on important social issues, including action on climate change and human rights. We are committed to respecting human rights as a financial services provider⁴ and our ambition is to become a net-zero, climate resilient bank. We aim to provide products and services that support customers to transition and adapt⁵; and mobilise capital to incentivise development of transition technologies and climate adaptation measures.

We seek to bring together these commitments (particularly our Net-Zero Banking Alliance (NZBA) interim 2030 sector targets in our lending portfolio⁶), and to set a new sustainable finance target. To support development of this new target, we are developing a Westpac-specific sustainable finance taxonomy that incorporates robust science-based and credible industry practice definitions and performance thresholds in defining green, transition and social economic activities.

Our taxonomy will help us to direct financing to meet sustainable objectives, and aim to support delivery of our 2021 to 2023 Sustainability Strategy, which aligns with the UN SDGs.

We hope that what we develop can contribute to, inform and ultimately align with the national taxonomy. The aim is also for our taxonomy to interact with and be informed by evolving standards, and for it to be flexible and dynamic so it is able to change as science, technologies and regulation change.

4. Our Human Rights Position Statement and 2023 Action Plan sets out the principles that guide our approach and commitment to respecting human rights in line with the UN Guiding Principles on Business and Human Rights (UNGPs).
5. For institutional customers we are, where applicable, supporting their transition by providing guidance on climate strategy and in the development of decarbonisation plans; and offering a suite of finance solutions and products to help them meet their sustainability goals including changing business models, investments in emissions reduction, low/zero carbon technologies, sustainable finance, and infrastructure. We also see opportunities to further support commercial, small and medium businesses and consumers in their transition to net-zero. This includes engaging with businesses and providing access to products and services that support customers to reduce their environmental footprint and transition to a low carbon economy.
6. For more information on our NZBA commitment and targets, refer to our Climate Change Position Statement and Action Plan and Westpac Net-Zero 2030 Targets and Financed Emissions – our methodology and approach. See <https://www.westpac.com.au/about-westpac/sustainability/our-positions-and-perspectives/>

Our taxonomy blueprint

Developing our taxonomy blueprint to meet climate, environmental and social outcomes

Our taxonomy is being developed to build on our existing work such as our Australian and New Zealand sustainable finance solutions⁷.

We are considering the following key attributes in defining our blueprint as shown below.

Table 1 - Our taxonomy blueprint

TAXONOMY ATTRIBUTES	DESCRIPTION			
Purpose	<p>Our taxonomy aims to help provide the classifications and criteria for us to:</p> <ul style="list-style-type: none"> – develop sustainable finance products and services that align with our business strategy and net-zero commitments – support customers to transition by providing capital towards economic activities delivering sustainable outcomes – support the efforts for sustainable finance to be more accessible for a broader range of customers over time, including small businesses and retail customers. 			
Principles	<p>Our principles to develop a taxonomy are:</p> <ul style="list-style-type: none"> – Credible - having science-based performance thresholds and consideration of leading industry practice – Transparent - having clear criteria that supports measurement and tracking against a sustainable finance target – Useable - can be practically applied to customers and are easy to implement – Inter-operable - to tailor for Westpac, Australian and New Zealand contexts but are flexible to evolve and change as national taxonomies and emerging standards develop. 			
Classification	<p>Our taxonomy is a tool that supports the classification of eligible economic activities against three areas.</p> <table border="1"> <tr> <td>– Green finance</td> <td>– Transition finance</td> <td>– Social finance</td> </tr> </table>	– Green finance	– Transition finance	– Social finance
– Green finance	– Transition finance	– Social finance		
Objectives	<table border="1"> <tr> <td> <ul style="list-style-type: none"> – Climate change mitigation and adaptation – Sustainable use and protection of water resources – Circular economy, waste prevention, recycling </td> <td>– Transition towards a low carbon economy</td> <td> <ul style="list-style-type: none"> – Improved living standards and wellbeing – Inclusive and sustainable society and communities </td> </tr> </table>	<ul style="list-style-type: none"> – Climate change mitigation and adaptation – Sustainable use and protection of water resources – Circular economy, waste prevention, recycling 	– Transition towards a low carbon economy	<ul style="list-style-type: none"> – Improved living standards and wellbeing – Inclusive and sustainable society and communities
<ul style="list-style-type: none"> – Climate change mitigation and adaptation – Sustainable use and protection of water resources – Circular economy, waste prevention, recycling 	– Transition towards a low carbon economy	<ul style="list-style-type: none"> – Improved living standards and wellbeing – Inclusive and sustainable society and communities 		

7. See <https://www.westpac.com.au/corporate-banking/corporate-and-structured-finance/sustainable-finance/> and <https://www.westpac.co.nz/institutional/sustainable-finance/>.

TAXONOMY ATTRIBUTES	DESCRIPTION
Criteria	<p>The criteria is the eligibility screen to define the economic activity that is expected to substantially contribute to the environmental and social objectives. We will aim to take a quantitative and qualitative (principles-based) approach to setting the criteria.</p> <p>For example, the asset level criteria for electricity supply might include any distribution systems that are on a full decarbonisation pathway, as demonstrated by having a percentage threshold of newly connected generation capacity below an emission intensity (tCO₂-e/MWh) metric for Scope 1 and 2 emissions.</p>
Sectors	<p>The intention is for our taxonomy to apply to sectors where we:</p> <ul style="list-style-type: none"> – have the most material exposures – have the most material financed emissions exposures⁸ – see anticipated growth in sustainable sectors and technologies⁹, including mining, which plays a critical role in supporting the transition through the provision of critical minerals¹⁰. <p>We have identified the following sectors to consider for taxonomy development. We anticipate a stepped approach in our development and taxonomy publication and seek to prioritise sectors based on the above considerations.</p> <ul style="list-style-type: none"> <li style="width: 25%;">• Power Generation <li style="width: 25%;">• Manufacturing <li style="width: 25%;">• Transport <li style="width: 25%;">• Commercial Property <li style="width: 25%;">• Healthcare <li style="width: 25%;">• Indigenous Banking <li style="width: 25%;">• Mining <li style="width: 25%;">• Waste <li style="width: 25%;">• Water <li style="width: 25%;">• Agriculture and Forestry <li style="width: 25%;">• Residential Mortgages <li style="width: 25%;">• Education <p>We also expect the development process to be iterative. We will aim to include other sectors in future versions of our taxonomy, as it is refined and tested, and as new national taxonomies, industry standards and methodologies emerge.</p>

8. See FY22 Investor Discussion Pack, available at <https://www.westpac.com.au/about-westpac/investor-centre/annual-report/>.

9. Noting for example, the Australian Government’s Technology Investment Roadmap, Towards Net Zero series of reports from the Grattan Institute, Climate Bonds Initiative’s report on Green Infrastructure Investment Opportunities Australia and New Zealand.

10. As clean energy transitions and accelerates, there will be a shift of focus from the supply of traditional fuels to the supply of critical minerals. See International Energy Agency (IEA), World Energy Outlook, November 2022, page 318.

Using our taxonomy

The aim is for our taxonomy to act as a screen for activities that can be classified as delivering sustainable outcomes. It could be applied across a broad range of our products and services in our institutional, business and consumer banks. For instance, it could be used for financing portfolios, including identification of product financing opportunities, facilitation of customers’ bond issuances and our own funding products, such as deposits and bond issuances. Further, it could be used to provide clarity for entities providing sustainable products and services. For the application of the taxonomy, it is also important to maintain transparency to enable third party verification when reporting against a sustainable finance target.

When applying our taxonomy to financing portfolios, an assessment is required to understand whether the financing is for general or specific use of proceeds. The criteria for unlabelled general purpose lending are being considered given the key challenges raised in Section B.

Figure 1 – Determining financing use of proceeds flow diagram

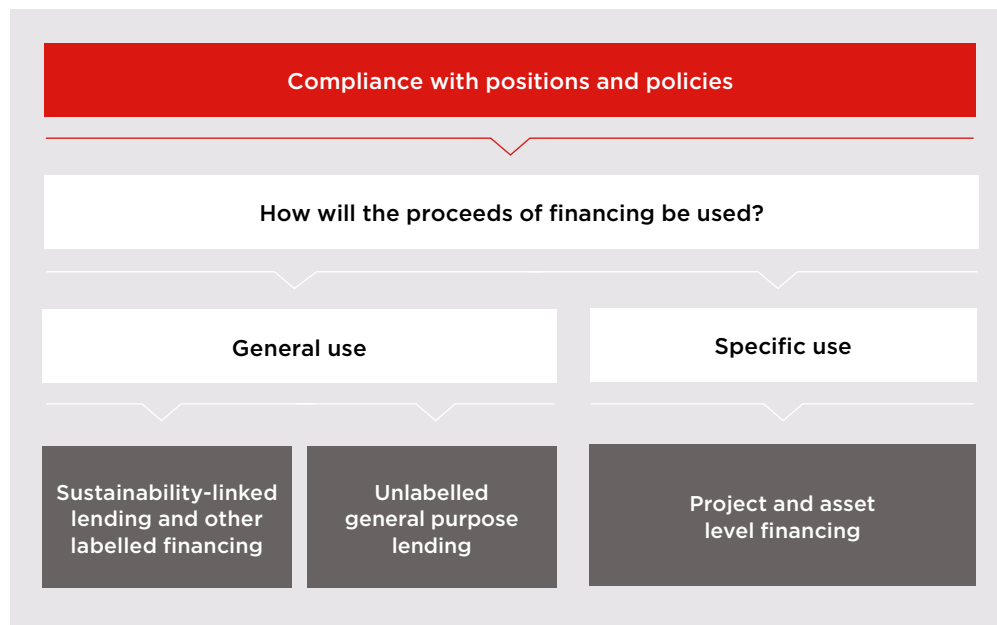


Table 2 – Types of use of proceeds financing

USE OF PROCEEDS	ACTIVITY LEVEL	TYPE OF SUSTAINABLE FINANCING
General purpose	– Entity	<p><i>Sustainability-linked lending (SLL) and other labelled financing</i></p> <p>These are labelled general corporate purpose or general purpose business lending. For SLL, Sustainability Performance Targets are set on Key Performance Indicators related to material ESG issues for the organisation. Other labelled financing where an external verification exists (e.g. verification of a green finance program).</p> <hr/> <p><i>Institutional and business lending</i></p> <p>These are unlabelled general corporate purpose or general purpose business lending that can be clearly identified using our taxonomy.</p>
Specific use of proceeds	– Project – Asset	<p>Financing of projects and assets (including specific/enabling technologies and activities) that can be clearly identified using our taxonomy.</p> <hr/> <p>These can be labelled or unlabelled financing.</p>

SECTION B

Areas for discussion – key challenges

Key challenges and considerations in developing our taxonomy

1 Intersections of climate, environmental and social objectives

Principle – *Credible, Useable*

A sustainable finance taxonomy should consider climate, environmental and social sustainability objectives and risks, and the interrelationships between them.

Key challenges

As the economy transitions to net-zero, we seek to support customers to address the physical and transition impacts associated with climate change along with the social impacts, including a just transition and the relationships to biodiversity and natural capital. Sometimes when working to create positive impact, the actions that may address one goal may result in other complex impacts. Given this intersection of objectives and impacts, there will be challenging decisions and trade-offs, but also opportunities.

For example, should we expect public transport that supports social inclusiveness by connecting communities in remote areas to also align with our environmental objectives to be recognised as ‘sustainable’? How do we support climate objectives, which might impact on our ability to support an orderly and inclusive transition to net-zero?

These dilemmas require careful consideration of how to achieve balanced outcomes. The EU Sustainable Finance Taxonomy (‘EU Taxonomy’) has taken steps to address this complexity through overarching principles to incorporate minimum safeguards and the requirement to ‘Do No Significant Harm’ to any of the other EU Taxonomy objectives. However, the practical application of this principle is challenging, requiring a degree of subjective interpretation and estimation.

International sustainable finance taxonomies developed to date are jurisdiction or region specific, so adapting those to Australian and New Zealand contexts remains a challenge. The most well-developed taxonomies currently focus on climate mitigation and adaptation objectives, while those that focus on other environmental, transition and social objectives are still in development. One reason for this is the limited availability of methodologies and data to measure the impact of activities towards these outcomes. There are also limitations on the level of information on customers’ upstream and downstream impacts or a product’s impact across its lifecycle to assess wider sustainability impacts.

Key considerations for discussion

For our institutional and business financing portfolios, we currently seek to manage climate, environmental and social risks against our position statements, policies and frameworks¹¹.

To further address the intersectionality challenge, our taxonomy proposes to define, where feasible – by sector, entity, asset type and activity – measurable and robust standards for green, transition and social objectives in the local context. Our initial view is to assess eligibility of the economic activity against the criteria that aims to contribute to each sustainable objective independent of each other as a practical starting point. There may also be instances where certain objectives could be applied across multiple sectors where relevant; for example, supporting Indigenous and remote communities. Refer to Appendix A for more details.

We will continue to review leading approaches, including new industry standards and methodologies, for how they might inform our approach¹².

For discussion

- How can taxonomies and screening criteria address and support practical assessment of the complex intersections between climate, environmental and social objectives?
- How might we meet a range of objectives, potentially with competing outcomes, whilst also supporting the holistic goals of a more resilient and inclusive economy?
- How do we best support our people, customers and other stakeholders to navigate implications, decisions and trade-offs?

11. As part of the implementation of our taxonomy, we aim to review and, where applicable, enhance our existing ESG risk management processes. See <https://www.westpac.com.au/about-westpac/sustainability/governance-and-accountability/sustainability-risk-management/>.

12. The EU Taxonomy proposes two models: an independent social taxonomy with environmental safeguards and an independent environment taxonomy with social safeguards; or an integrated taxonomy, where an activity must meet at least one environmental and one social criterion.

2 Setting the standard for net-zero 1.5°C and well below 2°C pathways

Principle – Credible, Transparent

Green and transition classifications require clear definitions and appropriate performance metrics aligned to net-zero 1.5°C and well below 2°C decarbonisation pathways.

Key challenges

The scientific consensus is that limiting global warming to 1.5°C above pre-industrial levels is needed in order to substantially reduce projected losses and damage related to climate change in human systems and ecosystems¹³.

Whilst this objective is clear, there are a number of challenges in developing and applying a taxonomy supporting a 1.5°C pathway:

- Distinguishing between activities that are aligned to a 1.5°C pathway compared to a well below 2°C pathway is difficult. There is limited guidance outlining these differences – and most current taxonomies are based on the Paris Agreement’s goal to limit global warming to well below 2°C. There is also a lack of data to help distinguish these differences.
- Activities that support the transition to a low carbon economy, but are not aligned to a 1.5°C pathway, are still being defined^{14,15} and further development is required for the local context. The Climate Bonds Initiative defines transition activities as those making a substantial contribution to *“halving global emissions levels by 2030 and reaching net-zero by 2050 but will not have a long-term role to play; or will have a long-term role to play, but at present the long-term pathway to net-zero goals is not certain”*¹⁶.

- While Australia has set targets to reach net-zero by 2050, national agreement has yet to be reached over sectoral pathways to achieve a 1.5°C temperature limit. These would be an important input to the development of a national taxonomy. New Zealand has recently released its first emissions reduction plan which is 1.5°C aligned¹⁷.
- Some companies are beginning to set 1.5°C climate goals, however very few companies are currently achieving 1.5°C performance or have a defined 1.5°C aligned pathway that includes Scope 3 emissions given challenges with data and methodologies.

Key considerations for discussion

One of the aims of our taxonomy is to support our existing and future NZBA sector targets¹⁸ and the transition to a low carbon economy. Given the challenges, we recognise the importance of supporting customers who may not be achieving aligned performance today but who are on the pathway to achieve this in the near future. Our initial classification therefore seeks to define green and transition financing in a way that distinguishes between activities or entities that are consistent with a 1.5°C pathway or a well below 2°C pathway.

Table 3 summarises the approach we are considering for our institutional and business banking portfolios. Our taxonomy could classify as ‘green’ an entity or activity that meets performance metrics that align to a 1.5°C pathway. To classify as ‘transition’, entities and activities would need to support a transition towards a low carbon economy that may not currently be aligned to a 1.5°C performance or pathway but is consistent with a well below 2°C pathway.

These classifications will be progressively reviewed and adjusted as required to meet any updated Westpac Group targets, national taxonomies or national agreements for sectoral pathways.

13. Intergovernmental Panel on Climate Change (IPCC) Sixth Assessment Report, Impacts Adaption and Vulnerability, Summary for Policymakers, February 2022.

14. A ‘traffic light’ approach, where taxonomy and thresholds are set for activities to be classified as green (sustainable), amber (transition) and red (unsustainable, also often referred to as ‘brown’). Over time, amber thresholds will be progressively adjusted to meet green thresholds to drive the transition. This is the approach taken by ASEAN and Singapore and recently proposed to be adopted by the EU.

15. A principles-based approach, based on the requirement for transition plans and commitments to remediate and adopt sustainable practices. This could be used for red activities, i.e. to engage and support customers to decarbonise their business and to develop a credible transition plan. This is the approach adopted by Japan and Malaysia taxonomies.

16. Definition from Climate Bonds Initiative and Credit Suisse White Paper: Financing credible transition. https://www.climatebonds.net/files/reports/cbi_fincredtransitions_final.pdf.

17. New Zealand Ministry for Environment (MfE) has released NZ’s first emissions reduction plan which is 1.5°C aligned and has sector plans for transport, energy and industry, building and construction, agriculture, forestry, waste and fluorinated gases. Aotearoa New Zealand’s first emissions reduction plan (<https://environment.govt.nz>).

18. One of Westpac’s key principles in our Climate Change Position Statement and Action Plan is acknowledging that a science-based transition to a net-zero emissions economy is required by 2050. As part of our NZBA commitment, we have continued our work on aligning our lending portfolios with net-zero emissions by 2050, consistent with a maximum temperature rise of 1.5°C above pre-industrial levels by 2100. The sectors in our lending portfolio with current targets set are upstream oil and gas, thermal coal mining, power generation, cement production and Australian commercial real estate (large customers with office properties). See https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/sustainability/Net-Zero_2030_Targets_and_Financed_Emissions-our_methodology_and_approach.pdf

Table 3 – Summary of green and transition classifications that incorporate global warming limits

	GREEN (CLIMATE ALIGNED TO 1.5°C PATHWAY)	TRANSITION (CLIMATE ALIGNED TO WELL BELOW 2°C PATHWAY)
Climate objectives	<ul style="list-style-type: none"> – Climate change adaptation – Climate change mitigation 	<ul style="list-style-type: none"> – Transition towards a low carbon economy
Global warming limit	<ul style="list-style-type: none"> – 1.5°C pathway 	<ul style="list-style-type: none"> – Well below 2°C pathway
Entity level	<ul style="list-style-type: none"> – Entity level aligned performance to 1.5°C pathway or – Entity level performance and a credible transition plan aligned to 1.5°C pathway 	<ul style="list-style-type: none"> – Entity level aligned performance to well below 2°C pathway or – Entity level performance and a credible transition plan aligned to 2°C pathway
Activities level	<ul style="list-style-type: none"> – Thresholds and performance metrics that align to 1.5°C 	<ul style="list-style-type: none"> – Thresholds and performance metrics that align to well below 2°C

For discussion

- How do we develop a taxonomy that supports a 1.5°C performance or pathway, and supports our emissions-intensive customers to transition?
- How do we manage to the current state – where it is generally recognised that there are limitations in data and methodology assessments, and guidance and frameworks are still in development?

3 Defining sustainability thresholds for general corporate purpose lending

Principle – Credible, Transparent

Definitions and thresholds for general corporate purpose lending are set to contribute to climate, environmental or social objectives and are set in line with decarbonisation pathways.

Key challenges

Our taxonomy is intended to cover a broad range of our products and services. General corporate purpose lending – e.g. supporting working capital needs, or to facilitate business growth – forms a significant part of our institutional and business lending portfolios.

Classifying asset-based finance, such as project finance of a renewable energy project, is far more straightforward. There is no settled consensus on what constitutes a ‘sustainable’ entity or how to measure this for general corporate purpose lending. Some banks use methods to measure, or attribute, the ‘sustainable’ portion of company activity. Others adopt the concept of a ‘pure play’ corporate entity¹⁹. Ranges using between 50% to 90% of revenue or turnover from sustainable activities can be observed among different banks and industry bodies²⁰.

While many organisations are moving their business operations to be more sustainable, currently few could meet a threshold set at revenue derived almost entirely from sustainable activities.

In adopting a threshold, we are keen to continue to support customers in their transition as they invest in more sustainable activities and their commitment to 1.5°C aligned or well below 2°C pathways. In addition, given the practical challenges and limitations with data and information, we must balance how we support transitioning customers with the requirements to maintain credible criteria.

Key considerations for discussion

Given the challenges of setting thresholds and applying global warming limits for general corporate purpose lending, we are working through and considering a range of options, including:

- applying the appropriate threshold level and performance standards to classify as green or transition for general corporate purpose lending.
- overlaying 1.5°C pathway and well below 2°C pathway commitment requirements, and whether a corporate transition plan is also required.
- utilising the green equity concept, such as the NASDAQ’s Green Equity Designation.
- basing thresholds on product-linked financing (whereby a range of sustainable activities are being financed).

For discussion

- Where should we set the standard and how should we embed the appropriate thresholds and global warming limit commitments to classify general corporate purpose lending as green as compared to transition?
- Could reliance be placed on a green designation opinion provided by a third party given the evolution for determining a company’s green/sustainability credentials?
- How should we develop a credible taxonomy that supports our customers’ transition and decarbonisation pathways and considers practical application and current state of data, information and implementing the assessment process?

19. See for example CBI Green Bond Database Methodology, July 2022 available at <https://www.climatebonds.net/2022/07/climate-bonds-releases-updated-green-bonds-methodology>.

20. The London Stock Exchange’s Green Economy Mark recognises London-listed companies that derive more than 50% of their revenues from products and services that are contributing to environmental objectives such as climate change mitigation and adaptation. NASDAQ’s Green Equity Designation of companies requires more than 50% of their revenue or investments allocated to activities considered green. Exchange platforms and second party opinion providers have also launched assessment services for green equity.

4 Defining social impact as social taxonomies are still in development

Principle – *Credible, Transparent*

A social taxonomy can help to define activities that deliver social impact and human rights outcomes, including:

- improved living standards and wellbeing
- inclusive and sustainable society and communities.

Key challenges

There is significant opportunity to build on these objectives, in alignment with our Sustainability Strategy and the UN SDGs. However, global taxonomies detailing social outcomes are largely still in development as methodologies to assess social impact and data are not yet mature. The few that exist rely on a principles-based approach with reference to international standards such as the UNGPs.

Key considerations for discussion

In developing our taxonomy, we are aiming to align to social outcomes and target populations²¹ recognised in international social financing principles²².

Target population examples could include, but are not limited to, those people that are:

- living below the poverty line
- excluded and/or marginalised populations, and/or communities
- migrants and/or displaced persons
- underserved, owing to a lack of quality access to essential goods and services.

Target populations may also be served by addressing social issues at the general public level where the issue threatens, hinders or damages the wellbeing of society.

The social financing principles have guided our initial views to consider categorising some specific activities as eligible, including healthcare and education services provided by the private sector, where government funding enables social benefits to be provided to target populations. While we will aim to include quantitative thresholds based on industry practice where possible, our proposed approach is largely qualitative and principles-based and will evolve as new standards and methodologies emerge and mature.

For discussion

- What are the priority areas to drive financing and investments to support achievement of social impact and human rights outcomes?
- How do we define and measure ‘target populations’ and reliably measure impact in this area given that methodologies and data sets remain immature?

21. Target population examples, as listed in the International Capital Markets Association (ICMA) Social Bond Principles.

22. Such as the ICMA Social Bond Principles and Loan Market Association Social Loan Principles.

5 Driving change and alignment in a world of evolving standards

Principle – Useable, Inter-operable

Our view is that taxonomy development should maintain flexibility and take into account emerging developments in government policies and regulatory and disclosure standards, while supporting customers to meet their climate, environmental and social objectives.

Key challenges

It has been challenging to adapt international standards to a local context and identify appropriate local thresholds in the absence of a national taxonomy and local standards. It is expected that the Paris Agreement and evolving climate science will lead to ongoing reviews and ratcheting of climate efforts over time to reflect increasing ambitions. We acknowledge the challenge of defining criteria seen to be ambitious today, which may be deemed as market standard in the near future.

In the coming years, we expect a national taxonomy will be developed along with moves towards harmonising regulatory and disclosure requirements across jurisdictions. It will be important that our taxonomy can evolve and align with the national taxonomy and interact with other standards, and is flexible and dynamic to change as science, technologies and regulation evolve.

Key considerations for discussion

We are benchmarking the development of our taxonomy against leading practice, including referencing specific sector standards. This includes the EU Taxonomy, Association of Southeast Asian Nations Taxonomy ('ASEAN Taxonomy'), Climate Bonds Initiative (CBI) Taxonomy ('CBI Taxonomy'), the International Capital Markets Association (ICMA) Green and Social Bond Principles and New Zealand SAFI. The Canada Transition Taxonomy will be considered as it emerges, along with the Australian national taxonomy under development.

We expect to consult with standard-setting bodies and industry stakeholders and establish a process to regularly revise our criteria and thresholds to stay aligned with the latest developments.

We are also mindful of the need for transparency and of the capacity to audit performance against our taxonomy in line with evolving assurance standards²³ requirements for relevance, completeness, reliability, neutrality and understandability, to enable external verification from third party reviewers.

For discussion

- How might our taxonomy best adapt to international standards while responding to regional circumstances of the Australian and New Zealand economies, as well as government policies and regulatory developments while national taxonomies are in the early phases of development?
- How do we consider updating thresholds and definitions to develop at pace and with adequate rigour, with evolving practices and standards? And how do we achieve a level of connection with other emerging standards and disclosure requirements?

23. ASAE (Australian Standard on Assurance engagements) 3000 and ISAE (NZ) International Standard on Assurance Engagements 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information.

6 Data and implementation challenges

Principle – Useable

Investments in data, technology and people to ensure useability of the taxonomy will be critical for customers and the economy to progress towards long-term decarbonisation and other sustainability objectives.

Key challenges

As taxonomies, standards and regulations develop, there will be an increasing need for more and better data relating to a company's or activity's sustainable performance. A national taxonomy could assist by setting out consistent data standards for reporting and target setting. Key data requirements include but are not limited to:

- revenue/expenditure allocation to sustainable activities
- performance data for assessments against technical screening criteria
- management data on social and environmental issues.

Data and technology challenges and limitations exist across sectors and industries expected to transition. Standardised and detailed data definitions and a common global baseline for reporting obligations should enhance comparability and consistency for informed decision making. For example, currently it can be challenging to obtain data and information to assess the credibility of a company's climate commitments. Many companies face challenges in measuring their own Scope 3 emissions, and may not include these in their climate transition plans; although increasingly stakeholders and reporting or regulatory guidance expect these emissions to be reported²⁴.

Another data challenge is the capability and investment required to manage and use meaningful data. One example is in the residential mortgage sector where appropriately collecting meaningful energy consumption data at the household level can assist householders in reducing their carbon footprint. Utilising solutions such as open energy data to access household energy data requires significant investment in developing the information systems and in managing data privacy concerns.

Limited access to data can present challenges for organisations to measure and monitor progress – including, for example, against long-term decarbonisation goals.

Also needed is investment in employee capacity to embed sustainability into day-to-day operations and lift understanding of sustainability risks and opportunities. We acknowledge companies are at varying stages on this journey.

Key considerations for discussion

Key considerations include how to balance setting the minimum standards required for measurement with the realities of data quality and availability; as well as how to develop the right capabilities (processes, frameworks and systems) to implement our taxonomy. We will aim to factor in improvement efforts, revising criteria as data methodologies and availability matures.

For discussion

- Given the data and implementation challenges, how might we balance setting minimum required standards while supporting customers to transition and meet their sustainability goals?
- What are the key considerations for developing implementation capabilities, including monitoring progress towards future long-term decarbonisation goals?
- What is our role in helping our customers provide data relating to a company's or activity's sustainable performance?

24. New Zealand mandatory reporting will require all material Scope 3 emissions to be reported and assured within the next two years.

Looking Ahead

National taxonomy and industry engagement

We will seek to engage and consult with stakeholders to gather feedback on the key challenges and to test and validate our thinking on thresholds and performance metrics. This is to progress and support our work as well as that being undertaken nationally. In parallel, we aim to participate and contribute to the development of the national taxonomy for Australia to support our customers and the economy to transition to a more sustainable and inclusive future.

We welcome feedback, comments and questions, which can be addressed to sustainability@westpac.com.au.

Taxonomy implementation and sustainable finance target

As we continue to progress our work, with the intention to publish a first iteration of our taxonomy in 2023, we aim to take a science-based approach to develop criteria for key priority sectors. We will further take into consideration leading industry practice in setting a new sustainable finance target that reflects our climate and sustainability commitments. We will also seek to integrate the application of our taxonomy into our internal processes, governance frameworks, data and technology capabilities, as we work to implement and operationalise it.

Appendix A

Summary – Taxonomy aligned activities

The table below is a non-exhaustive list of examples of activities which may be classified as green, transition or social.

		GREEN	TRANSITION	SOCIAL
Sectors	Power Generation	<ul style="list-style-type: none"> – Renewable energy generation (solar, wind, hydropower, geothermal, green hydrogen, ocean) – Biogas energy generation from green waste and agricultural or forestry waste products – Systems, equipment and infrastructure supporting the transmission and distribution of renewable energy – Battery storage 	<ul style="list-style-type: none"> – Lower-emissions substitutes for high-emitting electricity generation – Biogas energy generation from non-waste products and municipal solid waste – Processes and technologies to reduce emissions and leakages along the gas supply chain – Carbon capture and storage (CCS) technology²⁵ 	<ul style="list-style-type: none"> – Supporting Indigenous and Culturally and Linguistically Diverse (CALD) businesses with a focus on sustainability outcomes – Training programs that support alternative employment opportunities for those impacted by the phase-out of emissions-intensive assets – Funding of activities which promote improved access for remote and lower socioeconomic communities to basic facilities (school, transport, medical)
	Mining	<ul style="list-style-type: none"> – Water-efficiency and other systems for water intensive processes across minerals mining and upstream oil and gas supply chains – Renewable energy generation across minerals mining and upstream oil and gas supply chains 	<ul style="list-style-type: none"> – Processes and technologies that reduce emissions across minerals mining and upstream oil and gas supply chains – Mining of key metals and minerals essential for the manufacture of low carbon technologies which enable substantial greenhouse gas emission reductions in other sectors of the economy 	<ul style="list-style-type: none"> – Supporting Indigenous and CALD businesses with a focus on sustainability outcomes – Training programs that support alternative employment opportunities for those impacted by the phase-out of emissions-intensive assets – Funding of activities which promote the improved access for remote and lower socioeconomic communities to basic facilities (school, transport, medical)
	Manufacturing	<ul style="list-style-type: none"> – Net-zero aligned manufacturing – Water-efficiency and other water systems for heavy industrial processes – Waste prevention and control activities for heavy industrial processes – Alternative low emissions-based foods 	<ul style="list-style-type: none"> – Use of reduced clinker content in cement manufacturing – Low emissions iron and steel manufacturing – Low emissions aluminium manufacturing – Manufacturing secondary aluminium – Processes and technologies to reduce emissions in manufacturing – Other processes and technologies to reduce emissions in manufacturing (e.g. electrification) 	<ul style="list-style-type: none"> – Improved access to affordable and accessible food supply chains – Research and Development (R&D) to increase nutritional quality of food, beverages and raw ingredients – Supporting Indigenous and CALD businesses with a focus on sustainability outcomes – Supporting Indigenous, remote and lower socioeconomic communities

25. Subject to State and Federal Government requirements for meeting any specific operating conditions and environmental parameters.

		GREEN	TRANSITION	SOCIAL
Sectors	Transport	<ul style="list-style-type: none"> – Zero direct emissions transport (e.g. electric cars, hydrogen-fuelled vehicles) – Infrastructure supporting zero direct emissions transport – Infrastructure encouraging significant modal shift to low carbon transport 	<ul style="list-style-type: none"> – Low emissions conventional and hybrid transport – Low emissions public transport – Installation of more energy efficient or renewable equipment or infrastructure at airports 	<ul style="list-style-type: none"> – Transport systems supporting accessibility for underserved populations – Affordable and accessible transport – Accessibility infrastructure for physically disabled – Supporting Indigenous businesses and CALD with a focus on sustainability outcomes – Supporting Indigenous, remote and lower socioeconomic communities
	Waste	<ul style="list-style-type: none"> – Waste collection, recycling and reuse where secondary raw materials are sorted and reconditioned – Anaerobic digestion of bio-waste – Composting of bio-waste – Gas capture and utilisation from permanently closed landfills – Other activities enabling sorting, recycling and circular economy solutions 		<ul style="list-style-type: none"> – Supporting Indigenous businesses and CALD with a focus on sustainability outcomes – Improved access to sanitation services
	Water	<ul style="list-style-type: none"> – Water use/conservation management plan – Flood or drought prevention and protection systems – Energy-efficient front-to-end water supply system with energy efficiency – Energy-efficient seawater desalination and brackish water desalination plants – Centralised sewerage system – Anaerobic digestion of sewage sludge treatment 		<ul style="list-style-type: none"> – Supporting Indigenous and CALD businesses with a focus on sustainability outcomes – Supporting Indigenous, remote and lower socioeconomic communities – Improved access to affordable, clean water supply and sanitation services

		GREEN	TRANSITION	SOCIAL
Sectors	Commercial Property	<ul style="list-style-type: none"> Green building construction, acquisition or refurbishment Waste prevention and control activities for construction and demolition waste Water-efficiency and other water systems Improved resilience to physical climate risks 	<ul style="list-style-type: none"> Installation of or construction with low emissions and energy-efficient technologies Other processes and technologies to reduce emissions in commercial property (e.g. electrification) 	<ul style="list-style-type: none"> Supporting Indigenous and CALD businesses with a focus on sustainability outcomes Supporting Indigenous, remote and lower socioeconomic communities
	Residential Mortgages	<ul style="list-style-type: none"> Green building construction, acquisition or refurbishment Improved resilience to physical climate risks 	<ul style="list-style-type: none"> Installation of or construction with low emissions and energy-efficient technologies Other processes and technologies to reduce emissions in residential mortgages (e.g. electrification) 	<ul style="list-style-type: none"> Provision of loans to underserved populations
	Agriculture and Forestry	<ul style="list-style-type: none"> Sustainable on-farm certifications Methane reduction activities On-farm renewable energy water-efficient irrigation and other water systems for agricultural processes that increase water efficiency Waste prevention and control activities including collection of waste by certified waste management operators and use of natural and organic materials as substitutes to hazardous agrichemicals Reforestation of agricultural land and other land use or management practices for generation of carbon offsets Soil and other biodiversity and natural capital improvements which promote protection, restoration and regeneration of native flora and fauna 	<ul style="list-style-type: none"> Energy-efficient farming activities to maximise opportunities to reduce GHG emissions arising from the adoption of new technologies and farming techniques Support for the Forest Stewardship Council (FSC) or compliance with forestry standards which are aligned with Programme for the Endorsement of Forest Certification (PEFC) including the Standard for Sustainable Forest Management and the New Zealand Forest Certification Association Opportunities to improve carbon sequestration from forestry and soil that maximises biodiversity outcomes over appropriate timeframes for the nature of the activity 	<ul style="list-style-type: none"> Improved access to affordable and accessible food supplies Supporting Indigenous and CALD businesses with a focus on sustainability outcomes Supporting Indigenous, remote and lower socioeconomic communities

		GREEN	TRANSITION	SOCIAL
Sectors	Healthcare	<ul style="list-style-type: none"> – Green building construction, acquisition or refurbishment – Waste prevention and control activities for construction and demolition waste – Water-efficiency and other water systems – Improved resilience to physical climate risks 	<ul style="list-style-type: none"> – Installation of or construction with low emissions and energy-efficient technologies 	<ul style="list-style-type: none"> – Public and/or free healthcare – Improved access to basic and specialised healthcare services – Public emergency medical response – R&D activities for technologies and medicine – Affordable medicines and vaccines – Activities to increase recruitment, development and retention of health workforce – Financial risk protection for high-risk healthcare services – Health promotion programs for underserved populations – Aged and retirement care – Healthcare infrastructure and equipment – Supporting Indigenous and CALD businesses with a focus on sustainability outcomes – Supporting Indigenous, remote and lower socioeconomic communities
	Education	<ul style="list-style-type: none"> – Green building construction, acquisition or refurbishment – Waste prevention and control activities for construction and demolition waste – Water-efficiency and other water systems – Improved resilience to physical climate risks 	<ul style="list-style-type: none"> – Installation of or construction with low emissions and energy-efficient technologies 	<ul style="list-style-type: none"> – Public and/or free education services – Improved access to basic and specialised education services – Activities to increase recruitment, development and retention of education workforce – Resiliency plans for learning continuity between school and home environments – Education infrastructure – Childcare services – Supporting Indigenous and CALD businesses with a focus on sustainability outcomes – Supporting Indigenous, remote and lower socioeconomic communities
	Indigenous Banking			<ul style="list-style-type: none"> – Supporting Indigenous businesses with a focus on sustainability outcomes – Supporting active and healthy communities

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Contact

For questions and comments, please contact Westpac Group Sustainability:

sustainability@westpac.com.au

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