Thailand Taxonomy Outlook: Sustainable Classification

Overview of Thailand Taxonomy development

Taxonomy serves as a common framework for classifying economic activities enabling corporate sectors, financial institutions, and investors to manage and assess risk, and promote projects and investments that meet sustainability goals. Globally, taxonomies have been developed by regional and international organizations such as the EU, ASEAN, and Climate Bonds taxonomies, and independently established by several jurisdictions including Japan, China, Russia, and many others, as part of attempts to standardize approaches to sustainability disclosures. While the coverage of objectives and criteria under these taxonomies share some similarities, they are not identical.

Thailand has taken many steps towards becoming a carbon-neutral country by 2050 and achieving net-zero emissions by 2065 in accordance with its updated nationally determined contributions (NDCs) to the Paris Agreement. As part of this effort in the financial industry, regulators in the financial sector, including the Fiscal Policy Office, the Bank of Thailand, the Securities and Exchange Commission, the Office of Insurance Commission, and the Stock Exchange of Thailand have established the Working Group on Sustainable Finance to co-operate on a sustainable finance agenda and to support the Thai economy in achieving sustainable development goals. The working group has issued a joint statement on five key strategic initiatives to set the direction and framework for driving sustainable finance across the financial sector, one of which is to develop Thailand’s version of the taxonomy. The task was led by the Bank of Thailand and the Securities and Exchange Commission which are the working group members.

In an effort for consistency and harmonization with international taxonomies, the current draft of the Thailand Taxonomy is prepared to be compatible with the ASEAN and EU taxonomies, the details of which will be discussed below. The finalized Thailand Taxonomy, Phase 1 is expected to be issued by the first half of 2023.
Structure and key criteria

Thailand has opted for a targeted approach in its first phase and focuses on the disclosures on a voluntary basis. The draft Thailand Taxonomy features the key structure and criteria as follows:

1. **Sectoral classification**

   As the first step of applying the taxonomy, economic activities will be broken down into sectors based on their greenhouse gas emission profile and economic parameters. In this process, the draft Thailand Taxonomy employs the ISIC¹ Code system for sectoral classification. The energy sector and transportation sector are selected as the pilot sectors since the two sectors account for a significant portion of greenhouse gas emissions in Thailand, and technological feasibility in these two sectors is readily available for a sectoral shift to decarbonization.

2. **Activities assessment – Traffic Light System**

   The draft Thailand Taxonomy is based on technical screening criteria. Each sector will be disaggregated into activities and sorted by certain environmental thresholds under the color-coded system called the "traffic light system"². The color codes refer to the following activities:

   - **Green**: activities with near-zero carbon emission or having a clear pathway to net-zero;
   - **Amber**: activities that are in their transitional pathway to reduce carbon emissions. Note that all amber activities in this taxonomy have a sunset date of 2040; and
   - **Red**: activities that are not compatible with net-zero trajectory and are not going to become compatible anytime soon.

3. **Compliance with the ‘Do No Significant Harm’ principle (‘DNSH’) and minimum social safeguards (‘MSS’)**

   The projects or activities must also ensure compliance with the DNSH principle and with MSS in place in order to be considered taxonomy-aligned. A key function of the DNSH principle is to ensure that an objective will not harm other objectives while MSS ensures that the activity does not generate a negative social impact.

   Although for Thailand Taxonomy Phase 1, the climate change mitigation objective will be the pilot and the only objective, Thailand Taxonomy intends to have more comprehensive coverage of objectives, including, among others, the climate change adaptation and the transition to a circular economy objectives. Once the other objectives are implemented, additional DNSH criteria will be developed, and a project should ensure that it meets all DNSH criteria for all the objectives.

   DNSH criteria and MSS require each project and activity to abide by (i) the laws of Thailand or the laws of the local jurisdiction where such activity takes place and (ii) relevant international conventions related to each objective of the taxonomy. For instance, if a Thai company conducts energy business activities in a foreign country, Thailand Taxonomy will also consider compliance with the local laws.

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¹ISIC stands for International Standard Industrial Classification. ISIC is a hierarchical classification system which is a framework established by the United Nations.

²Note that the traffic light system also considers the support function of each activity. For instance, solar powerplants are generally labeled as green, however, if a solar powerplant is dedicated to support fossil fuel, it may fall into a red activity.
Where does Thailand Taxonomy stand among the international taxonomies?

On the objectives level, the draft Thailand Taxonomy shares the same set of objectives with the EU Taxonomy, which is a global reference point for many taxonomies, and aligns with most of the objectives of the ASEAN Taxonomy.

Among the taxonomies of various jurisdictions, there are key methods of screening criteria as follows:

- **Whitelist-based taxonomies** focuses on identifying lists of eligible projects and activities, and provides detailed descriptions of eligibility. This approach is applicable to China, Mongolia, and Russia taxonomies.

- **Technical screening criteria-based taxonomies** uses specific quantitative thresholds and screening criteria to classify the sustainable activities (as discussed above). This approach is applicable to the EU and ASEAN taxonomies.

- **Principle-based taxonomies** focuses on defining a set of core guiding principles to assess the economic activities. This approach is used in Green Bond Principles published by the International Capital Market Association (ICMA) and Japan and Malaysia taxonomies.

The technical screening criteria under the draft Thailand Taxonomy are science-based and are considered politically neutral in a similar manner to those of the EU and ASEAN Taxonomies. However, the draft Thailand Taxonomy is less compatible with the China Green Bond Project Catalogue, which is a whitelist-based taxonomy under which the activities that fall into a definition can be identified as green.

What does it mean for investors and companies?

While Thailand Taxonomy is being prepared by Thailand's regulatory bodies, it will not be introduced as a law but will serve as a guideline for the market. As such, Thailand Taxonomy will be used on a voluntary basis.
As part of the global movement to progress towards net zero, individual, corporate, and governmental sectors are in a race for reaching the ultimate sustainable development goals. Globally, several financial institutions are committed to sustainable financing, including some commercial banks in Thailand. In this regard, there is a significant rise in investment products being marketed as sustainable and labelled with terms such as ‘green’ or ‘ESG’. However, there are growing concerns about the accuracy of these claims and whether these products truly align with these sustainability indications. As such, the adoption of Thailand Taxonomy can fill in this gap where investors and financial institutions can employ it to identify which economic activities are sustainable investment opportunities, and minimize their risks of greenwashing. Meanwhile companies may use alignment with taxonomy to demonstrate their commitments to sustainability and to access sustainable finance. In addition, although Thailand Taxonomy itself is not legally binding, the Thai government could take Thailand Taxonomy into consideration when forming and proposing any relevant policy and regulation in the future.

Against this backdrop, we expect to see various incentives for taxonomy-aligned projects and financial products. For example, the companies may be able to access better loan packages if financial institutions decide to incentivize taxonomy-aligned activities e.g., more favorable terms, particularly on interest rates and pricing. In terms of the issuance of green bonds or provisions of green loans, Thailand Taxonomy criteria may be employed to supplement the green bonds and loans standards. For instance, to be qualified as a green bond or a green loan, the proceeds from the issued bonds or loans must be allocated to taxonomy-aligned projects. In addition, we may also see more policies from the Thai government to achieve decarbonization goals in line with the Thailand Taxonomy.

**Final thoughts**

Thailand Taxonomy Phase 1 represents a gradual but significant shift towards sustainable investing and a greener economy. While it may pose some challenges for businesses and investors in the short term, it also provides an opportunity to transition toward a more sustainable future. Thailand Taxonomy will serve as a tool to assess the sustainable development of economic projects and activities. As the Taxonomy is closely linked to environmental, social, and governance factors – all of which are increasingly important considerations for investors and businesses, especially for Thai listed companies whose reporting obligation on their ESG performance is mandatory – the adoption of taxonomy can be used as a benchmark to help these companies and other stakeholders better understand how to align with sustainability goals. It is also important to note that overlapping and diverse taxonomies could lead to difficult situations, especially where business is conducted on a cross-border basis. Therefore, understanding and complying with the applicable rules as well as the applicable taxonomy should be at the top of the agenda for all stakeholders, especially for global institutions.

If you have any questions in relation to the topic raised in this briefing, please contact the authors listed in the left-hand column.