

# Discussion of Chapter 1: Taxonomies

## Enhancing market transparency in green and transition finance

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Financial System (NGFS)

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# TAXONOMIES



- **Objective –**  
Identifying and evaluating the environmental **benefits and costs** (including externalities) of **assets, projects, and activities**

- **Challenges –**
  1. **Identification**: which projects and activities should be monitored
  2. **Data**: limited / no disclosures from companies, project owners, etc.
  3. **Translation**: physical effects into benefits and costs (in \$ terms?)
  4. **Classification**: what are the acceptable benefits and costs?
    - Transition projects?



# TAXONOMIES IDENTIFYING ACTIVITIES

- **Identification –**
  - Which projects and activities should be monitored
    - Green
    - Non-green
    - Transition
  - Disagreements across jurisdictions confuse companies and project owners
    - Potentially paralyzing economically beneficial activities
    - Is this intended?!?

# TAXONOMIES DATA AVAILABILITY AND DISCLOSURES

- **Data availability is still limited**
  - Firms don't always measure and/or disclose information that is relevant
- **Disclosure requirements –**
  - **Financial markets and exchanges**
    - Public firms may go dark, or
    - Shift to less restrictive jurisdictions
  - **Financial intermediaries + regulators**
    - Race to the bottom?
    - Non-green assets will end up in the hands of less responsible operators (financed by less responsible intermediaries)
  - **Mandatory vs. voluntary**
    - Consumers' and investors' roles in demanding disclosures
    - Norms and cultural differences

# TAXONOMIES TRANSLATION AND EVALUATION

- Translation need to be supported by scientific evidence
  - How do we treat 1 unit of pollution?
    - 1 unit of water pollution vs. 1 unit of air pollution?
    - What is the appropriate “unit”?
  - EU Taxonomy: “Manufacture of nitric acid”
    - What kind of resources will be needed for financial institutions to evaluate compliance and progress?

1. The economic activity has implemented **physical and non-physical solutions** (‘adaptation solutions’) that substantially reduce the most important physical climate risks that are material to that activity.
2. The physical climate risks that are material to the activity have been identified from those listed in Appendix A to this Annex by performing a robust **climate risk and vulnerability assessment** with the following steps: screening of the activity to identify which physical climate risks from the list in Appendix A to this Annex may affect the performance of the economic activity during its expected lifetime; where the activity is assessed to be at risk from one or more of the physical climate risks listed in Appendix A to this Annex, a climate risk and vulnerability assessment to assess the materiality of the physical climate risks on the economic activity; an assessment of adaptation solutions that can reduce the identified physical climate risk. The climate risk and vulnerability assessment is proportionate to the scale of the activity and its expected lifespan, such that: for activities with an expected lifespan of less than 10 years, the assessment is performed, at least by using climate projections at the smallest appropriate scale; for all other activities, the assessment is performed using the highest available resolution, state-of-the-art climate projections across the existing range of future scenarios(213) consistent with the expected lifetime of the activity, including, at least, 10 to 30 year climate projections scenarios for major investments.
3. The climate projections and assessment of impacts are based on best practice and available guidance and take into account the state-of-the-art science for vulnerability and risk analysis and related methodologies in line with the most recent **Intergovernmental Panel on Climate Change** reports(214), **scientific peer-reviewed publications** and open source (215) or paying models.
4. The adaptation solutions implemented: do not adversely affect the adaptation efforts or the level of resilience to physical climate risks of other people, of nature, of cultural heritage, of assets and of other economic activities; favour nature-based solutions(216) or rely on blue or green infrastructure(217) to the extent possible; are **consistent with local, sectoral, regional or national adaptation plans and strategies**; are monitored and measured against pre-defined indicators and remedial action is considered where those indicators are not met; where the solution implemented is physical and consists in an activity for which technical screening criteria have been specified in this Annex, the solution complies with the do no significant harm technical screening criteria for that activity.

<https://ec.europa.eu/sustainable-finance-taxonomy/documents/taxonomy.xlsx>

# TAXONOMIES CLASSIFICATION

- Tiered classifications –
  - **Green** vs. Non-green
    - **Green**: activities/companies aligned with the objectives of the given taxonomy
    - **Red**: activities/companies inconsistent with the objectives of the taxonomy
  - **Green** vs. **Transition** vs. **Non-green**
    - Traffic light
    - **Amber (yellow-orange)**: activities/companies with quantifiable and time-bound pathways either towards green or significant decarbonisation.

# TAXONOMIES CLASSIFICATION

- Tiered classifications –
  - **Green** vs. Non-green
  - **Green** vs. **Transition** vs. **Non-green**
  - **Green** vs. **Heavy Transition** vs. **Light Transition** vs. **Non-green**
  - **Green** vs. **Heavy Transition** vs. **Light Transition** vs. **Intent to Transition** vs. **Non-green**
  - **Dark Green** vs. **Light Green** vs. **Heavy Transition** vs. **Light Transition** vs. **Intent to Transition** vs. **Non-green**
- Why tiered classifications?
  - No incentive for very top / bottom
  - Distortions near the boundaries
  - Why not continuous models?

# TAXONOMIES COORDINATION

- **Colors have different meanings –**
  - **Green** vs. Non-green
  - **Green** vs. **Transition** vs. **Non-green**
  - **EU Green** vs. **ASEAN Green?**
- **Continuous measure**
  - Incentive for the very top to continue to improve
  - Incentive for the very bottom not to give up
  - Eliminate distortions near the color boundaries
  - Allows for easier coordination:
    - EU “50” = ASEAN “50”
  - But also allows for flexibility:
    - EU regulators can choose to treat that “50” differently from regulators in ASEAN countries



# SUMMARY

- **Great document –**
  - Very thorough, and written very well
  - Easily understandable
  - I encourage everyone to read it to understand the current landscape
- **Initial point to start thinking about:**
  1. How to make the sustainable finance system more robust, more interconnected, and more effective in achieving the ultimate objective
  2. How central banks can contribute further to the development of the infrastructure of more sustainable finance and the operation of the new financial system

# RESEARCH DIRECTIONS

- **Great document –**
  - Very thorough, and written very well
  - Easily understandable
  - I encourage everyone to read it to understand the current landscape
- **Initial point to start thinking about:**
  1. How successful are taxonomies in improving the sustainability of business activities, in comparison to other approaches that are more market-based?
  2. What kind of frameworks do we need to combine environmental focus with societal and economic developments (including financial profits, but also beyond profits)?

# THANK YOU