EXPANDING COMMON GROUND: DEEPENING INTERNATIONAL COOPERATION ON TAXONOMIES

An online convening hosted by E3G | 15 February 2022 9-11am GMT

Convening overview

E3G convened over 50 taxonomy policymakers and practioners to explore concrete next steps for enhancing the interoperability of taxonomies globally, building on the EU-China **Common Ground Taxonomy** (CGT), developed through the International Platform on Sustainable Finance (IPSF), and the UNDESA-IPSF **taxonomy principles** that fed into the G20 Sustainable Finance Working Group. The panel consisted of:

- Kate Levick, Associate Director, Sustainable Finance, E3G (moderator)
- Ma Jun, Chair, Green Finance Committee, China and Co-Chair IPSF Taxonomy Working Group
- Paulina Dejmek Hack, Director for General Affairs at DG FISMA, European Commission
- Bridget Boulle, Head of Taxonomies, Climate Bonds Initiative
- Stephen Nolan, Managing Director UN Financial Centres for Sustainability (FC4S)

The convening took place under the Chatham House rule and so the messages and outcomes below are non-attributed.

Key discussion points

The need for taxonomy interoperability in a broader sustainable finance agenda

The world is in a very different place to where it was when the IPSF began the CGT process in 2019, when the EU and China were the main taxonomy jurisdictions and few other jurisdictions had begun considering taxonomies as a salient policy issue. Since then, taxonomies and definitions of sustainable activities have proliferated rapidly, with over 30 jurisdictions around the world said to be developing or implementing their own versions.[1] Banks and other organisations are also developing taxonomies for specific purposes, meaning that the number of existing taxonomies cited can be as high as 200 worldwide.

Taxonomies offer the potential to facilitate easier capital allocation into sustainable activities, lowering operational costs in identifying such investments. However with many independent development processes there is also a risk of market fragmentation and inadequate comparability of information. In 2021 the G20 Sustainable Finance Working Group outlined principles to support interoperability of approaches to green finance, and a Common Ground Taxonomy (CGT) was published for comment by Europe and China.

The CGT was created as a tool for comparing different taxonomies. It initially compares EU and China but there is potential to expand it to include others, for example interest in participation has been shown by Singapore. Despite being created very recently and not yet including all economic activities the CGT already provides several de facto functions:

- Offering a way to compare different taxonomies with one another and enable use of common metrics.
- Supporting development of green financial products which can potentially be marked in several countries, e.g, China Construction Bank issued CGT labelled green bonds in Dec 2021.
- Acting as a reference point for other jurisdictions to develop their own taxonomies, e.g. Hong Kong will use the CGT as a basis for its taxonomy development, and the UNDP is supporting Latin America countries to create taxonomies that build on the CGT. Development of interoperability approaches will also be welcomed by financial centres in Africa.
- Providing a baseline building block which can be built on to allow for inclusion of elements which relate to local markets and policy priorities. In this context CGT can be a tool for identifying activities that are not universally included in sustainability taxonomies across countries, excluding them from the set of commonly recognised activities while still enabling

[1] https://gsh.cib.natixis.com/our-center-of-expertise/articles/sustainable-taxonomy-development-worldwide-a-standard-setting-race-between-competing-jurisdictions

governments to include additional elements in taxonomies at jurisdictional level.

A rich discussion ensued around the role of taxonomies in a broader sustainable finance agenda to accelerate the low-carbon transition. Whilst critical in providing a labelling system to help prevent greenwashing, establish performance measures, and create policy incentives for green product development, taxonomies must be situated in a broader sustainable finance agenda that may include mandatory disclosure of climate impacts by financial institutions and/or reforming the corporate governance structures of those institutions.

Taxonomy interoperability must adequately address climate transition, although it important to note that taxonomies alone can provide the necessary market signals and incentives for this and are not the only tool which can be used, or necessarily the best tool.

Major financial centres and private firms are increasingly seeing an urgent need for international standards on green finance and for interoperability of the multiple taxonomies now under development. This is a common need that supports a 'pre-competitive' dynamic, however it is also clear that ultimately there will be 'winners' and 'losers' in terms of which taxonomies become dominant in markets.

Taxonomy interoperability work will need to be able to deal with the dynamic nature of taxonomies, and to constantly evolve.

Critical issues for taxonomy interoperability to be addressed

A key issue for interoperability is the level of granularity at which taxonomies are expect to show equivalence. If interoperability principles remain at a high level, the advantage is many countries will probably wish to participate but the risk is that the common baseline for level of ambition around sustainability goals may be relatively low. High requirements on granularity enable a more robust approach to equivalence but may discourage countries from participating by setting a high ambition bar.

Another challenge is to design taxonomy interoperability principles and regimes which are inclusive of developing countries that are starting at different places to jurisdictions like the EU and China. This is linked to challenge of usability - taxonomies can be highly complex tools and many small and medium size enterprises (SMEs) do not have the capacity or expertise to engage with them. Gathering the needed data to assess compliance with taxonomies and to report against them may be a new challenge for firms in general but is likely to present additional challenges to SMEs. This will be even more of an issue if such data is not readily available in their country of operation.

Not all jurisdictions take the same approach to taxonomy design. While most taxonomies are codified rather than principles-based, not all have adopted features such as the Do No Significant Harm approach used by the EU, creating challenges when it comes to deciding on interoperability and equivalency.

Connection between taxonomies and transition

Financing the transition is an international imperative and a priority for the G20 Sustainable Finance Working Group. Several participants spoke about the emerging trend to develop transition taxonomies (for example by the EU and Canada), and the potential role of the CGT in promoting international agreement on what is meant by climate transition in the context of taxonomies.

The discussion highlighted several key issues:

- Lack of clarity over what constitutes a transition activity and over what timeframe, which will differ by sector –a “red” taxonomy of unsustainable activities was proposed as a possible element to support a solution here;
- How to deal with companies from sectors, particularly high-emitting industrial sectors, that do not have a viable transition pathway based on existing technology but need to rely on the development of new technology;
- The extent to which social issues related to transition – ensuring that transition is fair, just and affordable – can be dealt with through taxonomies;
- Financial markets, governments and real economy players lack expertise and experience on transition finance, and there is not yet a consensus as to what role taxonomies should play alongside other tools to incentivise transition finance;
- Transition taxonomies may be well suited to a principles-based approach, in order to avoid unintended consequences such as carbon lock-in or limiting financing of future innovations, however it may be difficult to

monitor and enforce such an approach. The alternative is to use a codified approach like most existing taxonomies, or to use a combination of the two.

- In order to incentivise transition finance other tools will be needed in additional to taxonomies, for example transition plans for companies.

Role of Multilateral Development Banks and other Development Banks in taxonomies

The role of Multilateral Development Banks (MDBs) in developing and emerging economies in creating and building markets means that they are well placed to support the development of national taxonomies. Further, MDBs can also demonstrate the use of taxonomies in their own operations and thereby create spill over effects into private capital markets.

Integrating nature and biodiversity concerns into taxonomies

Adding the perspective of nature and biodiversity to taxonomies was widely recognised as a critical issue by numerous participants. Participants pointed to already existing progress in the context of the joint Study Group on Biodiversity and Financial Stability. As taxonomies increasingly address nature and biodiversity impacts, these elements can be included within an expanded CGT.

Upcoming work relevant to the taxonomy agenda

A great deal of ongoing work on taxonomy development was noted under the during the event. Upcoming developments include:

- Q1 response to consultation on Common Ground Taxonomy
- Q1 report of joint Study Group on Biodiversity and Financial Stability, and great interest in this topic from a range of actors
- Ongoing work on transition pathways and taxonomy approaches for specific high-emitting sectors by China Central Bank
- Confirmation process for second EU Delegated Act on taxonomy (Q1-Q3)
- EU Platform work relating to social taxonomy, non-climate environmental objectives

- Q1 consultation on UK green taxonomy’s climate change thresholds
- Related work by UN Financial Centres for Sustainability

About E3G

E3G is an independent climate change think tank with a global outlook. We work on the frontier of the climate landscape, tackling the barriers and advancing the solutions to a safe climate. Our goal is to translate climate politics, economics and policies into action.

E3G builds broad-based coalitions to deliver a safe climate, working closely with like-minded partners in government, politics, civil society, science, the media, public interest foundations and elsewhere to leverage change.

More information is available at **www.e3g.org**