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Climate Finance Taxonomy

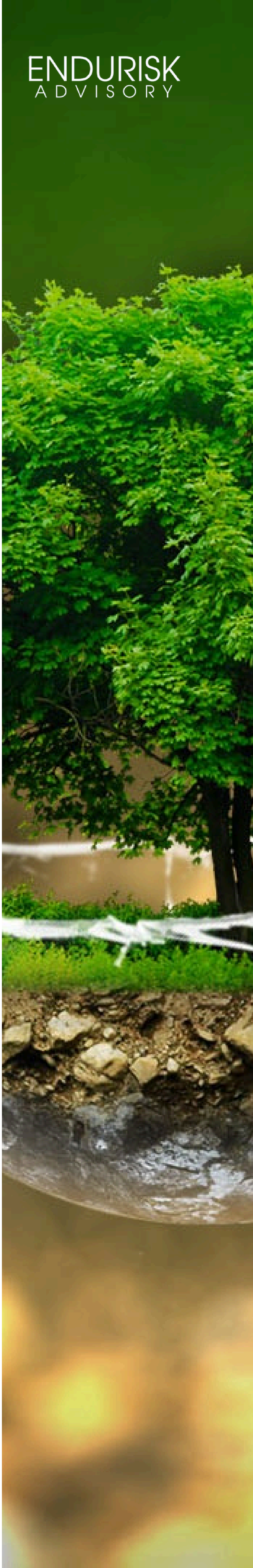
India’s Finance Minister announced in the Union Budget speech on 23 July 2024, *“We will develop a taxonomy for climate finance for enhancing the availability of capital for climate adaptation and mitigation. This will support achievement of the country’s climate commitments and green transition.”* The development of a climate finance taxonomy is a strategic move to systematically support and finance India's transition to a sustainable and climate-resilient economy. Let’s look at the basics!

What is a Taxonomy?

A taxonomy is a system for classifying and organizing things into groups or categories based on shared characteristics. Think of it like a detailed sorting system that helps make sense of the relationships between different items. For example, in biology, a taxonomy organizes living things into categories like species, genus, and family based on their similarities and differences.

What is a Climate Finance Taxonomy?

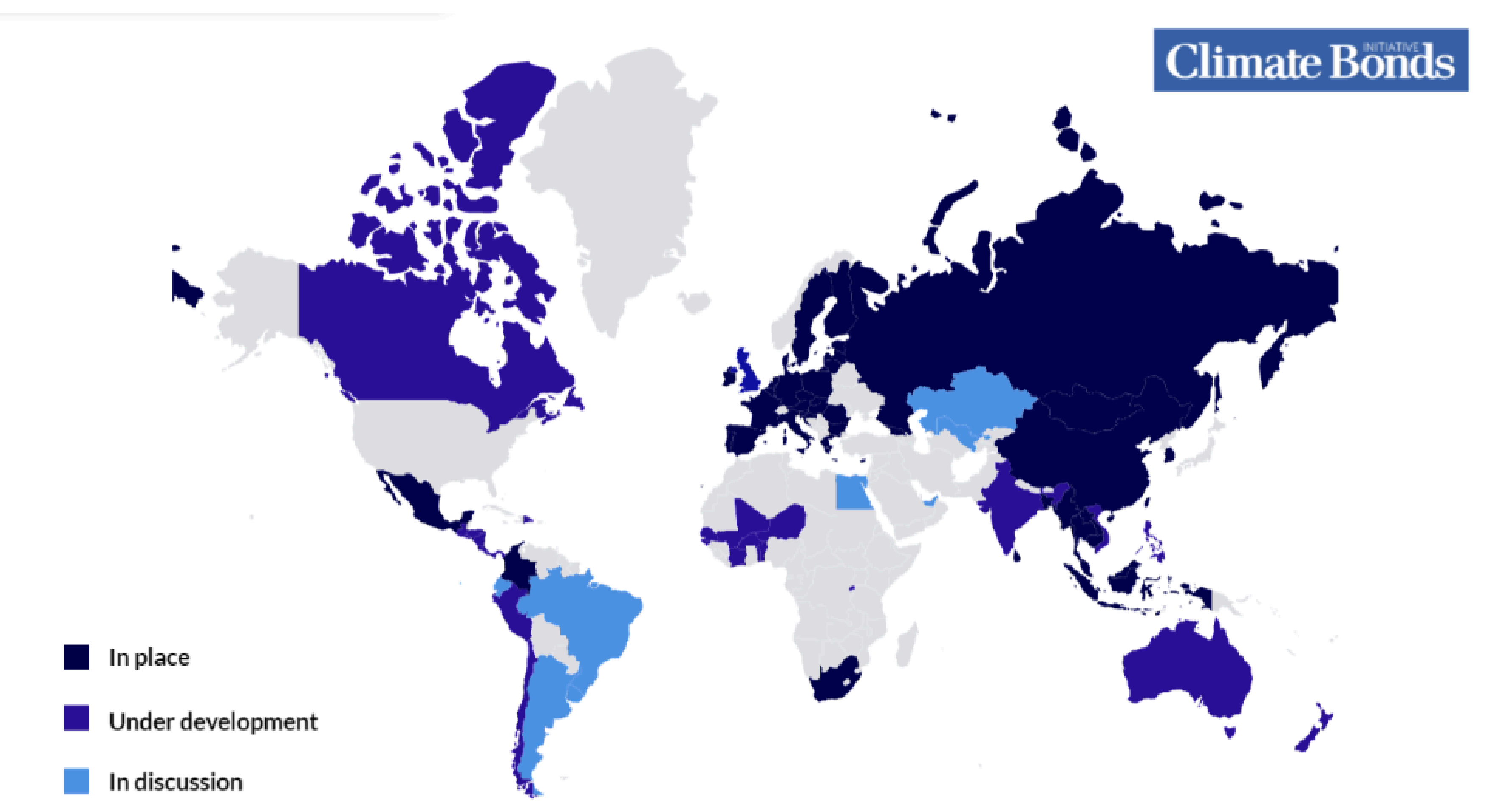
In climate finance, a taxonomy is a classification system that defines and categorizes economic activities based on their environmental impact and contribution to sustainability goals. It helps investors, companies, and policymakers identify which investments are environmentally sustainable, guiding capital towards projects that support climate action and green growth.



Which countries have developed taxonomies?

Several countries and regions have developed or are developing climate finance taxonomies to promote sustainable investments. Some of the prominent ones include:

1. **European Union**: The EU Taxonomy is one of the most comprehensive and influential systems, providing a clear classification framework for sustainable economic activities.
2. **China**: China has developed the Green Bond Endorsed Projects Catalogue, which serves as a taxonomy for green bonds, specifying what types of projects are eligible for green financing.
3. **Malaysia**: The Climate Change and Principle-based Taxonomy developed by Bank Negara Malaysia provides guidance for financial institutions to classify economic activities based on their impact on climate change.
4. **South Africa**: South Africa has introduced a Green Finance Taxonomy to support sustainable finance and investments, aligned with global best practices and local conditions.
5. **Russia**: Russia has developed a national taxonomy to identify and classify green projects, promoting investment in sustainable activities.
6. **Colombia**: Colombia has introduced a Green Taxonomy to guide investors and promote environmentally sustainable projects within the country.



Countries and their stages of sustainable activities taxonomies.
Source: Climate Bonds Initiative

What does a taxonomy contain?

A taxonomy is a guidebook that outlines what is and what is not considered sustainable. While each country or jurisdiction may structure their taxonomy document in their own way, they generally all contain specific guidelines on what activities are deemed sustainable. This helps direct investment and policy action towards those activities.

For example, the Malaysian taxonomy developed by Bank Negara Malaysia (the Central Bank of Malaysia) contains five guiding principles for the classification of activities:
1. Climate change mitigation
2. Climate change adaptation
3. No significant harm to the environment
4. Remedial measures to transition
5. Prohibited activities

Each principle includes a list of sample activities that fall under that principle.

Similarly, The EU Taxonomy contains several key elements that define and guide what economic activities are considered environmentally sustainable. These include:

1. **Environmental Objectives**: The Taxonomy outlines six environmental objectives that sustainable activities should contribute to:
   - Climate change mitigation
   - Climate change adaptation
   - Sustainable use and protection of water and marine resources
   - Transition to a circular economy
   - Pollution prevention and control
   - Protection and restoration of biodiversity and ecosystems
2. **Overarching Conditions**: To qualify as environmentally sustainable, an economic activity must meet four overarching conditions:
   - Make a substantial contribution to at least one of the environmental objectives.
   - Do no significant harm to any of the other five environmental objectives.
   - Comply with minimum safeguards.
   - Comply with the technical screening criteria set out in the Taxonomy delegated acts.
3. **Reporting Requirements**: Companies within the scope of the Corporate Sustainability Reporting Directive (CSRD) must report in their annual reports the extent to which their activities are covered by the EU Taxonomy.
4. **Disclosures Delegated Act**: This act, supplementing the Taxonomy Regulation, specifies the content, methodology, and presentation of information to be disclosed by financial and non-financial undertakings.

These elements collectively provide a standardized approach to identifying, supporting, and reporting on sustainable activities across the EU.

Source: Climate Change and Principle-based Taxonomy; Bank Negara Malaysia
EU Taxonomy Navigator https://ec.europa.eu/sustainable-finance-taxonomy/

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Why does India need a taxonomy?

India needs a taxonomy for several reasons that are crucial for its sustainable development and environmental goals, similar to the motivations behind the EU Taxonomy Some of them could include the following

Guiding Sustainable Investments: Provides a framework to help investors identify and fund environmentally sustainable projects.

Facilitating Economic Transition: Supports companies in planning and financing their move towards sustainability and climate neutrality.

Preventing Greenwashing: Ensures transparency and trust by setting clear criteria for sustainable activities.

Accelerating Sustainable Financing: Speeds up funding for both existing sustainable projects and those needed for the transition

Aligning with Global Standards: Integrates with international best practices, attracting global investment.

Supporting National Policies: Enhances the implementation of national climate and sustainability policies.

Promoting Innovation and Competitiveness: Encourages green technologies and practices, boosting innovation and competitiveness in Indian industries.

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