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+ SUSTAINABLE FINANCE PRIMER SERIES:

Taxonomies

WHAT ARE TAXONOMIES?

The dictionary defines taxonomies as *"the science of classification; laws and principles covering the classifying of objects."*¹ For our purposes, a sustainable taxonomy provides a classification system for identifying activities that are consistent with sustainable activities, including climate change mitigation and adaptation.

WHAT ROLE DO TAXONOMIES PLAY IN SUSTAINABLE FINANCE?

Taxonomies can play an important role in advancing sustainable finance objectives by identifying, defining and classifying activities that can be considered sustainable. For example, the [January 2018 EU Expert Panel report](#) states: *"If Europe is to mobilise capital at scale for sustainable development, it needs a technically robust classification system to establish market clarity on what is 'green' or 'sustainable'."*² The Canadian Expert Panel on Sustainable Finance similarly noted on page 33 of its [October 2018 interim report](#) that *"accurate labeling enables the financial sector to more strategically identify and address sustainable growth prospects with a reasonable view of relative risk and opportunity."*³ In essence, taxonomies are tools that promote the allocation of capital toward, or away from, certain activities. They are necessary to prevent "green washing" behavior and are central to the proper functioning of markets for green bonds, transition financing, and other sustainable investments.

ARE THERE UNIVERSALLY ACCEPTED TAXONOMIES?

While there is widespread adoption of standards for Green Bonds (i.e., the Green Bond Principles), there are presently no broader coverage, universally accepted, sustainable finance taxonomies. Recognizing the importance of setting such global standards, the International Organization for Standardization (ISO) established a [task force](#) to develop such a taxonomy. According to the Chair of this committee, Peter J. Young, the desired outcomes from doing so include:⁴

- helping to reduce market confusion and lowering transaction, verification and communication costs for players engaged in the sustainable finance market;
- preventing "sustainability washing", which will underpin the credibility, integrity and scalability of sustainable finance activities, and guide financial institutions (including banks, investors and insurers) to better integrate environment, social and governance (ESG) considerations into investment and finance practices;
- improving understanding of sustainable finance activities to facilitate the innovation and development of sustainable financial products, as well as related services such as third-party verifications and ESG data provision;
- standardizing metrics to allow the measurement and improved transparency of sustainable finance flows and the ESG performance of sustainable finance activities, financial institutions and markets.

This series explores the foundations of sustainable finance, one of the most important emerging fields of our time. Sustainable finance aligns financial systems and services to promote long-term environmental sustainability and economic prosperity.

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GLOBAL ACTIONS

Following the recommendations of the [2018 EU Expert Panel report](#) noted above, the EU established a Technical Expert Working Group, which released a report in [June 2019](#), identifying the following basic principles:⁵

For an action to meet the definition of an 'environmentally sustainable economic activity' (Article 2) and thus be considered Taxonomy-eligible, it must:

1. Contribute substantially to one or more of the environmental objectives.
2. Do no significant harm to any other environmental objective.
3. Comply with minimum social safeguards (under the draft regulation, these are defined as ILO core labour conventions).
4. Comply with the technical screening criteria.

The implication is that economic activities, even when making a substantial contribution to climate change mitigation and/or adaptation, will not be eligible for the Taxonomy if they cannot be performed in a way which avoids significant harm to other environmental objectives.

WHAT'S HAPPENING IN CANADA?

In 2019, the Canadian Standards Authority (CSA) established a working group (now a Technical Committee) to create "[a national standard of Canada for Green Taxonomy](#)." The group has noted that existing taxonomies, such as the proposed EU taxonomy, are not appropriate for resource-based economies such as Canada's. This highlights the importance of developing a "made-in-Canada" taxonomy, consistent with Recommendation 9.1 of the [Canadian Expert Panel's final report](#).

The importance of developing more encompassing taxonomies that incorporate transition opportunities is evident in the [recent comments](#) provided by Mark Carney, the UN Special Envoy on Climate Action and Finance, and former Governor of the Bank of England, where he underscored that if we are concerned about the whole economy transition and mainstreaming sustainable finance, then we need a transition bucket in the middle, rather than just a binary of 'green' and 'brown' finance. This is consistent with one of the primary tasks of the CSA committee, which is the establishment of the Transition Definition and Framework document to provide guidance regarding sustainable transition activities within a Canadian context.

As noted by the CSA Technical Committee's Chair, Peter Johnson, "Canada wants to be a leading voice at the table on the creation of a global transition taxonomy that is relevant for Canada and other natural resource-based economies."⁶ Given the current lack of one globally accepted taxonomy, despite multiple efforts towards that end, there is a great deal of urgency to develop our own taxonomy, as well as to provide a unified Canadian perspective on taxonomy issues at the global level. In other words, it is important for us to be at the table, and to make meaningful contributions to ongoing conversations, otherwise we run the risk of letting others establish rules that may penalize our economy.

¹ [Taxonomy](#)

² [Financing a Stable European Economy](#)

³ [Expert Panel on Sustainable Finance](#)

⁴ [Building a Framework for a Sustainable Future](#)

⁵ [TEG Report on EU Taxonomy](#)

