

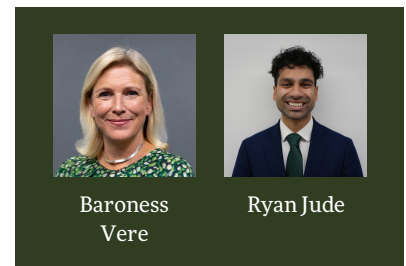


UK Green Taxonomy, 23 January 2024

With Treasury Lords Minister, Baroness Vere of Norbiton;
and Ryan Jude, Programme Director at the Green Finance
Institute, secretariat to the Green Technical Advisory Group

Introduction

Treasury Lords Minister, Baroness Vere, attended the APPG's second roundtable on the UK Green Taxonomy ahead of the release of a long-awaited Government consultation. The Taxonomy “shows what success looks like” by distinguishing sustainable from unsustainable economic activities, driving investment to greener companies and projects. However, as the EU's difficult experience with its green Taxonomy, implemented in 2020, shows that developing an extensive, evidence-based definitional tool covering large parts of the economy is fraught with difficulty.



Key takeaways

UK priorities and dilemmas to address

- Finance flows across borders, therefore interoperability is pivotal.
- The Taxonomy is a technical policy instrument, it needs to be as simple to use as possible, similarly ensuring the wider network of sustainability regulations is user-friendly is imperative. The UK must avoid the EU's “completely unrealistic” approach.
- The Taxonomy needs to be delivered as soon as possible — the Minister confirmed the consultation will be published in the next six months, a release in the next three months is doubtful however.
- Dilemma: Ministers want to maximise the UK's “second mover advantage” by learning from the EU's mistakes, however the longer we wait, the greater the risk of dormant green capital being invested in other jurisdictions.

Transition

The UK Taxonomy is set to be binary, accounting for a small proportion of the economy. What does this mean for transition? A traffic light taxonomy adopted by Singapore, whereby economic activities that are not entirely sustainable are classified as amber is unlikely to be adopted. The UK is a transition finance leader through the FCA's 'Sustainability Improvers' investment label and the Transition Plan Taskforce (TPT). The Minister highlighted the importance of the Transition Finance Market Review in supporting the growth of investment in transitional activities through the TPT and the Taxonomy. The Taxonomy itself sets a common standard of what is sustainable, but policymakers need to be aware this creates a cliff edge "Once you're not green, you might as well be dirty as you're not seeing the benefits".

The Supply chain: from FTSE 100 to SMEs

While companies with poor ESG ratings are often punished by investors, a good rating does not correlate with many benefits. Depending on the sector, customers typically prioritise price over a supplier's sustainability credentials, particularly in straitened economic circumstances. Companies' capacity to be both ESG-compliant and sustainable diminishes further down the supply chain as they become smaller. These issues will be even more pronounced after the Taxonomy comes into force – "we will need a slimmed down Taxonomy for SMEs". Mandatory TCFD climate disclosures help leverage investment, but they are costly and often do not translate to the marketplace. "Larger companies have a duty to support SMEs".

Issues raised

"Shifting the trillions" – unlocking sustainable investment

Currently, "we cannot define what success in sustainability looks like", billions of pounds are being held back. "Why should I invest in this building or that car if I cannot know whether it's fully sustainable?"

Second mover advantage

- The UK is learning from the EU's mistakes – as are Australia and Canada – by adopting the same structure and making improvements.
- On the other hand, the Taxonomy "doesn't need to be perfect", arguably the bigger priority is implementing the Taxonomy, releasing waves of green investment as soon as possible.
- Furthermore, the EU Taxonomy is "actually working well, even though it isn't perfect", it can evolve, and should. Like the EU's, the UK Taxonomy will be revised at regular intervals.
- Clarity is lacking, and increasingly where there is clarity it is treated with suspicion due to changes in Government policy – i.e. the rollback of 2030 net zero targets to 2035.
- How many billions? In the real economy, price remains pivotal. How attractive to investors are companies that are having to absorb the cost of transition because customers won't? We need more incentives/disincentives to put the whole economy on to a greener direction of travel, including investors.

Bridging the divide between box-ticking and delivering impact

TCFD and other reporting frameworks are innately bureaucratic. Companies submit sustainability reports because they are mandatory or because they assist with their investment strategy. Findings from reporting are unlikely to inform future decision-making or investment.

The gap between ESG reporting and impact won't be bridged until company boards know "what good looks like" through the Taxonomy. It's not unusual for a given economic activity to face 20+ sustainability thresholds, the Taxonomy will lay down the definitive standard.

Recommendations

- The Taxonomy Consultation needs to be released as soon as possible.
- The Government must diligently link together the various initiatives around the Taxonomy to ensure they are coherent and drive transition.
- A priority for the Taxonomy must be to make it SME-friendly.
- The Government must embrace the "what does good look like" mission by supporting the development of further tools – e.g. an extensive breakdown of asset classes according to sustainability.

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