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Implementing the taxonomy – challenges and opportunities

"Reforming our financial system in such a way that it not only creates wealth, but that it creates wealth, worth having: that is the challenge we now face" – Bianca Jagger (European Commission Open Hearing on Sustainable Finance, 17 July 2017)

Since Bianca Jagger spoke those words, almost four years have passed.

This is not a complaint. In the intervening four years much serious and substantive work has been done. This remark is rather a reflection of the major challenges inherent in the sustainable finance agenda, and in the creation of a taxonomy of environmentally sustainable economic activities.

A first major challenge is the compatibility with the price system. Prices serve as strong signals guiding investment and economic activity. The data derived from the taxonomy will also serve as a strong signal identifying investments that are sustainable and that will maintain their value in the long term.

It is critical that these two mechanisms complement, and do not counteract, each other. There is in other words a need for public authorities to have a coherent approach across different areas of public policy (including energy, emissions, and transport policy).

A second major challenge relates to the design of the taxonomy. A short and simple taxonomy will contain limited information, and will give clear and strong signals only for a limited area of economic activity. A broader and more complex taxonomy will contain more information, covering broader areas of economic activity, but at the cost of clarity and simplicity.

The world is a complex place, and managing the transition to a more sustainable economic system is highly complex, with often a need for difficult judgments as to the best transition path.

By its nature – as a piece of European legislation, and as it can be based only on judgments that have a high degree of certainty and of consensus – the taxonomy will be authoritative, foundational, but limited.

In order to meet the challenge identified by Bianca Jagger, we shall need to go beyond the taxonomy.

We shall need other, more diverse, types of data, as well as complementary frameworks that can cater for different and uncertain judgments as to what are the best transitional paths. And we shall need a financial system that uses and creates different types of data, and that facilitates those different paths.

This creates requirements and opportunities.

Key requirements include better access by investors to more, and more reliable, granular source data on companies and securities, as well as more efficient, and more effective, capital markets that can channel savings into diverse forms of innovative investment. We need, in short, progress on the revision to the Non-Financial Reporting Directive, the European Single Access Point, and all other items set out in the Capital Markets Union Action Plan.

Opportunities lie in digital innovation that can help make sense of, and derive insight from, disparate data from diverse sources and allow tracing of proceeds from ESG issuance. They lie in the enormous pent-up demand for green and sustainable investment products. And they lie in public sector actions such as the Next Generation EU issuance which can help create the foundation for liquid and efficient European capital markets.