COMMON FRAMEWORK OF SUSTAINABLE FINANCE TAXONOMIES

FOR LATIN AMERICA AND THE CARIBBEAN

By the Working Group on Sustainable Finance Taxonomies in Latin America and the Caribbean - Interagency Technical Committee - Forum of Ministers of Environment of Latin America and the Caribbean

Sustainable Finance Taxonomies: a framework to facilitate environmentally sustainable investments in LAC

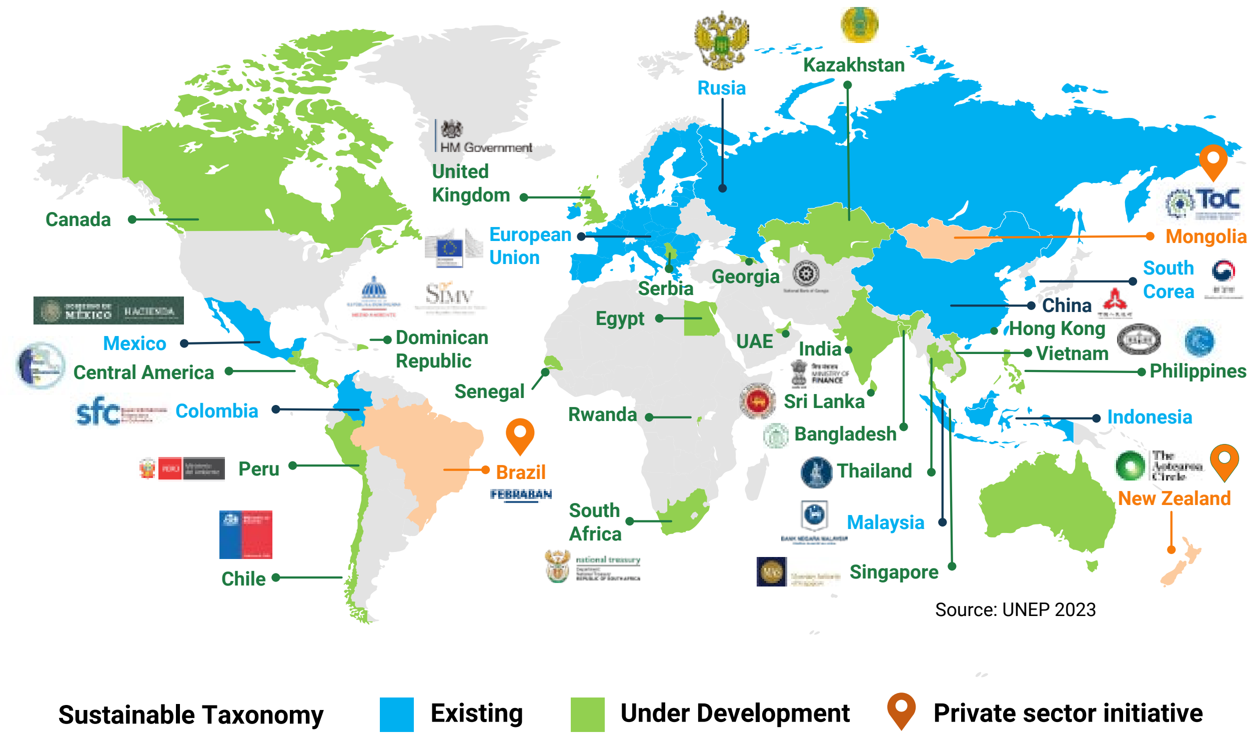
To meet the agreed climate, biodiversity and land restoration targets in LAC, it is necessary to redirect investments towards a sustainable, inclusive, and resilient economy.

Public finances will not be enough to achieve these objectives. Therefore, it is necessary to mobilize private capital towards environmentally sustainable investments. Sustainable finance taxonomies are playing a key role to achieve these objectives, as they establish a common language and a clear, science-based definition of 'what is green' and 'what is not' within a jurisdiction[1] .

Sustainable finance taxonomies provide credibility, integrity and transparency to the market, facilitating the identification of environmentally sustainable investment opportunities for the private sector, particularly for financial market participants, and, in turn, enabling the mobilization of capital linked to the goals of the Paris Agreement and other environmental objectives.

Sustainable finance taxonomies are being developed at a rapid pace in the LAC region. Colombia and Mexico are the only countries in the region that have adopted a taxonomy. However, a growing number of authorities are currently developing[2] or planning to develop[3] sustainable finance taxonomies based on different national climate and environmental objectives.

1. International Capital Market Association (ICMA, 2021), a green or 'environmentally sustainable' taxonomy is a classification system that serves to identify activities or investments that will move a country towards meeting specific targets related to priority climate and environmental objectives.
2. Chile, Costa Rica, Panama, Peru, Dominican Republic, Central America (El Salvador, Nicaragua, Honduras, Guatemala, Panama, Costa Rica, Dominican Republic, and Colombia)
3. Brazil, Ecuador, Paraguay, and Uruguay.



Why is interoperability across sustainable finance taxonomies important?

Establishing compatible and interoperable sustainable finance frameworks across jurisdictions is essential to avoid market fragmentation, information asymmetry, increases in transaction costs, and the greenwashing risk. Addressing these barriers is particularly relevant for emerging markets, as they seek greater integration of their financial markets with other international markets.

Increased regional alignment does not imply a "one size fits all" solution. Flexibility is needed to accommodate local specificities. A comparable and interoperable set of definitions in and among jurisdictions will facilitate access to cross-border capital flows for environmentally sustainable investments in the region.

Working Group on Sustainable Finance Taxonomies in Latin America and the Caribbean

The Working Group on Taxonomies of Sustainable Finance in LAC was created as part of the Interagency Technical Committee (ITC) of the Forum of Ministers of the Environment of LAC and is constituted by UNEP and its Finance Initiative (UNEP FI), UNDP, IFC, IDB, CAF, ECLAC, FAO, staff of the IMF and the World Bank, and the European Commission, as external technical advisor.

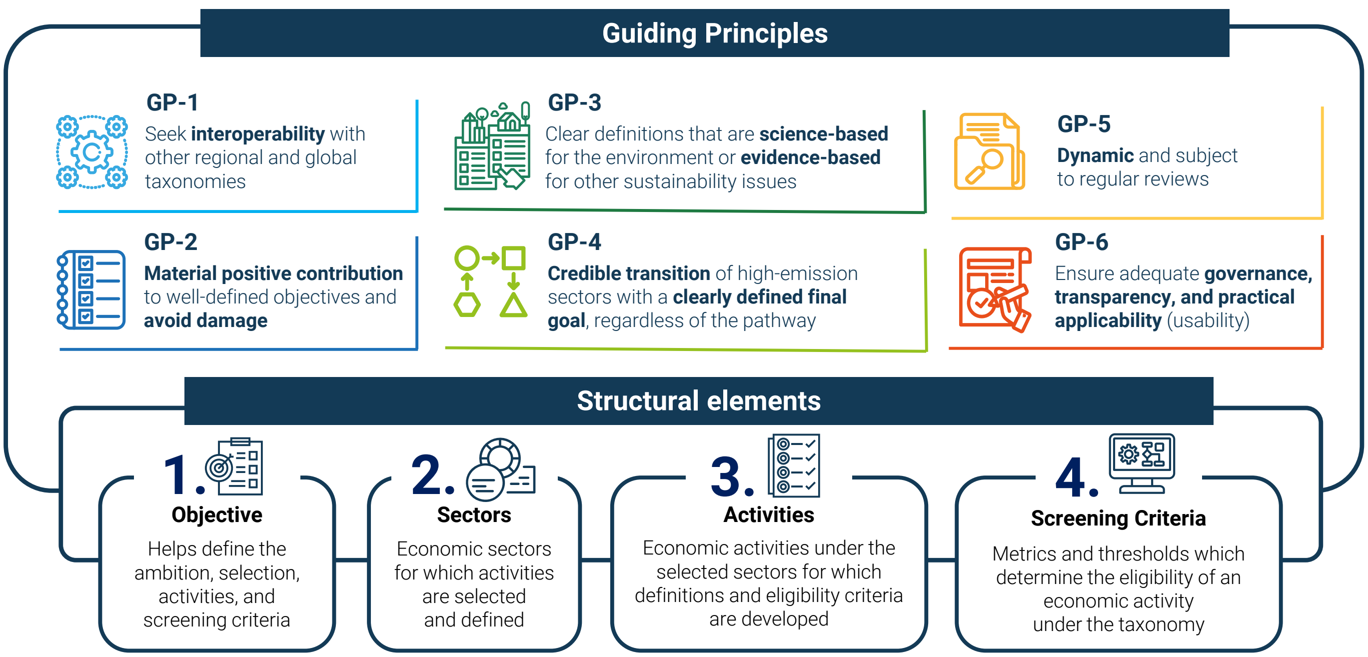
The objective of the LAC Taxonomy Working Group is to promote regional dialogue to support LAC authorities in developing sustainable finance frameworks that are interoperable across LAC jurisdictions and internationally.

What is the Common Framework of Sustainable Finance Taxonomies for LAC?

It is a guidance document that can serve as a voluntary reference to orient LAC countries that are in the process of or intend to develop sustainable finance taxonomies. It establishes guiding principles that will improve comparability and guarantee the interoperability of taxonomies in LAC and internationally.

The Framework establishes six guiding principles for taxonomy development and to ensure interoperability. Interoperability implies that taxonomies must be based on similar guiding principles, have certain design elements such as objectives, classification systems for sectors and activities that are comparable and are similar in approaches and methodologies used for defining eligibility. These principles also align with the principles established by the the G20 Sustainable Finance Working Group and other taxonomy developments globally:

Common Framework of Sustainable Finance Taxonomies for LAC



In a first phase, it focuses on climate change objectives (mitigation and adaptation); prioritizes sectors that are important to these objectives for the LAC region[4]. In a second phase, it is expected to increase the scope of the framework to other environmental objectives.

The framework does not specify activities that must be covered in the sectors as this must be assessed for every taxonomy based on their importance to the country and contribution towards the taxonomy's objectives. However, it provides recommendations on inclusion of activities based on their contribution to climate change mitigation or adaptation (substantial contribution, enabling, transition, minimum performance).

4. Agriculture, forestry and fishing, Mining and quarrying, Manufacturing, Electricity, gas, steam and air conditioning supply, Water supply; sewerage, waste management and sanitation activities, Construction, Transportation and storage, Information and communication, Financial and insurance activities, Real estate activities, Professional, scientific and technical activities, Administrative and support services, Education, Human health and social work activities.

The framework also provides guidance on the exclusion of activities that harm or cause a negative contribution to climate change objectives. However, for existing assets and activities that are not aligned, it is important to phase them out with an appropriate transition plan or replace them with taxonomy-aligned alternatives.

Additionally, the LAC Common Framework provides guidance for setting the ambition, establishment of metrics and thresholds and guidance on Do No Significant Harm (DNSH) for certain prioritised sectors. This provides a menu of options for technical committees of taxonomy development to choose from for activities of the taxonomy based on the local context and information available in the respective countries.

Finally, the Framework shares best practices and recommendations for the countries of the region to define the governance structure for the development, implementation, and monitoring of the sustainable finance taxonomy.

Who are the main beneficiaries of the Common Framework of Sustainable Finance Taxonomies for Latin America and the Caribbean?

National authorities of LAC countries (governments, central banks, financial supervisors and regulators), development cooperation agencies, international organizations, and any other interested stakeholders that are in the process of or intend to develop sustainable finance taxonomies in the LAC region.

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Contact

Mercedes García Fariña, LAC Policy Lead, UNEP FI