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PARTNER-TAX,
IMPACT AND CLIMATE
FINANCE, TRILEGAL

**WHILE THE PACE
OF REGULATION
HAS PICKED UP,
THE PROBLEMS ARE
BETTER TACKLED
THROUGH AN
EMPOWERED
INSTITUTION WITH
THE MANDATE TO
ATTRACT
AND SUPPORT
CLIMATE FINANCE**

TAXONOMY FOR THE NATION

The draft framework for climate taxonomy is a significant step but the devil lies in the details. The urgency with which this will be updated on an ongoing basis remains to be seen

THE MINISTRY OF FINANCE recently released a draft framework for climate taxonomy, which has significant implications for foreign and domestic investors, companies (in power, mobility, construction, iron, steel and cement sectors), MSMEs and stakeholders in the agriculture sector.

The climate financing needed to achieve net-zero goals is estimated at \$250 billion annually till 2047. Further, this capital is required broadly in two areas, financing the energy transition and climate mitigation/adaptation investments, with more capital required earlier for financing the capex for the energy transition and investments into climate technologies. Commercial and concessional capital, therefore, has a huge role to play in filling this gap.

A robust taxonomy could accelerate the flow of capital to activities it covers. India has currently proposed only a framework and not a full taxonomy. The sectors proposed to be covered initially are power, mobility, buildings, agriculture, food, water, iron, steel and cement. It proposes to start with qualitative standards and then later introduce quantitative metrics. There is also a special focus on MSMEs and agriculture.

In designing and assessing a taxonomy suited to India, we have the

benefit of learning from other countries. Some aspects of India's framework that stand out and those that need further improvement are mentioned below.

Firstly, the key criterion for the taxonomy is to have a clear definition of what activities qualify as climate mitigation, adaptation or transition. Notably, the proposed framework covers specific sectors to start with and to that extent, it is unlikely to be a comprehensive guide for investors. Additionally, where the taxonomy is principles based and not guided by quantitative criteria, there is more subjectivity and lack of clarity, leading to disagreements and non-standardised approaches.

Secondly, the taxonomy has to categorise activities based on a science-based criteria. Quantitative criteria, such as emission standards to qualify for being a climate mitigation activity, should be set taking into account the best scientific approaches available. Since the science in this space is evolving rapidly, this would require consistent monitoring and revisions as technology advances.

Thirdly, each country is differently placed and, therefore, cannot transition all sectors at the same time. However, a clear taxonomy is intended to provide clarity as to the

best path to be followed for each sector, including for transition financing, that is, permitting investment in sectors that are not considered 'green'. Further, in many cases, activities which are currently permitted under transition finance come with an end date. Without adequate guardrails, the concern is that polluting activities will continue to raise finance under the transition category without making any meaningful effort.

Fourthly, since the objective is to raise and attract climate finance from foreign investors, alignment with foreign taxonomies will be critical. For instance, for science-based standards, there should lesser reason to deviate from international standards. However, the focus on MSME and agriculture and the manner in which certain activities are categorised could result in different classifications under the Indian and foreign taxonomies.

Fifthly, the Indian taxonomy also incorporates the principle of 'do no significant harm'. This means that for any activity to qualify, it must not do any significant harm to any of the other activities that are eligible for categorisation. Interestingly, the EU taxonomy also has a minimum standard principle that means that fair treatment of works or prevention of child labour would also be necessary.

A few key questions arise in terms of the proposed framework. Would the taxonomy be voluntary (as it is in ASEAN or Malaysia) or mandatory (like in the EU) or made voluntary using a glide path (as in the case of Singapore)? Would the taxonomy also permit carbon credits to be used as offsets and allow activities in hard-to-abate sectors be classified after accounting for such offsets? Would the taxonomy follow a

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traffic light system of green, amber and red or a permissive white-list or an ambiguous principle based one?

It is clear that in many cases, to attract private capital into risky climate investments, it is necessary to use government or CSR or philanthropic money to de-risk transactions through blended finance mechanisms. That is something the framework does not currently solve for. Updating and maintaining the taxonomy will be an intensive and ongoing exercise. Solving for these issues in India will also be essential

to make sure that the national interest is achieved.

While the pace of regulation has picked up, the problems set out above are better tackled through an empowered institution with the mandate to attract and support climate finance in India. The draft framework is still a significant step forward, but the devil lies in the details and the urgency with which this will be issued and updated on an ongoing basis remains to be seen. **BT**

Views are personal