Australia’s sustainable finance taxonomy: good governance is a can of worms

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Treasury has opened its consultation on a sustainable finance strategy that promises to strengthen the ability for Australia’s financial markets to allocate capital to decarbonising Australia’s economy.

The new strategy outlines priorities for whole-of-government transition planning and is a major step towards actualising the government’s vision for a values-based capitalism where environmental and social values are the backbone of a resilient economy.

One of these priorities is a sustainable finance ‘taxonomy’ that will establish what economic activities warrant the special consideration by green and transition-labelled finance pools focused on mitigating the effects of climate change.

The potential leverage includes Australia’s $3.5tn superfund pool, the banking sector’s collective $400bn in sustainable finance targets, and the Government’s proposed Green Bond program. However, this mobilisation of capital for decarbonisation will only succeed if the taxonomy is credible and achieves widespread market adoption. Real and perceived conflicts of interest in its development can undermine this objective, and government endorsement of the process alone may not counteract this.

With efforts to prevent greenwashing a core feature of regulatory intervention, a commitment to transparency will guard against both the risk of undue influence and any such perception, contributing to confidence in the Taxonomy’s effectiveness in achieving climate outcomes.

This requires standards derived from scientific principles, empirical evidence and robust governance practices that ensure that rigour is not compromised by conflicts, as well as sufficient independence in oversight to prevent corruption of the process integrity by vested interests.

Development of the Australian taxonomy has been outsourced to the Australian Sustainable Finance Institute (ASFI), a finance sector body whose Board of Directors and members represent financial institutions which in turn provide the majority of funding. Key to the process is the Taxonomy's Technical Expert Group (TTEG) which comprises overwhelmingly finance sector representatives.

TTEG participants are said to be operating in their personal capacity rather than that of their organisation. However, without additional safeguards, commercial interests can nonetheless override rigour. The corruption at PwC Australia is a timely reminder of vested interests subverting national interests.

Already, there may be signs of this. The draft strategy codifies “practicality” as a design principle of the taxonomy, alongside usability and interoperability. This is an appropriate consideration for guidance on how to apply the taxonomy in practice, but not for decisions affecting the design of the taxonomy itself, particularly when combined with a 'transition' label, whose intention is to support the financing of activities that are inconsistent with net zero.

Specialists, such as those with the technical veracity to transitioning the economy and/or developing criteria that satisfy the 'no-harm' principles under international law, are plugged into the TTEG via separate, issue-specific working groups.

Information flows from these groups, however, rely on making it up the hierarchy and, in any case, the TTEG itself is limited to providing input and endorsing the new standard. The Australian taxonomy development process must provide for all proposals to be contested by those independent of industry and finance to avoid conflicts of interest, and avert external cynicism.

If the current governance model can be adequately improved, it may sidestep the challenges experienced in other jurisdictions, including low adoption, significant re-work, and diminishing confidence.

The Canadian taxonomy faced lengthy delays due to vested interests and an inability to resolve differences of opinion in a manner that remained faithful to the goal and, after significant delay, was passed through with stronger rules around fossil fuel assets. The European Commission faced the threat of legal action after the EU taxonomy codified some use cases for gas and nuclear in their green label. It has subsequently faced low levels of adoption after persistent classification changes, and now in the process of revising criteria for stronger frameworks. The UK taxonomy has faced similar delays.

The establishment of robust governance practices can help to avert the risk of a similarly costly result and delay. The Council of Financial Regulators, which include Australia's prudential and corporate regulators plus the Reserve Bank and Treasury, needs to play a more assertive role in guiding Taxonomy development processes and decisions to ensure consistency with public/national interest.

Of additional public concern here is that the TTEG members are required to sign non-disclosure agreements, making the taxonomy development process opaque, and filtering all communication through ASFI, whose governance structure does not protect against intrinsic commercial conflicts of interest.

To help mitigate the risk of a pay-to-play model prevailing, we urge the adoption of practices consistent with probity and transparency, such as publishing meeting agendas and minutes as well as all responses to consultation drafts. An open process is more likely to result in a taxonomy that is more widely accepted and seen as a legitimate framework.

There are promising signs for the Taxonomy's future implementation and iteration. Treasury has indicated the potential for legislative integration that would support long term integrity, if (and only if) the taxonomy earns public trust in its early phases.

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