

The green transition is more urgent than ever. Here is a real solution.

Last year, 16,565 people died in Europe as a direct result of the climate crisis and this is now the fastest-warming continent in the world, the World Meteorological Foundation reported recently. **Furthermore, earlier this year, our planet broke the record for its hottest day ever — three times.** The facts are inescapable: to preserve our society, our prosperity and our future, we have no choice but to transform our economies and make them sustainable. The risks we run otherwise are unacceptable.

Many companies and financial institutions are ready to seize the green transition's countless economic opportunities and to protect themselves from the disruption of environmental collapse. Speeding up the transition is not only good for business, it is also reasonable and prudent: as the **European Central Bank** underlines, "a failure to adequately manage environmental risks is no longer compatible with sound risk management".

However, companies and financial institutions are not scientific organizations: in fact, research by the Institute and Faculty of Actuaries suggests many do not fully understand the **climate risks** they face. They need help to build a transition that will allow them to innovate, protect themselves from risk and maintain their profitability. As the European Commission confirmed in its June recommendations on transition finance, a large part of the answer can be found in the EU's sustainable investment guidebook, the EU Taxonomy.

A traffic-light taxonomy would help companies and financial institutions fund the transition

If done well, such a taxonomy would act as a map: it would guide financial institutions in allocating their capital so it truly finances the green transition and would give companies the means to plan their transition with confidence.

That is why coalitions such as the Investors' Group on Climate Change, which gathers institutions with over €65 trillion in assets, are supporting a traffic-light taxonomy. They suggest grouping economic activities into green, yellow and red categories, depending on whether they are environmentally sustainable, intermediate or unsustainable. The experts in the EU Platform on Sustainable Finance proposed it as well.

The objective is to promote an open, honest, mutually beneficial discussion between financial institutions and companies about how to work together to set corporate targets and robust transition plans. Being transparent about the steps it will take in its transition helps the company to convince an investor or a lender to finance its projects. It also reassures the investor or bank that the company has a robust and credible plan to modernize and innovate.

Imagine how the conversation might go. For example, the CEO of a steel manufacturer with a high environmental impact might want to raise €1 billion in the next five years, as a first

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step, to fund its transition toward innovative, low-carbon steel — a product which is likely to answer growing international demand from clients who are eager to improve their own environmental performance.

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Using the traffic-light taxonomy, the CEO could sit down with a bank and agree on a set of Key Performance Indicators that would be the foundation of a billion-euro bond. They could agree that the company, which might make 90 percent of its revenues from high-impact steel, would reduce that number to 60 percent in five years, to 30 percent in 10 years, and to zero in 15 years. The company would also be able to prove, with the help of a credible EU instrument, that it was increasing its green and yellow spending and reducing its red assets accordingly.

The traffic-light taxonomy is particularly helpful for companies with unsustainable assets as they can tell a positive story about their transition — how and when they will move out of the red category and toward the green. Luckily, the technical work for a traffic-light taxonomy has already been done: the EU's existing taxonomy has already set thresholds for sustainability and for unsustainability — known as 'substantial contribution' and 'do no significant harm'. All that is left to do is to test the traffic-light taxonomy in practice.

A color-coding system that would help companies to reduce financial risks

Many companies and financial institutions are already analyzing their portfolios to identify the risks created by unsustainable, intermediate and sustainable activities, as it is now clear that an activity's environmental performance can affect the risk of financial losses.

However, the Network for Greening the Financial System, a global group of central banks which was created to better manage climate and environmental risk, has found that financial institutions struggle to understand the risks of sustainable and unsustainable assets because "a clear taxonomy, and available granular data, are not yet in place in most jurisdictions".

The EU should help relieve the burden of this analysis: the traffic-light taxonomy would give companies and financial institutions a full view of their impacts and of the areas of the business that need improvement.

It is not only private financial institutions which need support. Central banks have also been asking for this instrument for years to help them monitor credit risk in the financial system and to ensure banks engage in a prudent, responsible, well-managed transition. As the European Central Bank has observed, a traffic-light taxonomy "would facilitate the assessment of transition risk in the balance sheets of financial institutions".

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Singapore, Canada, Indonesia, ASEAN, and Thailand are all creating a traffic-light taxonomy. The EU must not lag behind.

Calling on companies: raise your voices!

We call on European financial institutions and companies which are committed to preserving Europe's economic stability, and securing its place as a leader in innovation, to test the traffic-light taxonomy and let the European institutions hear your voice. Explain to them what transition guidance you need. Tell them that the environmental transition is not a choice but an absolute necessity for your business.

We call on European investors and companies: tell the EU institutions that the environmental transition is not a choice but an absolute necessity for your business.

The U.S. and China are racing to take the economic opportunities of the [green transition](#). We must ensure that European companies get clear policies that help them innovate and transition faster.

A traffic-light taxonomy will give everyone a simple road to follow. Let us not look back on this opportunity and wonder why we didn't act sooner.

Source: Politico