THE INVESTMENT ASSOCIATION

Response to consultation

UK Green Taxonomy

FEBRUARY 2025

This consultation response was submitted via an online form. Please note that the question numbering in the consultation document and the online form do not correspond and this draft uses the numbering of the online form. The online submission did not require an executive summary.

3. To what extent, within the wider context of government policy, including sustainability disclosures, transition planning, transition finance and market practices, is a UK Taxonomy distinctly valuable in supporting the goals of channelling capital and preventing greenwashing?

Existing Government policy on sustainability disclosures provides, or is well advanced in establishing, a framework to prevent greenwashing and for channelling capital to environmentally sustainable outcomes (if supported by a credible real economy policy framework). This contrasts with a much more limited landscape for sustainable finance policy (in the UK and internationally) five years ago. As such, the case for introducing a UK Taxonomy is now less clear.

At the time the policy to create a UK Green Taxonomy was first proposed, in November 2020 in a statement to the House of Commons by the Chancellor of the Exchequer on the future of financial services, the other substantial Government policy focused on sustainability reporting was the roadmap towards mandatory climate-related disclosures aligned with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD). Since then, and most notably at the 2021 Mansion House speech and the publication later that year of the Greening Finance roadmap, the Government set out a more detailed framework known as the Sustainability Disclosure Requirements (SDR), of which the taxonomy formed one part.

This framework has developed guidance on transition planning through the Transition Plan Taskforce, built on the UK's integration of the TCFD recommendations, and established a process for introducing the IFRS sustainability standards (ISSB) in the UK. Indeed, since the initial announcement relating to the taxonomy was made, the IFRS Foundation has created the International Sustainability Standards Board, it has finalised two standards, and the UK Sustainability Disclosure Technical Advisory Committee has recommended their endorsement to the Secretary of State for Business and Trade. Having participated in this process and that of the Transition Plan Taskforce, in addition to the resource intensive implementation of the FCA requirements for sustainability disclosure and investment labelling, investment management firms now consider the UK to have a nascent framework for supporting the goals of channelling capital and preventing greenwashing.

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There has been a long-standing expectation that the Government would bring forward a UK Green Taxonomy and the Green Technical Advisory Group (GTAG) has provided advice to Government on the design and implementation of a UK Green Taxonomy. While investment managers are consequently able to articulate a potential use case for the taxonomy, the industry on the whole does not regard it as likely to be distinctly valuable in achieving the Government's aims currently.

4. Are there other existing or alternative government policies which would better meet these objectives or the needs of stakeholders?

Several sectoral and overarching regulatory initiatives currently exist to prevent and discourage greenwashing. For investment managers, the FCA has developed rules as part of the SDR framework which include an anti-greenwashing rule and associated guidance for sustainability-related financial products and services that applies to all FCA-authorised firms, and investment labels, disclosure, and naming and marketing rules that apply to UK investment managers.

We note that the FCA's final Policy Statement on SDR and investment labels states that the regulator will consider updating disclosure requirements if a UK Green Taxonomy comes into use. A similar commitment is made for future ISSB standards and the outputs of the Transition Plan Taskforce. The Policy Statement suggests that "an authoritative taxonomy such as the EU taxonomy or forthcoming UK Green Taxonomy" may form a part of the criteria for a robust, evidence-based standard aligned with a product's sustainability objectives. Some investment managers regard this as the most viable use case for a UK Green Taxonomy. However, the EU taxonomy already serves this purpose and is likely to maintain a dominant position as the more established taxonomy, serving a larger local market. Each of these initiatives will carry a financial cost for corporates and financial institutions. While the UK lacks formal mechanisms to influence the development of the EU taxonomy, and it is therefore unsuitable for direct inclusion in FCA rules, UK businesses which trade in the EU will nonetheless be likely to continue to report against the local taxonomy. Layering additional and distinct reporting requirements is guaranteed to add complexity and cost while the potential benefit remains unclear.

The possible case for a future UK Green Taxonomy would be stronger at such time as the UK's body of real-economy transition pathways were more developed, clearer, and included policy incentives. Investors and companies require an effective real economy policy framework, based around credible sectoral roadmaps, to inform decisions on company strategies and the allocation of capital to transition-aligned activity. To be credible, these roadmaps should be consistent with the Climate Change Act and the UK's long-term decarbonisation targets.

The FCA's rules are not contingent on the existence of a UK-specific taxonomy, although they have suggested it could be a useful tool in future revisions should a UK taxonomy be available. Investment managers have suggested that the new SDR framework should be allowed time to become established and have its effectiveness assessed. In choosing to adopt a future UK Green Taxonomy as a pillar in any consumer protection rules, regulators should be expected to provide an assessment of the extent to which they have observed ongoing greenwashing in their sector, and why existing regulatory initiatives have been unsuccessful. It should be noted that perceptions of greenwashing can ultimately be subjective, and the introduction of a UK Taxonomy will not wholly prevent accusations of greenwashing in future. Indeed, the EU Taxonomy itself has been described by Greenpeace as "an exercise in greenwashing" [Greenwashing in the EU Taxonomy, October 2024].

5. How can activity-level standards or data support decision making and complement other government sustainable finance policies and the use of entity-level data (e.g. as provided by ISSB disclosures or transition plans)?

We anticipate that transition plan disclosures and ISSB standards will become a core feature of the UK's sustainable finance policies, and the introduction of these requirements should create a common framework for reporting at entity-level. Corporates that consequently produce transition plans and report against UK Sustainability Reporting Standards (UK SRS) should have the knowledge and authority to produce credible transition plans which outline strategies and investment including the provision of relevant data at an activity-level.

To set strategies and make investment decisions, corporate preparers of transition plans and UK SRS disclosures will require clearer information from Government on how future regulation and policy incentives will affect them. While this information might subsequently be presented and categorised within a taxonomy, potentially facilitating a degree of standardisation in the reporting and processing of data, investment managers are concerned that the Government currently lacks the detailed policy plans across sectors that would be necessary to populate the taxonomy. The Government should first focus its resource on the development of clear sectoral policies if it intends for the taxonomy to inform investment decisions and channel capital to environmentally sustainable activity.

Users of the EU taxonomy have noted that it is focused on sectors that can be most easily categorised as 'green'. A UK taxonomy that is similarly focused on 'green' rather than 'transition' activities may fail to provide the depth of information that investment decision makers require to support the range of investments necessary to drive a transition from 'brown' to 'green'. However, a taxonomy focused on transition activity is also likely to be more complex and liable to change, which could lead to reviews and updates that are time consuming and resource intensive for Government and industry and misaligned with typical investment timeframes. We encourage the Government to focus on developing activity-level standards to support decision making and for use within the UK SRS and transition plan framework. This information could be presented in other formats and should ultimately form a part of a credible Carbon Budget Delivery Plan.

6. How could the success of a UK Taxonomy be evaluated? What measurable key performance indicators could show that a UK Taxonomy is achieving its goals?

The overall objective for this exercise should be the achievement of entity-level decarbonisation of companies and their activities in a way that contributes to the 2050 target for the net UK carbon account. Given the international nature of large businesses established in the UK, it is to be expected that this would also make a positive contribution to the carbon account of other countries.

At a more granular level, the key performance indicators will need to be appropriate for the sectors and activities that are being analysed. The Carbon Budget Delivery Plan published in 2023 provides a potential model. The table showing real-world deployment assumptions for each sector, based on the proposals and policies in the Carbon Budget Delivery Plan (table 7 in appendix c) provides assumptions, suitable units of measurement and target years applying to relevant sectors.

As an additional method of assessment, the Government could look to measure private sector financial flows to different taxonomy-aligned activities. This could lead to a further assessment in Government of whether there are barriers to investment and whether further policy action is required.

While these indicators are important, and necessary to the achievement of public policy goals, it is uncertain how they could be specifically attributed to the existence or use of a UK taxonomy. Investment in taxonomy-aligned activities might equally occur because of other sustainability disclosure requirements or because of commercial decisions unrelated to any sustainability disclosure framework.

The Chancellor has recently argued that business can be "held back by a complex and unpredictable regulatory system" that "is a drag on investment and innovation". While financial services regulators have been given new growth-focused remits, it is also important that the Government applies the same tests to new requirements introduced directly by Government. This consultation is concerned with the potential use cases for a UK taxonomy but, to evaluate if additional reporting is a potential drag on investment, the

Government should also assess the financial costs and benefits that are likely to follow from the introduction of this policy.

7. What are the specific use cases for a UK Taxonomy which would contribute to the stated goals? This could include through voluntary use cases or through links to government policy and regulation.

Investment managers have identified each of the potential use cases proposed in paragraph 2.2 of the consultation document while identifying no additional potential use cases. To channel capital to sustainable activity, use cases focused on input to project and business finance decisions, supporting investor stewardship and engagement, and informing the development of sustainability-focused financial products would be most beneficial. The use case concerned with investment fund and investment portfolio product disclosures would appear more beneficial to the goal of preventing greenwashing, although it could over time lead to clients reallocating funds to sustainability-focused financial products which they consider to be better aligned with their investment objectives. It should be noted, however, that each of these potential use cases is already served by existing norms and standards and is likely to be bolstered by the wider adoption of transition planning and utilisation of UK SRS.

Investment managers with experience of the EU taxonomy report that it is more typically used as an ‘output’ function to meet regulatory disclosure requirements and much more rarely informs capital allocation decisions. This is largely due to the known usability challenges associated with the EU Taxonomy outlined in our response to question 17. The transition to a greener economy, whether focused on decarbonisation or better utilisation and stewardship of natural resources, is recognised as a priority for the UK Government and many others globally. Resource in both the public and private sectors is limited and for the Government’s targets to be achieved in the timescales deemed necessary it will be essential that any taxonomy is focused firmly on channelling investment. The pursuit of multiple objectives may add layers of complexity or create a preference for compliance through regulatory reporting (especially where this is mandatory) rather than a pursuit of innovation.

14. Is a UK Taxonomy a useful tool in supporting the allocation of transition finance alongside transition planning? If so, explain how, with reference to any specific design features which can facilitate this.

Both taxonomies and transition plans are in a relatively early stage of development and implementation. Investment managers have reported that, where they are produced, transition plans are becoming an important tool and providing relevant information that can influence investment decisions. In contrast, it is generally reported that taxonomies are not a widely used tool for the allocation of transition finance. The incorporation of taxonomy-related information within a transition plan framework could contribute to standardisation and comparability between transition plans.

However, a UK taxonomy which is not developed to allow for uncertain and evolving transition activities (in contrast to those that are already defined as green) may not fully align with the objectives or frameworks of the UK’s transition planning requirements for companies. A potential consequence of failure to allow for transition activity in a taxonomy while linking it to transition planning could be that transition plans are reduced to being reports on the short-term alignment of the reporting entity with a green taxonomy. Some market participants have suggested that a UK Green Taxonomy could be better aligned with transition plans, and properly reflect the more complex nature of transition, perhaps by adopting a traffic light system. It is essential that preparers of transition plans feel able to report on transition objectives and investment for activities that are not currently considered ‘green’.

There is significant potential to increase the UK’s green bond market as a means of providing transition finance to support credible transition plans. A UK taxonomy could help to develop this market through standardised terms for use in disclosure. Alternatively, the UK could choose to encourage the adoption, on a voluntary basis, of the Climate Bonds Initiative (CBI) taxonomy. Government resource might also be more efficiently allocated to supporting and influencing the future development of the CBI taxonomy.

15. There are already several sustainable taxonomies in operation in other jurisdictions that UK based companies may interact with. How do respondents currently use different taxonomies (both jurisdictional and internal/market-led) to inform decision making?

The UK investment management industry is global in outlook and nature. In 2023 (the most recent year for which data is available) assets under management (AUM) by Investment Association members totalled £9.1trn. Of this total, 49% was managed for overseas customers. More than three quarters (78%) of the shares managed in the UK are invested in overseas markets for domestic and overseas clients. This global outlook benefits the UK because it attracts investment management firms from around the world. Nearly two thirds (63%) of total assets managed in the UK are managed by companies headquartered outside the UK [Investment Management in the UK 2023-2024, October 2024]. Because the UK is at the centre of a global investment chain, investment managers located here will have obligations to report to clients in a range of regulatory jurisdictions and the companies in their investment portfolios will be making sustainability disclosures in line with the markets in which they operate. Each new reporting requirement carries additional cost and complexity throughout the investment chain which needs to be justified with improved outcomes for clients.

Where they have exposure to international taxonomies, UK-based investment managers report the greatest experience of the EU Taxonomy. This reflects the EU’s role as an early adopter of a taxonomy, the integration of the EU Taxonomy in regulatory obligations, and the close interaction between the UK and other European capital markets. Investment managers report very limited use of the EU Taxonomy as a determining factor in investment decisions and note that while they have observed an increase in disclosures by companies in scope of the taxonomy regulation, this has not led to an increase in taxonomy-aligned assets within EU funds. Data from Morningstar shows a significant majority of EU funds (94% for Article 8 and 72% for Article 9) show 0% as their planned minimum taxonomy-aligned investments. Despite the limited utilisation of the EU Taxonomy as an input in the investment process, investment managers still need to disclose taxonomy alignment information leading to additional costs and complexity related to compliance.

17. Are there any lessons learned, or best practice from other jurisdictional taxonomies that a potential UK Taxonomy could be informed by?

Investment managers have expressed concern that the proliferation of taxonomies across multiple jurisdictions may contribute to market fragmentation, affecting the ability of companies to make strategic decisions that comply with multiple jurisdictions and limiting the ability of investors to compare transition activity. Should the UK opt to proceed with a green taxonomy, it should seek to achieve comparability and interoperability through participation in the International Platform on Sustainable Finance (IPSF) and with reference to the Common Ground Taxonomy. In doing so, investment managers anticipate that a UK taxonomy would closely align with the EU Taxonomy while allowing for a small number of exceptions where UK policy differs.

There are, however, flaws with the EU Taxonomy which should inform the decision on whether to proceed with the development of a UK taxonomy. The EU Taxonomy adopts a binary classification, leading to activities which are not taxonomy-aligned not being regarded as sustainable. The EU Taxonomy seeks to embed EU industrial and regulatory standards through its technical screening criteria without properly acknowledging that investors have global portfolios which invest in entities not bound by EU regulation. The EU Taxonomy also does not cover activities, such as agriculture, which are still significant sources of emissions but where it is currently deemed too complex to develop ‘green’ criteria. These challenges were among the issues identified in the research conducted by Public for the Department for Business and Trade [The EU Taxonomy Framework: Research on the Impact on Companies, November 2024]. We regard the interviews and analysis presented in that report as representative of the views of UK-based investment managers and their stakeholders.

It is not feasible to develop a UK Taxonomy which avoids repeating existing flaws in the EU Taxonomy without further fragmenting global reporting requirements and adding costs for businesses with a presence in the UK. The Government should recognise that some sectors are currently too complex to categorise as 'green', prioritise the development of policy frameworks that are optimised to support transition activity, and recognise that investors and businesses operate across borders and are subject to competing regulatory standards.

23. It is likely a UK Taxonomy would need regular updates, potentially as often as every three years. Do you agree with this regularity?

While the principle of review and revision would allow for the inclusion of new technologies and new knowledge on existing approaches, the expectation of regular updates could undermine confidence in Government decarbonisation policy. It is important that investors and businesses have certainty around the policy environment in the jurisdictions in which they operate. The Government should consider the signal it would send to those making investment decisions if it was expected that experimental or necessary transition sectors and technologies could be subject to removal from the UK taxonomy within three years.

Most issuers of transition plans would not be able to take note of changes in the taxonomy, meaningfully revise strategies, implement changes to the business, and report on the new approach within the proposed three-year interval between taxonomy updates. To foster confidence, the Government should seek to minimise the stages at which it is possible or anticipated that policy can change. In some cycles, the proposed timeframe could result in multiple changes within one parliamentary term or Carbon Budget period. As set out in answer to question 26, the UK has a well-respected framework for the development and scrutiny of decarbonisation pathways, which includes Carbon Budgets, and should seek to align revision of decarbonisation policy with this process and its timetable.

24. Would this pose any practical challenges to users of a UK Taxonomy?

It is to be assumed that the purpose of the taxonomy is to support the development of corporate strategies and investment decisions. As such, an update period should take account of both the time it takes to develop such strategies and the need to have confidence that public policy decisions would be sufficiently long-term to make investment worthwhile. Regular updates to a taxonomy would provide practical challenges to people making investment decisions, including the users and preparers of transition plans.

If a short-term update process were to be introduced, it would be important that it was preceded by a formal statement that any changes to the taxonomy should have a high bar or favour the addition of new activities over the removal of existing activities. A government seeking to incentivise investment should prioritise a stable, clear and supportive policy environment and assurance of long-term policy decisions could be provided through another mechanism, potentially underpinned by legislation.

25. Would this timeframe be appropriate for transition plans?

Investment managers support transition planning as an integral part of the development and disclosure of corporate strategy, which is already set out in the annual strategic report. Some investment managers have advocated for a standalone transition plan to be produced at multi-year intervals, perhaps every three years, with focused progress updates provided annually within the annual report.

Any change in Government policy, including revisions to a Green Taxonomy, which took place near the publication either of a progress report in an annual report or standalone transition plan will create challenges for some issuers. Inevitably, greater long-term certainty can be provided by making fewer revisions to Government policy whether through a taxonomy or in any other form.

26. What governance and oversight arrangements should be put in place for ongoing maintenance and updates to accompany a UK Taxonomy?

There are several factors that the UK Government would need to consider when developing governance and oversight arrangements which both give credibility to any proposed UK Taxonomy and give confidence to investors and companies in the UK's long-term policy pathways. These include the role that should be played by the devolved governments and the UK and devolved parliaments.

The UK currently has a well-respected framework for the development and scrutiny of decarbonisation pathways through the Climate Change Act, Carbon Budgets and the Climate Change Committee (CCC). Any governance and oversight arrangement should seek to leverage and align with the processes which have contributed to this reputation.

It would be necessary to consider, among other things, how the annual CCC Progress Report and the Carbon Budget Delivery Plan would utilise and influence the UK Taxonomy. It is particularly important to consider what steps would be taken where there was a mismatch between the emerging green sectors identified in a taxonomy and the level of ambition and policy detail required of the UK Government to develop those sectors. There is also a question around the role of the Secretary of State for Energy Security and Net Zero and their department in the development of a taxonomy.

The Climate Change Act gives the Secretary of State a duty to ensure that the UK carbon account is net zero by 2050 but it is noted that the UK Taxonomy policy was announced by the Chancellor of the Exchequer and this consultation is being run by the Treasury. To give confidence, it is important to clarify how these functions of government would operate and intersect. The Government might conclude that the existing, respected decarbonisation policy framework is the optimum vehicle for identifying green sectors while incorporating sufficient governance and oversight arrangements. For wider environmental objectives, the Government should consider how the Climate Change Act framework might also offer an example for the achievement of Environment Act 2021 targets.