Guide for Creating a Green and Sustainable Finance Taxonomy:

Lessons Learned from Mexico's Government and Banking Sector

Mexican–German Climate Change Alliance

Multiplying Efforts for a Dignified and Sustainable Future

FOREWORD

This guide draws from the experiences of the *Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH* in developing two processes for the creation of a taxonomy for green and sustainable finance. The first, carried out with the banking sector through the Association of Banks of Mexico (ABM), focused on green assets; the second, elaborated with the Government of Mexico, focused on identifying economic activities and a methodology for defining metrics and thresholds of Mexico's sustainable financing taxonomy. The objective is to share the lessons learned and best practices with other countries so that they can implement and operate a classification system for economic activities that contribute to sustainability and/or climate change within their countries.

Until a few years ago, no plans yet existed to develop a taxonomy in Mexico, which is why the GIZ began to help coordinate interests. Through partnerships with the private sector, in this case the ABM, and with the support of the Bank of Mexico, it began by developing a financial classification exercise for green assets. This analytical exercise helped assess the challenges of developing a taxonomy at the national level that would be effective, harmonious and provide market certainty.

Based on the lessons learned outlined in this handbook, decision-makers, international development practitioners and other sectoral stakeholders will have the tools and frameworks to develop processes for the design and construction of green and/or sustainable taxonomic classification systems. The guide considers the minimum elements and principles required for developing a taxonomy.

The analysis of best practices includes lessons from two experiences, the first a bottom-up approach with Mexican banks, and the second a top-down approach led by the financial supervisor, the Ministry of Finance and Public Credit (SHCP). The experiences and lessons learned from the first exercise are considered in the second exercise. In the latter, GIZ helped identify economic activities and the methodology for managing the Sector Working Groups of the three Sustainable Development Goals (SDGs) selected for the identification of activities. As part of the creation of Mexico's sustainable taxonomy system, several stakeholders and international development organizations are involved to support the development of different system components.

Learning about existing taxonomies and finding new design solutions that are appropriate to the political, social, and economic context of each country is key. Moreover, sharing this information will help improve classification systems and identify climate action investments that contribute to meeting the Paris Agreement targets.

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LIST OF ABBREVIATIONS

ABM: Association of Mexican Banks (for its acronym in Spanish)

NADBank: North American Development Bank

TEC: Technical Evaluation Criteria

ESG: Environmental, social, and corporate governance

FSSC: Financial System Stability Committee

SFC: Sustainable Finance Committee

FIRA: Trust Funds for Agricultural Development (for its acronym in Spanish)

GIZ: Deutsche Gesellschaft für Internationale Zusammenarbeit (for its acronym in German)

IPCC: Intergovernmental Panel on Climate Change

SDGs: Sustainable Development Goals

SHCP: Ministry of Finance and Public Credit (for its acronym in Spanish)

MRV: Monitoring, Reporting and Verification System

1. INTRODUCTION

The year 2015 was a watershed year for international progress towards agreements on sustainable development and climate action. The United Nations agreed on the Addis Ababa Action Agenda on Financing for Development, the 2030 Agenda and its 17 Sustainable Development Goals (SDGs), and the Paris Agreement. The latter commits countries to limit global temperature rises to well below 2 degrees Celsius and to make efforts to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels. Over the next decade, commitments concerning the transition to low-carbon, climate-resilient economies will be critical to confronting the climate emergency.

The mobilisation of public and private resources is key to achieving global goals. The participation of public financial institutions, banks, institutional investors, corporations, and capital markets is crucial to ensuring financial flows are sustainable and green.

Therefore, it is essential to provide investors with information on activities that help meet climate change and natural resource conservation objectives. Taxonomies are classification systems that contain criteria and indicators to classify different economic activities according to their contribution to climate change mitigation and adaptation, or to the sustainability of a country. In other words, they classify financial funds according to their objectives, thus giving certainty to the market, and avoiding greenwashing and social washing[1]. Thus, **the creation of taxonomies for green, sustainable or climate finance supports this process to become the cornerstone of a green financial system**. The financial sector should consider environmental issues—climate change particularly—as integral to their businesses and always carry out risk and opportunity analyses related to the environment and climate.

For the purposes of this document, a **green taxonomy** refers to a framework or classification system with criteria and indicators that allow for the classification, organisation and evaluation of activities or investments aimed at meeting specific objectives related to environmental issues, including climate change, that are based on the application of a methodology to identify their impact (World Bank, 2020). Meanwhile, a **sustainable taxonomy** seeks to classify activities or investments that include the three spheres of sustainability: social, environmental, and economic, as well as consider the Sustainable Development Goals of the 2030 Agenda (PRI, 2022).

1 Greenwashing is when a company or organisation spends more time and money on marketing itself as being sustainable than on minimising its environmental impact. Social washing involves the same misleading practices, but on social issues (Earth, 2021).

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FIGURE 1. Sustainability Gradients

Sustainable Development

Environment **Social** **Economic** **Governance**

Climate change mitigation **Climate change adaptation** **Other**

Emissions reduction **Resilience**

Climatic

Green

Socio-environment

Sustaintable
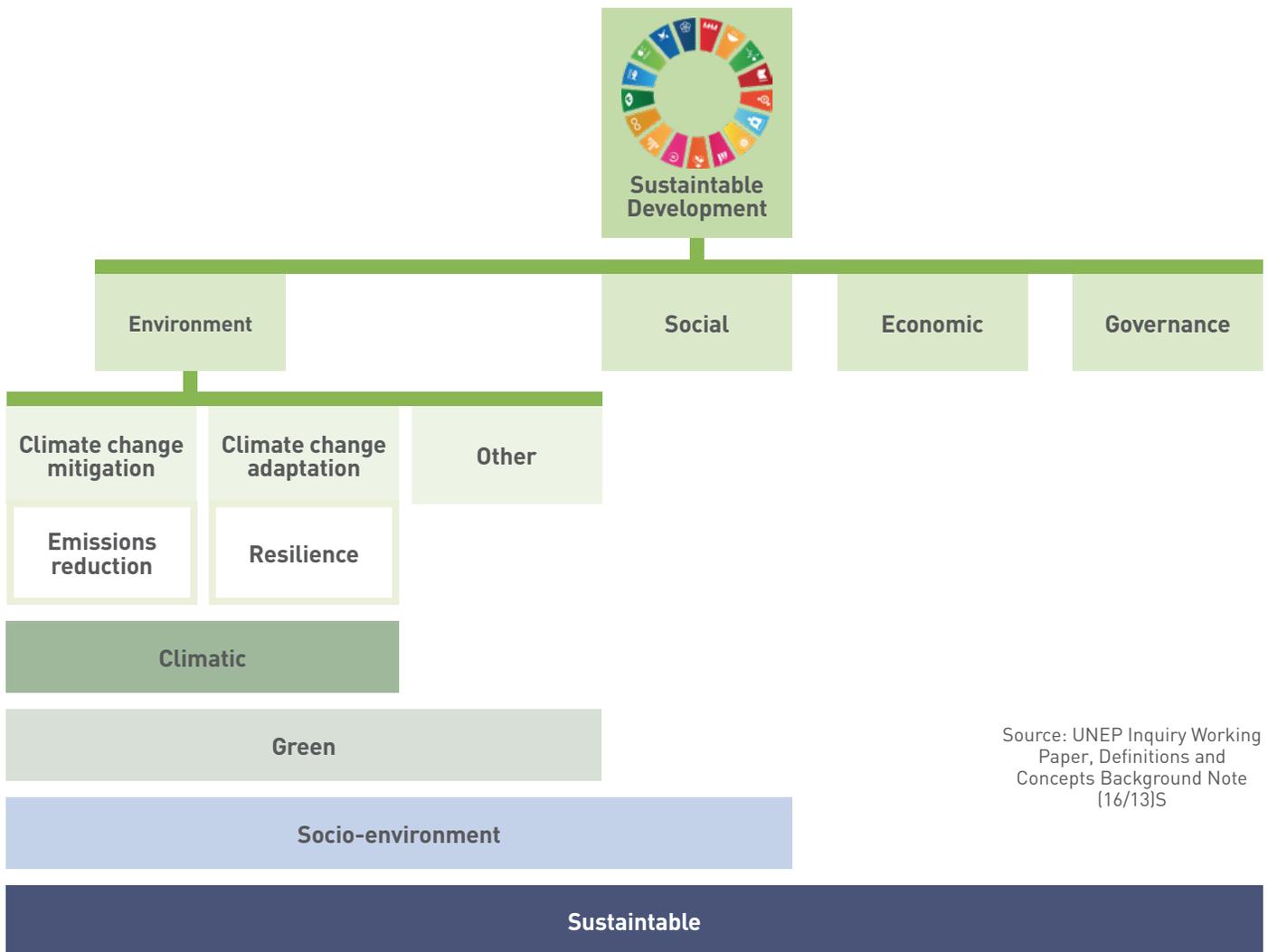
Source: UNEP Inquiry Working Paper, Definitions and Concepts Background Note (16/13)S

The *Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH*, through the Mexican-German Climate Change Alliance, has worked on two distinct processes to develop the first efforts at creating green and sustainable taxonomies in Mexico. The first was carried out with the banking sector through the Association of Banks of Mexico (ABM); and the second with the public sector through the Ministry of Finance and Public Credit (SHCP). The collaboration with the banking sector followed a bottom-up approach, while that with the public sector was top-down. Going from the global to the specific, elements from the first exercise on the banking sector served as a starting point for developing a taxonomy at the national level.

GIZ's role was key in bridging the development of the two taxonomies and creating multi-stakeholder processes to promote climate ambition, as well as helping to make the green finance agenda a priority for both the banking sector and the government.

1.1. COOPERATION WITH THE ABM FOR A GREEN TAXONOMY

The Mexican banking sector knows that climate change presents a challenge, especially for companies that will face increased regulation at the international level due to transition risks. With this in mind, it sought the assistance of GIZ in creating a controlled pilot exercise for the banking sector that included a governance proposal. The goals were to co-create a green taxonomy to help prepare for the challenges associated with the transformation of the financial system, the medium-term challenges of regulation and the transition to a greener financial sector.

During the exercise with ABM, a pilot was designed with a methodology that allows financial institutions to classify assets under the same environmental or climate category and develop a monitoring, reporting and verification (MRV) mechanism. This tool will give certainty to the mobilisation of green capital, as well as support the shift towards a portfolio of low-emission and climate-resilient investments.

Normative Principles of a Taxonomy

Analyses of various information sources were carried out, including:

- Mexico's environmental and climate commitments[2]
- International best practices and benchmarks (such as the European Union's Taxonomy and China's Taxonomy)
- The Mexican regulatory system
- National initiatives promoting green finance (Banking Sustainability Protocol) and the taxonomies of varios banks operating in Mexico and also some bilateral banks such as NADBank.

Based on the analysis of these sources, the following guiding principles for the green taxonomy were established:

1. Contribution to the greening of a low-carbon economy.

2. Economically sustainable transition.

3. Adaptation and resilience.

4. Social safeguards.

5. Compliance with technical assessment criteria.

6. Adherence to scientific evidence.

7. Contribution to better risk management in portfolios.

8. Adaptation to the changing environment.

9. Relevance over time for the entire financial sector.

10. Serving as an instrument of positive change for the country.

2 Different environmental commitments have been made over the years to safeguard or provide environmental protection in different areas. Among the most prominent recent commitments are the Paris Agreement, the Sustainable Development Goals and the Convention on Biological Diversity.

The exercise focused on credit as the primary instrument, with the flexibility to incorporate other instruments[3] after a pilot exercise. Through a verification protocol, financial funding was confirmed as contributing to the greening of the Mexican economy.

To select the economic sectors on which to focus the analysis of "greening" during the first stage of the taxonomy, the following criteria were applied:

1. **ENVIRONMENTAL IMPACT:** Identification of the economic sectors with the greatest contribution to environmental objectives (in particular climate change mitigation).

2. **INVESTMENT:** Identification of the sectors with the greatest investment potential:
   a) Largest historical investment in Mexico.
   b) Largest flows of green finance at the international level.

3. **BEST PRACTICES:** Experience and harmonisation with national and international best practices, such as those followed by the North American Development Bank (NADBank), Trust Funds for Agricultural Development (FIRA) and Mexican commercial banks already involved in green finance, among others.

Based on the analysis of these three components, **the green finance taxonomy for commercial banks in Mexico** was created, which seeks to prioritise economic activities in at least the following three sectors: energy, transport, and agriculture. However, this proposal does not exclude or limit the consideration of more economic sectors, as long as they are aligned with the transition to a sustainable, low-carbon economy, and generating investor interest.

The first exercise included the banking sector and represented a first attempt at greening the country's financial system. As a pioneering exercise in green asset classification in Mexico, it laid the groundwork for the challenges and opportunities from a taxonomy user's perspective, providing a path for financial supervisors to build a taxonomy governance process at the national level. This helps create a more secure environment for promoting green and sustainable investments and preventing greenwashing.

> Learn more about the ABM green taxonomy

1.2. COOPERATION WITH THE SHCP FOR A SUSTAINABLE TAXONOMY

In 2020, the Sustainable Finance Committee (SFC) of the Financial System Stability Committee (FSSC) was created with the participation of Mexican financial authorities. The SFC was created from the idea of generating a sustainable finance agenda for the Mexican financial system, which, as part of the FSSC, focuses on measuring and identifying risks related to sustainability and climate change. The SFC included four working groups, each coordinated by a different financial authority. The SHCP oversees the Sustainable Taxonomy group.

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3   The pilot exercise incorporated: project finance, syndicated loans, equity capital markets, debt capital markets, mergers and acquisitions, and tax relief for venture capital investments (tax equity).

TABLE 1. Sustainable Finance Committee Working Groups

Sustainable Taxonomy
Leveraging for Capital Mobilisation
Social, and corporate governance (ESG) Risk Measurements
Disclosure of ESG Information

The exercise developed by GIZ, in collaboration with the ABM, was presented as part of the SFC Taxonomy Working Group and provided the basis for starting a taxonomy design and classification process in Mexico.

The pilot provided an opportunity to scale the process and increase government interest in prioritising the creation of a sustainable taxonomy. This is in line with the latest issuance of sustainable sovereign bonds by the Mexican government—for example, through the BONDESG—as part of a commitment to promote sustainable financing (SHCP, 2022).

In 2021, the SHCP started working with the sustainable taxonomy group to create a classification system under the broad concept of sustainability. The aim was to determine which activities have the most positive environmental and social impacts so that financial market stakeholders from different sectors can more easily identify the impacts.

To do so, the recommendations from the World Bank and those shared in ABM's green taxonomy exercise were taken as a reference. GIZ supported the exercise to develop the national taxonomy (IKI Alliance, 2021). An analysis of Mexico's economic sectors was carried out to identify users of the taxonomy, as well as to design reporting guidelines for the taxonomy.

The development of taxonomies mainly involves the selection of criteria based on climate change mitigation and adaptation targets. Mexico developed an innovative approach to a **sustainable taxonomy** that integrates three SDGs as starting points: 5, 11 and 13.[4] The selection of sectors and economic activities for the taxonomy considered their contribution to the three SDGs. It is important to note that Mexico is pioneering in the methodologies being implemented.

4 SDG 5 "Gender Equality", SDG 11 "Sustainable Cities and Communities" and SDG 13 "Climate Action".

The SHCP invited GIZ to be part of the sustainable taxonomy working group to identify economic activities derived from and linked to the three SDGs mentioned above. Based on this, it conducted an analysis to identify the positive and negative correlations between the SDGs. Finally, it developed the methodology and governance model of the Sectoral Working Groups where metrics and thresholds were defined. To develop metrics and thresholds, previous taxonomies were taken as a reference, as well as fundamental elements to ensure impact and avoid greenwashing and social washing.

Having a transparent and science-based methodology is fundamental to the creation of Mexico's sustainable taxonomy. Therefore, the structure of this methodological proposal, i.e., the elements included, are based on the structure of the Technical Evaluation Criteria (TEC) of the European Union's sustainable taxonomy. It is important to mention that the development of the national sustainable taxonomy is still in a consolidation process, led by the SHCP together with various international cooperation agencies, National and Multilateral Development Banks, and key actors.

TABLE 2. Elements Making up the Methodological Basis

SUSTAINABLE ECONOMIC ACTIVITY

Main Parameter

Substantial Contribution
• Metrics and Thresholds

No Significant Harm

Minimum Safeguards

2. STEPS TO IMPLEMENT A GREEN OR SUSTAINABLE TAXONOMY

Based on the analysis of lessons learned from both exercises, key elements and phases were identified that should be considered in other similar processes, both from the bottom-up experience with the private sector or users of the taxonomy, and from the top-down experience with financial regulators. Five development stages were identified to create synergies between the two processes. **This guide highlights eight steps for designing a green or sustainable taxonomy.**

TABLE 3. Stages for the Development of Green and Sustainable Taxonomies

GREEN TAXONOMY	SUSTAINABLE TAXONOMY
1. Local and international literature review	**1.** General literature review, international and local
2. Methodology, metrics, and thresholds design	**2.** Review of metrics regarding the SDGs
3. Reporting framework design	**3.** Identification of achievable SDGs in taxonomic areas
4. Piloting	**4.** Methodology, metrics, and thresholds design
5. Green taxonomy proposal	**5.** Governance mechanisms

Taxonomy implementation is best started within the first years of a new administration, considering the possible extension of some of its stages and helping to maintain continuity in the participation of governmental stakeholders.

FIGURE 2: General Outline of the Process in Mexico
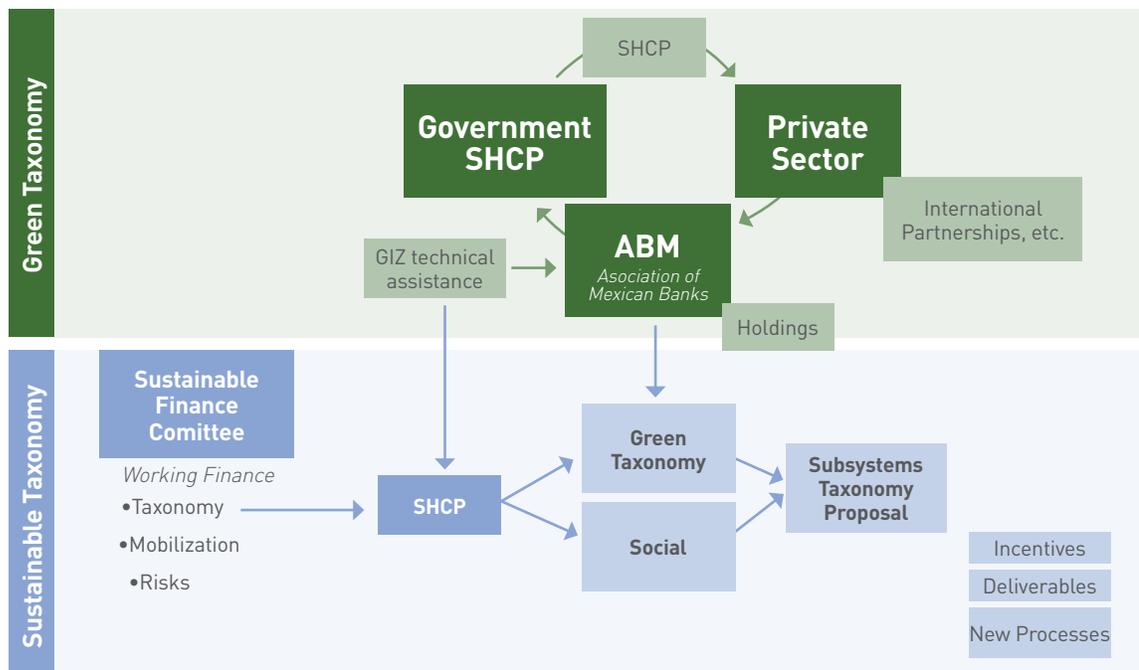
Universal Recommendations

As part of a cross-cutting approach to the development of a taxonomy, the following recommendations should be taken into consideration:

- Identify the right stakeholders for each phase, making it an inclusive and multi-stakeholder process.
- Include stakeholders that are allies, such as development banks, government regulators, key financial stakeholders, international development agencies, and representatives from all sectoral levels.
- Develop an agenda that integrates the entire financial sector into the green and sustainable taxonomy.
- Develop and maintain high levels of communication with federal government and financial stakeholders.
- Develop scalable piloting exercises.

- Make progress towards measuring impact.
- Develop application toolkits.
- Using a cross-cutting approach, train decision-makers and all departments of participating institutions.
- Learn about best practices and lessons learned from taxonomies developed by other countries.
- Seek support and technical assistance from international development agencies in the design, development, implementation, and scalability of the taxonomy.
- Provide continuous training to the stakeholders involved in the process.
- Develop a simple and understandable process that evolves into a more complex taxonomy.
- Identify activities that allow greater access to information and produce more impact for the population.

FIGURE 3. Eight Steps to Developing a Green or Sustainable Taxonomy

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2.1. STEP 1: LITERATURE REVIEW

To start the process of creating a taxonomy, the international literature on taxonomy should be reviewed. Previous work and exercises should be analysed on a global and regional scale, looking for similar conditions to those in the country where the process will be implemented. The institutions and people in the country responsible for generating the information should also be identified, along with those capable of identifying processes for improvement.

2.2. STEP 2: DEFINING THE SCOPE OF THE TAXONOMY

After conducting an analysis of the taxonomy creation processes at the regional and global level, the scope and sectors of the taxonomy can be defined. For example, this step will define whether the taxonomy will be a **green, sustainable or climate taxonomy.** The following steps are recommended:

- Begin with an assessment that provides a baseline for the process.
- Identify possible conflicts in the application of the taxonomy.
- Take the country's climate goals as a starting point for defining the desired impacts of climate change mitigation and adaptation.
- Identify public policies that are implementing some of the programs of relevance to the taxonomy.
- Take advantage of the existing reporting practices of the banking and other sectors and adapt or adjust these systems to improve information sharing for the taxonomy.

- Manage the ambition, expectations, and applicability of the taxonomy in local contexts.
- Choose, where appropriate, the SDGs that would be incorporated into the taxonomy as a starting point.
- Propose a roadmap for moving to a more complex methodology.
- Consider the impacts that asset classification has on the business aspects of the different stakeholders in the financial system.
- Leverage, update and improve the reporting exercises developed by the banking sector, following their good corporate governance practices for taxonomy reporting.
- Identify public policies, such as sustainable finance programs, in which public debt is financed.
- Identify potential users and reporting guidelines for the taxonomy.

2.3. STEP 3: DEVELOPMENT OF METRICS AND THRESHOLDS

A taxonomy provides a list of eligible assets with thresholds and metrics established as needed. The harmonisation of eligible assets and metrics in the system is a key step because the taxonomy will provide guidance to both emitters and investors in the relevant jurisdiction (CBI, 2019). Some recommendations for defining metrics and thresholds are as follows:

- Identify which reporting and analytical practices within financial institutions can be used and adjust and adapt them to the new context.
- Identify the productive projects or companies with relevant best practices for the taxonomy.
- Create multi-sectoral committees led by regulatory bodies.
- Maintain the user's vision in the development of the taxonomy.

2.4. STEP 4: PUBLIC CONSULTATION

An in-depth public consultation is fundamental because it makes the process more inclusive and incorporates inputs from new stakeholders and actors. Recommendations include:

- Employing a horizontal approach, take advantage of public consultation periods to include the opinions of different leaders.
- Include the knowledge gained from the public consultation in the creation of the taxonomy.

2.5. STEP 5: PILOTING

The piloting process will support the application of the taxonomy under controlled conditions—for example, the exercise conducted with the Mexican banking system, which allowed the taxonomy to be scaled to a national level. This exercise can be adapted to expand and improve the capability and operability of the taxonomy. To implement this process, the following is recommended:

- Reserve extended periods of time to conduct pilots.
- Define times of year that facilitate stakeholder participation (avoid administrative closure periods).
- Share the co-benefits of developing green or sustainable taxonomy proposals.
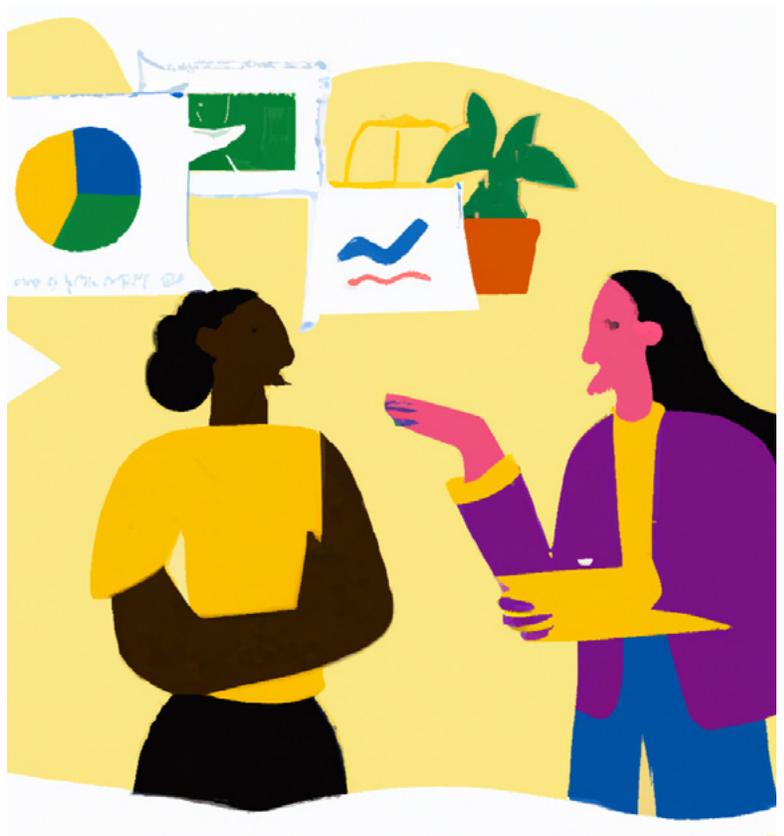
2.6. **STEP 6:** GOVERNANCE MECHANISMS

Governance mechanisms refer to the interaction between stakeholders and different sectors in the taxonomy system, including environmental, social, economic, public, private, and financial. These mechanisms help ensure the correct operation and integrity of the taxonomy. Responsibilities and mechanisms need to be identified so that compliance with the taxonomy is institutionalised. The following recommendations can facilitate the process:

- Develop methodologies to assess the financial risks and impacts of implementing a green and/or sustainable taxonomy.
- Promote capacity building in government and the financial sector.
- Develop technical assessment criteria, proposals for operationalisation and working group management, and a roadmap for regulatory bodies.
- Maintain flexibility and transparency in the evolution of the taxonomy.
- Standardise the definitions of the different green and sustainability criteria.
- To avoid greenwashing, maintain well-established frameworks that provide market-wide certainty on the variety of investments.
- Include working groups/working committees with multi-stakeholder participation.

2.7. PSTEP 7: SCALABILITY

Once the process has been piloted and the governance and monitoring system is in place, the taxonomy should be scaled up to the next level, i.e., to broaden its scope and the stakeholders involved. Scaling will expand climate ambition and take more sectors into account, which will lead to more green finance and sustainable development. To achieve this, the following is recommended:

- Develop market incentives for government and banking institutions.
- Share progress to avoid operational shock in financial institutions.
- Include outreach processes for different actors and users.
- Maintain transparency among the stakeholders during the process.
- Promote courses and workshops in the working groups.
- Rely on the technical expertise of development organisations, advisors, and specialised consultants.
- Involve leaders as members of the committee to accelerate the climate agenda.
- Encourage the use of the taxonomy through governmental enforcement mechanisms.
- Move forward with impact measurement, disclosure, and remediation schemes.
- Incorporate Mexican sectors in transition, such as the energy sector.
- Develop well-established frameworks that provide market certainty.
- Move forward in stages and steps, starting with the basics.
- Cooperate with other countries, have active dialogues at all stages of taxonomy development and evolution.

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2.8. STEP 8: OUTREACH AND COMMUNICATION (CROSS-CUTTING)

The success of a green or sustainable taxonomy system lies in its impact. That is why it is necessary to communicate and share progress made in greening the financial system. On the one hand, this helps bring the financial sector together to work on climate action. On the other, it involves stakeholders from government, the private sector, civil society, and academia in knowledge development processes that reinforce a framework of transparency and inclusiveness on climate change and sustainability. The following steps are recommended for creating impactful communication and information-sharing strategies that consider various target groups:

- Share the taxonomy in international, regional and national forums.
- Promote courses and workshops in the working groups.
- Develop communication strategies aimed at different stakeholders and share the importance of the taxonomy.
- Translate technical issues into language accessible for everyone.
- Empower key groups and sectors such as civil society, academia, the private sector, and youth and involve them in the dissemination of the taxonomy.

3. FINAL
CONSIDERATIONS

The process of systematising lessons learned is a tool that helps identify the challenges, opportunities, potential areas for improvement, and best practices to consider in the development of a green or sustainable taxonomy at the national level.

The following is a non-exhaustive list of recommendations drawn from this exercise. Readers are invited to reflect on and incorporate ideas that will contribute to enriching this document. The taxonomy is a tool that aims to level the playing field for competition and information sharing and provide inputs under a single asset classification to support internal monitoring, thereby ensuring that next steps towards mobilizing green finance are clear.

- The green and/or sustainable taxonomy is a performance instrument that aims to help move towards a more inclusive, low-carbon and resilient economy.

- Implementing a green and/or sustainable taxonomy is an opportunity for the country to reduce adverse climate change impacts by having a framework for establishing transparency actions aimed at mitigating and adapting to climate change, allowing it to meet its national climate goals.

- The process of developing a taxonomy consists of piloting and applying strategies to consolidate functional areas and find space for improvement in a flexible way.

- A taxonomy should move forward in stages.

- Identifying sustainable and green economic activities helps explain the risks, challenges and opportunities associated with specific economic activities, as well as how the macroeconomy affects the resilience of the country.

- Mexico has a lot to offer, both about the taxonomy process and its experience with a public policy environment that includes a taxonomy in the range of instruments used by tax authorities and the central bank. It is important not to isolate the process.

- A taxonomy is a medium and long-term process, which must adapt to the country's market and productive technology conditions.

- A resilient economy is a necessary end because, according to the Intergovernmental Panel on Climate Change (IPCC, 2022), climate impacts have increased the vulnerability of all countries. While a green taxonomy can help guide the process, some information is required beforehand. Countries need to know about vulnerabilities, where adaptive capacity and resilience need to be strengthened, and the areas to mitigate emissions.

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