



Nepal Green Finance Taxonomy, 2024

Nepal Rastra Bank (NRB) has officially launched the Nepal Green Finance Taxonomy 2024, on 20 October 2024 marking a critical step towards promoting sustainable finance. This taxonomy sets a standardized classification system for green investments across various sectors to ensure that financial institutions contribute meaningfully to Nepal's climate action and sustainable development goals. By providing clear guidelines, the taxonomy helps institutions assess, monitor, and report green investments, ultimately driving capital towards environmentally sustainable projects.

Key Highlights

a) Purpose and Scope:

- **Primary Objective:** The taxonomy serves as a guide for the financial sector to identify and promote investments that meet environmental, social, and governance (ESG) requirements. It facilitates the flow of domestic and international green finance by providing a standardized classification of green activities.
- **Target Users:**
 1. **Banks and Financial Institutions (BFIs):** Includes commercial banks, development banks, finance companies and microfinance institutions.
 2. **Insurance Companies and Capital Markets:** Insurance providers and securities firms will use the taxonomy to classify and develop green financial products.
 3. **Private Sector Actors:** Including MSMEs, pension funds, and investment funds.
- **Investment Sectors Covered:** Agriculture, energy, forestry, industry, transport, construction, and financial services are included, with a focus on economic activities contributing to climate resilience and sustainable growth.

b) Core Environmental Principles: The taxonomy is guided by four main environmental objectives, which all green investments must align with:

- **Climate Change Adaptation:** Investments that enhance the capacity of people and ecosystems to withstand the adverse effects of climate change. This includes climate-resilient infrastructure, flood control, and disaster risk reduction projects.
- **Climate Change Mitigation:** Projects that reduce or prevent greenhouse gas emissions, including renewable energy, energy efficiency improvements,

and carbon capture initiatives. Investments must align with Nepal's target for net-zero emissions by 2045.

- **Natural Resource Conservation:** Sustainable management and conservation of natural resources such as forests, biodiversity, and water resources, promoting ecological diversity and resource efficiency.
- **Pollution Prevention and Control:** Initiatives that minimize or eliminate pollution to air, water, and land, including waste management, air quality improvements, and soil conservation efforts do not have the right to claim those missed dividends in the future.

c) Application Procedures:

The application procedures of the Nepal Green Finance Taxonomy outline how the taxonomy should be used by financial institutions, investors, and other market participants to classify economic activities and direct investments into sustainable projects. It involves several key steps:

1. Sector Classification:

- Sectors are classified based on the Nepal Standard Industrial Classification (NSIC).
- Lending areas of BFIs are categorized as approved by NRB, guided by the Unified Directives and the Supervisory Information System (SIS).
- Sectors under the capital market are regulated by the Securities Board of Nepal (SEBON), and non-life insurance sectors are directed by the Nepal Insurance Authority (NIA).
- National commitments on climate action, such as the Nationally Determined Contributions (NDC),

- National Adaptation Plan (NAP), and Long-Term Strategy for Net Zero Emissions (LTS), are also integrated into sector classification.

2. Screening and Assessment of Investments:

- The taxonomy applies **principle-based** and **whitelist-based (pre-defined list of green investments/projects)** approaches to screen and assess investments:
 - The **principle-based approach** defines core environmental principles to assess economic activities.
 - The **whitelist-based approach** identifies eligible projects or activities that are clearly defined as green.
- Investments are classified into **green, amber, or red** based on their environmental impact, as discussed below in the **classification** section.

3. Application Process:

- The application of the taxonomy follows a structured approach:
 - The financial institution or investor identifies the relevant sector for an investment.
 - They classify the investment based on the principles outlined in the taxonomy (green, amber, red).
 - Once classified, the investment undergoes regular monitoring, reporting, and verification to ensure continued compliance with green standards.
- The taxonomy also provides flexibility, allowing market actors to adjust investments classified as amber (transitional) to meet green standards over time.

d) Classification System: The taxonomy introduces a traffic light classification system to help stakeholders assess green investments

- **Green or Transformative:** Economic activities that fully comply with environmental objectives. These include projects that contribute significantly to climate change mitigation and adaptation, such as renewable energy generation, green buildings, sustainable agriculture, and waste management.
- **Amber or Transitional:** Activities that are on a transition pathway towards sustainability but require improvements to fully align with green criteria. Examples include industrial sectors shifting from fossil fuels to cleaner energy sources.
- **Red or Non-compliant:** Economic activities that do not meet green criteria and are likely to cause environmental harm. These are discouraged, and financial institutions should avoid investments in such activities.
- All economic activities, whether green or transitional, must ensure they **Do No Significant Harm** to other environmental objectives.

- **Social Inclusion:** DNSH also considers social aspects such as protecting human rights, preventing forced labor, and ensuring financial inclusion for marginalized communities.

e) Financial Sector Roles and Responsibilities:

- **BFI:** Required to adopt the taxonomy into their lending practices, ensuring that green loans and investments are aligned with the environmental objectives. BFIs must track and report on green finance flows annually.
- **Insurance Providers:** Insurance companies must design green insurance products (e.g., climate risk insurance, green bonds) that support investments in renewable energy, sustainable agriculture, and disaster recovery.
- **Capital Markets:** Green bonds and other financial products must be issued in compliance with the taxonomy to attract investment in green projects.

f) Roles and Responsibilities of Regulators

Regulators like NRB, SEBON, and NIA ensure financial institutions comply with the Nepal Green Finance Taxonomy. Key responsibilities include:

- **Compliance Verification:** Regulators scrutinize reports from financial institutions to ensure alignment with green finance principles and address any non-compliance with flexibility.
- **Creating a Level Playing Field:** They provide incentives to financial institutions and clients to encourage investments in green sectors.
- **Training and Capacity Building:** Regulators offer training and guidance to build institutional capacity for green finance implementation.
- **Supervision and Guidance:** They conduct regular reviews and provide corrective advice to keep green investments on track.
- **Reporting and Transparency:** Regulators compile and publish consolidated reports on green finance activities, ensuring transparency.
- **Utilizing Existing Systems:** Existing supervisory systems, like NRB's Supervisory Information System (SIS), are used to streamline green finance monitoring and reporting.

g) Monitoring, Reporting, and Supervision:

- Monitoring is essential to assess the transition of Nepal's financial sector toward sustainable finance and a green economy. Every organization utilizing the taxonomy must disclose its alignment with taxonomy principles and standards.
- Market participants (banks, financial institutions, insurance companies, and merchant bankers) are responsible for regularly monitoring the use of taxonomy-aligned financing by their clients. They should ensure the finance is directed toward "green" activities and take corrective measures as necessary.

- Regulators, such as the NRB, SEBON, and NIA, oversee these market participants and perform annual checks to verify the progress of green investments and to address any deviations. Checks by regulators start by suggesting improvements if alignment falls short and applying stricter measures only in cases of significant non-compliance.

- The extent to which taxonomy is applied.
- Detailed descriptions of investment contributions to climate adaptation, emissions reduction, and ecosystem conservation.
- Governance measures to ensure the effective application of the taxonomy and the management of environmental and climate risks.

h) Reporting by Market Participants:

- Nepal's taxonomy requires that financial institutions classify their assets and prepare detailed annual reports for both internal risk management and regulatory supervision.
- Financial disclosure requirements include:
 - Stating annual targets and actual achievements in green finance, highlighting both new financing and refinancing of existing projects.
 - Disclosure of the proportion of investments aligned with taxonomy standards. This includes categorizing investments as "green or transformative," "amber or transitional," or "red" based on their compliance with sustainability criteria.
- Non-financial disclosures focus on the broader environmental, social, and governance impacts of green investments. These disclosures cover:

i) Regulators' Reporting and Consolidation:

- Regulators aggregate and publicly disclose the annual green finance taxonomy reports received from financial institutions, integrating both financial and non-financial data.
- These reports consolidate the financial sector's contributions toward national climate and sustainability goals, categorized by economic sector and sub-sector. The existing Supervisory Information System (SIS) by NRB, along with SEBON and NIA's reporting frameworks, will facilitate this process.

j) Prevention of Greenwashing:

The taxonomy provides clear criteria to prevent greenwashing, where companies falsely claim that their activities are environmentally friendly. It aims to create transparency by requiring detailed disclosures and independent audits of green investments.

PKF Comment

*The **Nepal Green Finance Taxonomy 2024** is a landmark document that sets the foundation for transitioning towards a green, resilient, and inclusive economy. It provides a clear roadmap for financial institutions to support Nepal's ambitious climate action and sustainable development goals, helping to unlock new investment opportunities while promoting environmental stewardship.*

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