Box 5
The development and challenges of sustainable finance in Taiwan

Financial institutions, which take in funds from the public and manage and utilize those funds by undertaking activities such as lending and investment, are a key force in steering public attention toward sustainable development. Against this backdrop, in recent years, more and more economies have incorporated sustainable finance as a core strategy of their financial development policies. In order to ensure that the financial system plays its role and function of driving the society in the pursuit of sustainable development in Taiwan, the FSC adopted several measures. The Bank also continued to pay attention to international trends of sustainable finance. However, domestic financial institutions still face some challenges to their efforts of promoting sustainable finance. It is thus hoped that a vision of sustainable finance ecosystem will be achieved through close coordination and cooperation among relevant government agencies, the private sector, and international organizations.

1. The definition of sustainable finance

The research on sustainable finance is still in the early stages, so there is no universal definition or taxonomy for sustainable finance. According to the IMF,[1] sustainable finance is defined as the incorporation of environmental, social, and governance (ESG) principles into business decisions, economic development, and investment strategies. Furthermore, promoting economic and financial stability is also the objective pursued by various competent authorities to support sustainable finance.

Sustainable finance not only focuses on the environmental and climate issues related to green and climate finance but also values social finance so as to enhance social well-being. In some cases, it even extends to cover “impact finance,” which incorporates both financial aspects mentioned above.

2. The development of sustainable finance in Taiwan

2.1 The FSC implemented green finance and revised the relevant regulation

In order to enhance effective operation of the domestic green finance market and promote comprehensive development in sustainable finance, the FSC formulated the Green Finance Action Plan 1.0 in November 2017, encouraging financial institutions to provide the green energy industry with investment and financing. Furthermore, the FSC proposed the Green Finance Action Plan 2.0 (hereinafter referred to as Action Plan 2.0) in August 2020, with the range further expanded to cover sustainable finance. The short-term focus of Action

Plan 2.0 is to develop a clear definition and taxonomy for sustainable development industries, and enhance the quality and transparency of ESG disclosure in corporate financial reporting. The mid- to long-term action will be establishing an ESG data integration platform and a database for sustainable development to resolve the pending issues related to sustainable development.

Action Plan 2.0 included a total of 38 measures that cover the following eight aspects: credit, investment, capital market fundraising, professional development, information disclosure, promotion of further development of green financial products or services, prudential supervision, international connections, and incentive mechanisms. The FSC will study the international development trends, and establish the relevant regulations and guidelines based on the legal environment and the directions of industrial development in Taiwan.

2.2 Financial institutions have actively complied with international principles for sustainable finance and incorporated ESG factors into their risk management strategies

In recent years, financial institutions in Taiwan have actively complied with international trends, cooperated with the government to promote sustainable finance, and established dedicated units or teams to promote the relevant policies. Moreover, some financial institutions also have voluntarily supported or adopted internationally sustainable finance standards, such as the Equator Principles (EPs), the recommendations by the Task Force on Climate-Related Financial Disclosure (TCFD), and the Principles for Responsible Banking (PRB). In addition, some financial institutions have incorporated ESG factors into their risk management strategy so as to raise awareness of sustainable finance-related issues and strengthen governance effectiveness within the organization. As of the end of March 2021, eight domestic financial institutions[3] have adopted the EPs, while 16 domestic financial institutions have embraced the TCFD framework.

In addition, some financial institutions have worked together with academic institutions to assess the potential impacts of climate-related risks on their own financial positions, and sought to enhance their resilience to weather the climate risk and to address those impacts in a timely manner.

2.3 The Bank has increasingly taken sustainable finance into consideration for policymaking

As many central banks have incorporated green bonds in their investment portfolios recently, the Bank has also gradually included ESG financial products as part of its FX reserves investment strategy, such as ESG bonds issued by international organizations like the World Bank, the Asian Development Bank, and the European Investment Bank. Furthermore, if needed, the Bank is ready to act as the lender of last resort should financial institutions suffer significant losses from climate-related risks and face liquidity problems.

In light of the fact that the approaches to assessing climate-related risks are still in their infancy, coupled with unavailability of the relevant data, the Bank will continue to pay attention to international development trends and domestic implementation of green finance and climate risk disclosure conducted by financial institutions, and utilize the information for assessing related risks in the future.

3. Challenges facing financial institutions in promoting sustainable finance

3.1 Inconsistencies in the definitions of sustainable finance

As sustainable finance involves a wide range of issues and exhibits high complexity, relevant information seems to be under continuous development. However, some economies have developed the taxonomy for sustainable economic activities in recent years. Currently, Taiwan does not yet have uniform and clear definitions or criteria to determine whether an economic activity or asset qualifies as green or sustainable. As a result, there is a lack of reliable and consistent information and criteria as the basis for financial institutions to make judgement upon, and this is also unfavorable for the competent authority to make peer comparisons.

3.2 Quality improvement in corporate ESG disclosure

The global sustainable finance initiatives and related principles proposed by international organizations as well as the FSC’s Action Plan 2.0 tend to require or encourage financial institutions to disclose ESG-related information of their investment and financing targets and of the customers getting credit from them. However, listed companies in Taiwan have not fully disclosed the aforementioned information, which makes it difficult for financial institutions to acquire related information in full. This could create hurdles when they attempt to comply with international principles.

3.3 Hindrances to the advancement of sustainable finance within organizations

For financial institutions, the path to sustainable finance within the organization tend to involve hefty costs such as internal communication, organization restructuring, and employee training. Among them, the processes of internal communication and organization restructuring are time consuming. Moreover, cultivating expertise in sustainable finance and building professional capabilities are neither easy tasks. All of these increase the difficulty of promoting related practices within financial institutions.

3.4 Difficulties in stakeholder engagement

When promoting sustainable development in the corporate sector, on the one hand, financial institutions need to engage with their stakeholders. For example, they are expected to share experiences with enterprises on ESG issues, jointly respond to sustainable initiatives with their customers, and encourage enterprises to embark on gradual transformation towards low-carbon industries. However, on the other hand, in order to comply with ESG principles or standards, enterprises would have to change their business models, resulting in a substantial increase in operating costs. Since domestic enterprises are mainly small and medium-sized enterprises, the additional costs deriving from ESG implementation might have a great impact on their revenue. This therefore dampens the willingness of enterprises to change, increasing the difficulty for financial institutions to engage with them towards sustainable development.

4. Conclusion

In order to help domestic enterprises and the financial industry clearly understand the scope of sustainable economic activities, communicate in a common language, and avoid green washing, the FSC and the Environmental Protection Administration, Executive Yuan jointly commissioned a research project on the sustainable finance taxonomy, which is expected to be completed by the end of 2021. In addition, the FSC proposed to integrate climate and environmental information from relevant government agencies to build a database platform for sustainable development of industries. Such a platform will serve as a basis for enterprises and the financial industry to conduct risk assessments and scenario analysis.

In the future, it is expected that relevant parties will jointly discuss and learn about international development trends through close coordination and cooperation among agencies, the private sector, and international organizations so as to fine-tune their legal systems as well as the directions of industrial development in Taiwan and establish effective frameworks and foundations for promoting markets for green and sustainable finance. Furthermore, it is also expected that the role of financial institutions in the financial markets may be leveraged to raise the awareness of enterprises and investors regarding ESG issues, thereby bringing about a healthy cycle of investment and sustainable development and helping the country attain emissions reductions and sustainable development goals.

Notes: 1. IMF (2019), *Global Financial Stability Report*, October.
2. Impact finance is the financing of businesses or economic activities which could generate verifiable, direct, and positive impacts on society and/or the environment based on agreed metrics and benchmarking while also seeking market aligned or better financial returns. See ICMA (2020), "Sustainable Finance: High Level Definition," May.
3. As of the end of March 2021, 16 domestic financial institutions have adopted TCFD recommendations, including 14 life insurance companies and financial holding companies, as well as one management consulting company and one vehicle financing company.
4. Stakeholders here include employees, shareholders, investors, customers, suppliers, academics and experts, government, competent authorities, and other financial institutions.