EBF response to the EC consultation on Delegated Act Taxonomy Article 8

1 June 2021

Key points

- **Need for alignment between the CSRD and Article 8 Delegated Acton scope and application timelines (including any possible transition periods).**
- **The GAR should only cover assets for which the information is publicly available.**
- **Financial institutions' disclosure can only occur with 1 year time lag following the disclosures of financial and non-financial clients and counterparties.**
- **KPIs should be defined consistently. If certain activities are excluded from the numerator on the basis that it is not possible to assess their sustainability or irrelevance, they should also be excluded from the denominator.**
- **EBF is proposing an alternative approach that will achieve the same objectives as the proposed DA but provides for a better and fairer comparison of GAR, while providing full transparency to the market based on data availability and feasibility. While market participants will be in the position to calculate any ratio based on the full disclosure, the GAR will provide for comparable information on a more level playing field basis).**
- **Additional KPIs to be disclosed on a voluntary basis separately from GAR on taxonomy alignment of exposures to**

non-CSRD entities that are reporting on a voluntary basis will allow entities to report on the progress.

Alignment with CSRD scope and disclosure obligation of non-financial undertakings

While the CSRD text is at the beginning of its legislative process and the final text will reasonably not be adopted before mid-2022, **as a matter of principle, there should be an alignment between the CSRD and Article 8 Delegated Acton scope and application timelines (including any possible transition periods).**

Concerning the **scope**, if the legislators will exempt certain companies from the CSRD reporting requirements (because of their dimensions or their extra EU territorial nature), the **same reasoning should apply to Article 8 Delegated Act**. Financial entities should not be requested to get (and be liable of) information that the companies are legally not required to provide. Gathering information based on good will and through bilaterally contacting counterparties not covered by CSRD is operationally not a feasible solution. Also, there is no corresponding legal basis or potential incentive that would oblige or motivate entities not covered by CSRD to deliver reliable , standardized and complete information, in particular on exposures that were granted in the past.

The GAR should therefore only cover assets for which the information is publicly available. From banks' perspective, we remind that the information needs not only to be available, comparable but also standardized and assured to ensure reliability. Only the information disclosed as per the CSRD meets all these conditions. Any other arrangement could impair the overall quality of the KPI, potentially losing all the benefits in terms of comparability and transparency.

Also, the assessment of the contribution of credit institutions to the climate targets should be consistent with that of its counterparties. For non-financial undertakings the main KPIs are the share of their turnover, CAPEX and OPEX associated with taxonomy aligned activities. All these KPIs reflect the **activity of the undertaking during the last year**. In the case of credit institutions, the main KPI proposed is the GAR that also considers the stock on banks' balance sheets, which reflects the activity of the last 5 to 10 years, or even more in the case of mortgages.

The management of a credit portfolio where the stock is totally conditioned by the long-term nature of the relationship of the banks with their clients is completely different from that of investment portfolios. We understand that the objective of the point-in-time information on the stock of lending is to have a clear view of the level of alignment with the Taxonomy. **Banks' contribution to sustainability, however, mainly relies on the new origination and in its progress**. Given

this and the challenges to provide information on the existing stock, we welcome the simplification – as we understood it – to start collecting information on the stock in 2022. We would however appreciate a confirmation of this understanding in the DA (ie. reporting the 2022-23-24-25-26 flows until we have 5 reporting periods (cf art. 9(3)), and then in 2027 we publish the GAR KPI stock covering 2022 to 2026 exposures).

Also, the application date and the reporting frequency should be aligned with that of CSRD as banks' own reporting is **dependent on the annual disclosures of their counterparties**. While we appreciate the pragmatic approach of the European Commission for a simplified disclosure in the first year of application, we would like to point out that disclosures for credit institutions in subsequent years should occur with a time lag (staged approach) following the disclosures of financial and non-financial clients and counterparties that would allow sufficient time for data gathering, incorporation into internal systems, aggregation, and due diligence. As a direct consequence of this, there is a need for a **1-year time lag for banks after corporates disclose their taxonomy alignment**. It also **means 1 year after the 1st disclosures of other credit institutions**. **(consequently, a two years delay from the corporates disclosure is needed to include in the GAR the financial counterparts).**

This is the case also on an ongoing basis where disclosures for financial entities will have to be published with a time lag with respect to their counterparties' disclosures. E.g. On February of the year X+1 the company A publishes its CSRD information with reference date year-end X. Financial entities will have to gather the information from all companies, incorporate it in their internal systems, aggregate it, perform quality checks, etc which **will require a 1 year delay** from February X+1 to enable financial institutions to disclose this information.

Consistent approach to KPIs

We fully support the EBA view in its advice to the European Commission that KPIs should be defined consistently. If **certain activities are excluded from the numerator on the basis that it is not possible to assess their sustainability, they should also be excluded from the denominator.**

However, in the delegated act, exposures and investments in activities not covered by the EU Taxonomy ('non-eligible activities') or in undertakings that are not subject to an obligation to publish nonfinancial information pursuant to Article 19a and 29a of Directive 2013/34/EU should be included in the denominator of the GAR, while being excluded from the numerator. This will give an unfairly negative impact for credit institutions that have a large exposure to SME's and other borrowers that are not subject to the reporting requirements.

As stated by EBA, including SMEs in the denominator but not in the numerator would mean, de facto, that they are also included in the numerator but with a 0%

weight. This would mean that we are assuming that SEMs activities are not sustainable activities, which is inaccurate, as in reality there is no methodology or public information that allows their sustainability to be assessed.

If the information is presented this way, it will not only **be misleading but also distortive of a level playing field based on the business model of a bank.** While we agree with the proposal in the DA to exclude undertakings not in the scope of the CSRD(SMEs and non-EU exposures) from the scope of GAR, these should be excluded consistently from both numerator and from denominator**.** Otherwise, institutions financing activities outside the EU, institutions that are primarily focusing on SMEs financing and also those financing activities that are not yet covered by the Taxonomy (e.g. social activities, social housing, health, education etc) will report the most disadvantageous GAR. In addition, as new activities are assessed in the EU taxonomy, the numerator will change of scope without an equivalent change in the denominator, distorting the evolution and consistency over time.

We are concerned that the market (as well as media) will be primarily interested in GAR and its comparison amongst banks (as it is the case with Tier 1 capital) and as already shown in the media coverage of the EBA pilot sensitivity exercise that showed lack of understanding of GAR (e.g. media headlines such as long way to go from 8% to 100%).

As stated by EBA, institutions may be encouraged to improve their KPIs by purely reducing the denominator, moving their financing away from those activities. We therefore believe and support the EBA view that exposures excluded from the nominator should also be excluded from the denominator. We do not understand why this logic would only apply to some but not all exposures (only for sovereigns and central banks exposures).

This sound principle of consistency between numerator and denominator of KPIs should be applied to all financial undertakings: credit institutions, investment firms, asset managers and insurers.

EBF proposal for an alternative approach to GAR, ensuring full transparency

The GAR should be defined within a reason and in consideration of operational feasibility, limiting calculation to those balance sheet exposures for which it is possible to evaluate the taxonomy eligibility and where it makes sense also considering the objectives of GAR.

We would like to propose an **alternative approach** to the Main GAR whereby the scope of GAR:

- will be **limited to activities for which it is possible to evaluate the taxonomy alignment** (need to amend the formulas in the excel file Annex 6)
- **Will be limited to entities in the scope of the CSRD both in numerator and denominator**
- Will also include **retail exposures**, based **on energy performance certificates**

and whereby all exposures **excluded from nominator will also be excluded from the denominator**, as proposed by EBA.

To achieve the full transparency the European Commission is seeking, we would propose to additionally disclose:

1) The value of total assets
2) Value of assets not covered by GAR
    i) SMEs and NFCs (other than SMEs) not subject to NFRD/CSRD disclosure obligations
    ii) Total value of exposures to non-EU counterparties
    iii) Derivatives
    iv) Trading book
    v) On demand interbank loans
    vi) Exposures to sovereigns and central banks
    vii) Value of total exposures for which no TSCs are developed yet

In addition, **separately from GAR, we would propose and additional voluntary disclosures of the following KPI to allow entities to show progress:**

1) Taxonomy aligned exposures of non CSRD covered entities/taxonomy eligible exposures of non-CSRD covered entities
2) Taxonomy aligned exposures of non-EU counterparties/taxonomy eligible exposures of non-EU counterparties.

This will allow reporting of taxonomy alignment of exposures to non-CSRD entities that are reporting on **a voluntary basis** (ideally based on the voluntary SME simplified standard to be developed by EFRAG as mandated by the CSRD to ensure consistency of banks' voluntary disclosures and avoid multiple information requests to SME) according.

We believe this alternative approach will **achieve the same objectives but provide for a better and fairer comparison of GAR, while providing full transparency to the market based on data availability and feasibility** and would also continue to promote lending to SME's .While market participants will be in the position to calculate any ratio based on the full disclosure, the GAR will provide for comparable information on a more level playing field basis.)

Additional KPIs

Also, we believe disclosures of the proposed **KPIs on fees and trading books should be removed**, even if only restricted to CSRD counterparts. We do not see how these indicators could be relevant for market participants as they do not measure the re-allocation of funds to green activities. They also do not represent a significant portion on banks' activities while disclosing them would require a high degree of complexity that is not justified. **The relevance of their disclosure should be re-examined similarly to the treatment of sovereign exposures**.

On top, the threshold in the DA is related to the whole trading book (article 94(1) CRR and Article 325a(1)), while we believe it should be based on the part of the trading book that relates to sectors covered by the Taxonomy or specifically excluded from the Taxonomy (e.g. fossil fuels). Finally, concerning the trading book, it is stipulated that credit institutions shall explain potential limits in terms of climate and environmental risks and how they manage the environmental risks that may impact the value of the portfolio. We do not see a reason for including risk disclosures among these requirements as Taxonomy regulation is not a risk regulation.

Regarding the Fees and Commission KPI, the only fees that make sense in order to appraise the re-allocation of funds to Taxonomy aligned activities are those generated by the structuration and placement of Taxonomy aligned financial products such as the Green Bond Standard emissions. All the other type of fees are not related to the re-allocation of funds to green activities.

Grandfathering of use of proceeds loans

To provide legal certainty, **there should be no change of classification of the outstanding amount of exposur**e that is considered taxonomy aligned at inception when the TSC is changing, the and

On the other hand, in order to incentivize customers to transition without delaying financing at the time when required, it should be allowed to re-classify a previously granted loan as taxonomy aligned when the taxonomy alignment is proven. However, in both cases it is important to find a right mechanism to ensure a transparent portray of the GAR and avoid a lock-in effect in case of grandfathering, while ensuring the needed legal certainty as it is not possible to change loan conditions after contracts have been signed.

Exclusion of GAR from Pillar 3

Finally, given that the GAR will be subject to a Delegated Act on Article 8 of the Taxonomy Regulation, as well as the focus of Pilar 3 on risk measures**, we believe that the Article 8 reporting requirements should not be included in the Pillar 3 scope**. We do not consider the taxonomy aligned KPIs suitable for ESG Risk purposes, as they do not embed any risk-based classification.

In order to avoid any ambiguity for the use of GAR (and the accompanying and additional KPIs) by the market, it should be disclosed in the Universal Reference Document, and only under Article 8 of the Taxonomy Regulation.

Request for clarification

The excel template accompanying the delegated act requires instructions for completion. Many of the terms chosen do not have clear definitions in the FINREP reporting system (e.g. "local government"). Concerning definitions however, it is important that Art. 8 should not in itself define certain terms which are or could be defined in other legislation. Where such terminology is defined in other legislation, these definitions should be incorporated by reference.

In general, we believe the **final delegated act would benefit from further clarification and more guidance** including on how to determine taxonomy alignment. In this regard, please note that together with UNEP FI, we are working on a joint project to provide banks with further guidance on application of the EU taxonomy to core banking products. A close cooperation and common understanding with legislators is necessary to provide clarity and certainty for the industry.

We would like to highlight some areas of the DA where further clarification is needed.

Definitions & clarification

- The DA refers to "**specialised lending**". It is not clear how should specialised lending (use of proceeds known) be defined. In the instruction to the template, specialised lending is described as "Specialised lending as defined in paragraph 89 of Part 2 of Annex V to Commission Implementing Regulation (EU) No 680/2014.", which we understand is the ultimate reference to art 147(8) CRR. In the Taxonomy and in the consultation on the implementing standards for pillar 3 reference is however done to "special purpose lending exposures where the use of proceeds is known" where specialised lending is an example. Does the instruction to the template mean that the reporting does not include the whole scope of special purpose lending exposures, but solely specialised lending? As art 147(8) CRR is limited to exposure to corporates, does this mean that the column on specialised lending is not relevant for the reporting on households? If the meaning is broader than specialised lending, it needs to be clarified including what is meant with special purpose lending exposures, for

example is there a need for a monitoring process for such exposure? To ensure correct reporting, this would need to be clarified.

- We understand that special purpose lending exposures can be accounted for 100% of their gross carrying amount when they meet the taxonomy criteria, instead of the share of the company turnover derived from products and services associated with economic activities that qualify as environmentally sustainable under EU Taxonomy.

- What kind of evidence is needed when banks are reporting use of proceeds assets as aligned with the EU taxonomy?

- How should on**-demand interbank loans** be defined? Should the FINREP definitions apply to for example loans and advances and debt instruments

- **Taxonomy-non-eligible economic activity'** is defined as an economic activity that is not described in the delegated acts adopted pursuant to Articles 10, paragraph 3, 11, paragraph 3, 12, paragraph 2, 13, paragraph 2, 14, paragraph 2 and 15, paragraph 2, of Regulation (EU) 2020/852;". As some assets are excluded from the nominator, and therefore non-eligible, by this delegated act, this definition should be amended to reflect this.

- Article 8 in the DA refers to Bonds under EU legislation. Could the reference to the EU Green Bond Standard be made clearer?

- How to differentiate counterparties on their NFRD-compliance in FINREP.There is no easy way for differentiation in FINREP.

- Concerning the requirement to disclose **forward-looking information** based on scenario analysis and their business strategies, and information on short, medium and long-term targets as a complementary information to GAR, we would appreciate clarification as to whether these are related to taxonomy and why such information is only considered for credit institutions within the scope of this DA. Basing these on scenario analysis may be premature given the maturity of the methodologies and not be appropriate in the context of the delegated act

Consolidation

- More clarity would be appreciated on how to report if a bank is a licensed credit institution, that additionally holds a MiFID license at the same level. Would that bank than only disclose as a credit institution, or also as an

investment firm? This is not yet clear from the draft DA text. This differs from the scoping scenario where a credit institution as parent of the group, with several subsidiaries (some of which would qualify as e.g. asset managers, investment firms, insurance undertaking) where it islinked to the prudential consolidation approach. We would appreciate if EC could clarify both scenarios.

- We propose that, following the DA requirements, banks will disclose on a mandatory basis both the Main GAR on the Banking Book and the Off balance sheet KPIS. The AUM KPI will reflect the Asset Management and Insurance activities. We believe banks should not be required on a mandatory basis to calculate and disclose an aggregated weighted average ratio to include these different activities (based on different nature KPIs), which will add additional complexity to already complex requirements. Investors should be able to choose the main KPI of the main business for a consolidated group.

- Where companies include non-financial information in a combined Annual and Sustainability Report, the inclusion of the information according to this Regulation could create confusion and challenge for clear reporting due to that this reporting is based on the prudential consolidation and according to these specified allocations (FINREP). The scope of consolidation will be different from other financial information according to i.e. the accounting standards, which may be difficult to clearly explain and reconcile for a reader. What is the reason for using FINREP as a basis for information to be included (often) in the Annual Report?

Public financing

- What is the threshold for when a credit institution is to be deemed to have a business model based to a great extent on financing public housing? Is it correctly understood that credit institutions not meeting such threshold does not need to report on this KPI?

- Art. 8 (1) DA excludes exposures to central governments (and central banks) from the numerator and denominator of the KPIs. Exposures to regional governments and local authorities are not explicitly mentioned in art. 8. Are these exposures covered by art. 8 (3), meaning that these exposures should be excluded from the numerator (but not denominator) of the KPIs? This would lead to a disproportionally low GAR ratio for banks with exposures to local authorities and regional governments.

- Also, Section 1.2.1.5 of Annex V seems to assume that financing public housing runs through municipalities but this is not the case in all MS - public

banks may be financing public housing authorities directly. Consequently, this KPI cannot be disclosed as a portion of loans to municipalities.

Retail exposures

- According to Art 11 (4) of the draft DA *"Credit institutions shall disclose from 1 June 2024 the elements of key performance indicators concerning retail exposures related to immovable property for stock in accordance with Article 4".* Could you please clarify why only immovable property shall have a different treatment between stock and flow and not car loans? Regardingretail exposure, could it be considered that for immovable property the EPC certificate will be sufficient? Would European Commission consider providing conversion tables for EPC and also for car loans (technology-based certificates?).

- Are the DNSH requirements for retail exposure and to real estate loans to SMEs to apply? As EBA highlighted in its suggestion, it is difficult for banks to assess the compliance of loans granted for house purchases with the 'do no significant harm' (DNSH) criteria and proposed therefore not to consider the DNSH criteria for retail and SME exposure. To ensure the possibility to report on these assets, we suggest that EBA's approach is applied.

Other

- What is the reason for having a separate column for adaptation activities (i.e. not enabling), while not having a separate column for mitigating activities (i.e. not transitional nor enabling)?

About EBF

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