

#### **About this project**

This report is generated based on discussions and input of banks participating in the joint EBF-UNEP FI project on the application of the EU Taxonomy to banks' lending products. The content of this report is neither binding, nor can be considered as legal interpretation of the EU law.

#### **About UNEP FI**

United Nations Environment Programme—Finance Initiative (UNEP FI) is a partnership between the UN and the global financial sector created in the wake of the 1992 Earth Summit with a mission to promote sustainable finance. UNEP FI works with more than 450 members banks and insurers, and over 100 supporting institutions to help create a financial sector that serves people and planet while delivering positive impacts.

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The European Banking Federation (EBF) is the voice of the European banking sector, bringing together national banking associations from across Europe, with active members in 32 countries. The EBF is committed to both promoting a thriving European economy underpinned by a stable, secure and inclusive financial ecosystem, and contributing to a prosperous society in which financing is available to fund the dreams of citizens, businesses and innovators across the globe.

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# Foreword UNEP FI and EBF

The global financial sector has the potential to support the transition to a sustainable economy by linking financing needs to global sources of funding. Scaling up sustainable finance worldwide is a challenging task, for which coherent definitions of sustainability across jurisdictions and a higher degree of standardisation and transparency on data are necessary.

Europe is one of the most advanced jurisdictions in this area, with both regulators and financial institutions demonstrating an unparalleled level of ambition on sustainability and showcasing credible commitments and consistent rules to reach the global goals. The EU needs to keep the level of its ambition, without losing sight of the global developments should it wish to become a beacon for international action, paving the way for other jurisdictions to follow suite.

The EU regulators are continuing their efforts to employ the EU Taxonomy that is further growing, both in its scope and ambition. A true backbone of a transformative agenda, it allows for consistent definitions of what can be considered an environmentally sustainable economic activity, underpinning disclosure requirements of economic actors, corporates and financiers alike, to improve the availability and comparability of ESG data.

Banks, as the main financiers of the European economy, are also coming forth, both individually and collectively, to harness their capabilities. We have recently seen the launch of the industry-led and UN-convened Net-Zero Banking Alliance, now representing banks with over 40% of global banking assets, the majority being European. Banks within the alliance are committed to aligning their lending and investment portfolios with net-zero emissions goal by 2050. They are also setting intermediary targets for priority sectors where they can have the most significant impact in a transparent and publicly accountable way.

Progress can be further advanced through joint efforts, exploring synergies between public and private sectors at the regional and the global level. This report is a very clear reflection of such synergies. Convened by UNEP FI and EBF, it is the result of extensive exchanges with and between 24 major banks, 12 banking associations and six observ-

ing organisations, with the inestimable aid of our colleagues at EY. We are extremely grateful for being able to work with banks that, during a busy period, amid regulatory overhaul and implementation efforts, were able to engage in this project and provide not only practical insight but also contribute to exploratory discussions on the use of the EU Taxonomy in a forward-looking manner, to advance the initial thinking within the banking sector and beyond.

In addition to the application of the EU Taxonomy in the EU regulatory context, this report explores the potential of the EU Taxonomy to facilitate the engagement between banks and their customers in the evolving business and regulatory environment. It is indeed important that banks finance all activities capable of accelerating companies' transition. Financial solutions based on companies' transition plans could, in the future gain on importance and, in a complementary manner to the financing of the EU Taxonomy aligned activities, substantially contribute to achieving the global objectives of net zero.

With this second iteration of our cooperation, we are exploring options for banks that wish to use the EU Taxonomy as an engagement tool and not only for reporting purposes. This is a learning process for all, and, as we have been doing for the past years, we remain fully committed to further supporting banks on their sustainability journey.



Eric Usher Head UNEP FI



Wim Mijs CEO EBF



# **Foreword**

The EU Taxonomy is a first-of-its-kind classification scheme that creates a common understanding of how economic activities can qualify as environmentally sustainable. It has been designed to bring clarity to investors and businesses by presenting reliable, coherent, and comparable sustainability-related indicators for several economic activities. In doing so, it plays a key role in delivering the EU's environmental ambitions to build a resilient European economy.

In the Phase I report, this study shared key insights from the first set of comprehensive case studies on the application of the EU Taxonomy to core banking products (retail banking, SME lending, and corporate banking). 26 banks tested the EU Taxonomy through more than 40 engagements and existing client relationships. The report presented recommendations to legislators, regulators, developers of environmental and social standards and frameworks, labels and certification schemes used by banks, and banks themselves.

Over the past few months, Phase II brought together 24 banks from all over Europe and beyond to understand the demands of the EU Taxonomy and how it can be realised to meet disclosure and transparency requirements and shape their internal sustainability frameworks. The benefits, challenges, and impacts of the regulation were explored through workshops, focus groups, and case studies to develop this comprehensive guide. For the participating banks, adapting to the EU Taxonomy is a welcome challenge, one that increases the accountability and efficiency of their sustainable lending practices.

The aim of this report is to increase the understanding of the EU Taxonomy, its requirements and its application for disclosure requirements which covers both mandatory and voluntary aspects. It is a guidance notice from banks, to banks on how they can navigate the regulatory landscape—It is not an EY opinion. The EBF and UNEP FI took over the role of the Secretariat, bringing together stakeholders and defining the focus areas of this study. The EY team supported the development of this paper by facilitating workshops, providing industry insights, and delivering the report. Our special thanks go to Ms Bhavya Balakrishnan for her exceptional dedication and commitment to this project.

The transformative power of finance underpins the role of financial institutions. Over the next few years, the European economy will adapt to these new reporting requirements, compelling businesses and financial market participants to show the extent to which their activities and investments are supporting the green transition. We are in the nascent stages of this exercise and the coming years will be crucial for all parties involved—Investors industries, banks, governments, regulators—to align the European economy with the EU's vision of building a sustainable future.



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# **Executive summary**

Banks play an important role in supporting the EU objectives of carbon neutrality and the European Green Deal. Their financing activities continue to represent most of the external funding for European corporates and SMEs. To support their clients in the climate transition. banks offer sustainable financial products including green and social loans, bonds, sustainability-linked loans and other types of ESG improvement loans. In the long run, they also engage with corporate clients on their sustainability journey and facilitate capital structures to support green transition plans.

To reorient capital flows towards sustainable economic activities, it was first necessary to have a common understanding of what activities can be considered environmentally sustainable. The **EU Taxonomy**, a classification scheme provided under the Climate Delegated Act for Climate Change Mitigation and Adaptation, was designed for this purpose and has since become a cornerstone of the EU Sustainable Finance agenda.

Tackling the "greenwashing" risk, the EU Taxonomy provides a clear, science-based classification of economic activities. Through the provisions of Article 8 of the EU Taxonomy Regulation—complemented by the Article 8 Disclosures Delegated Act—banks are expected to report the extent to which their balance sheets support economic activities that contribute substantially to achieving the EU net-zero target in 2050.

Moreover, the bulk of the data that banks need to meet these reporting obligations will be provided through the EU Taxonomy disclosures of their clients, as specified under the on Article 8 Disclosures Delegated Act.

This report was prepared based on discussions with participating banks as part of the second phase of the joint project of EBF and UNEP FI.<sup>1</sup>

**Section A** of the report covers the regulatory application of the EU Taxonomy. It focuses on disclosure requirements under the EU Taxonomy Disclosure Delegated Act. It looks at practical aspects of reporting for banks, such as the use of NACE, reporting on general- purpose lending, and possible processes for implementation of the regulation. It also aims to facilitate the understanding of the Green Asset Ratio for external stakeholders.

Further sections look at possible non-regulatory applications of the EU Taxonomy.

For the outcome of Phase I please refer to <u>Testing-the-application-of-the-EU-Taxonomy-to-core-banking-products-EBF-UNEPFI-report-January-2021.pdf</u>

**Section B** explores how the EU Taxonomy could be further used to gather EU Taxonomy compatible information for banks clients who do not yet have an obligation to disclose under the Article 8 of the EU Taxonomy Regulation. These are SMEs and non-EU companies, often referred to as non-NFRD companies.<sup>2</sup> At the time of finalisation of this report there was no mandatory obligation for banks to report the Taxonomy alignment of their exposures to non-NFRD companies, although EBA is proposing mandatory KPIs on such exposures in their final draft ITS on Pillar 3 ESG disclosures, that are still subject of adoption process of the European Commission. This chapter also addresses compliance with minimum safeguards of the EU Taxonomy regulation and simple tools such as a questionnaire that could be used to gather EU Taxonomy-aligned data as a starting point.

**Section C** discusses in an exploratory way, how the EU Taxonomy could be used by banks that wish to engage with clients whose economic activities are eligible for analysis under the EU Taxonomy but are not yet aligned with the listed Technical Screening Criteria. Such an application of the EU Taxonomy for client engagement (E.g. using the Technical Screen Criteria to set targets) is still at an early stage. This section provides the participating banks' initial thoughts on the matter and outlines a simple transition engagement tool—a step-by-step approach for banks that wish to evaluate the degree of misalignment of their clients 'activities with the EU Taxonomy, to choose the appropriate engagement strategy. It further explores other possible financing solutions based on the transition plans of companies. Finally, this section looks at possibilities of mapping exposures to the EU Taxonomy based on NACE-sub activities and products codes of companies to actively steer the financing of sustainable activities.

The aim of this report is to present a comprehensive and practical approach to the EU Taxonomy, to support banks in their regulatory implementation journey and their client engagement efforts. We also hope this report may provide helpful insights and inputs to regulators and legislators as they further develop the sustainable finance framework.

<sup>2</sup> NFRD refers to the Non-Financial Reporting Disclosure Directive

# **CEO** quotes

#### Ana Botin

Executive Chairman

Banco Santander

President

EBF

"The biggest challenge societies face is the transition to a low carbon economy, while ensuring we have green, sustainable growth. The financial sector has an important role to play. Europe is leading the way, and the EU Taxonomy sets the criteria for meeting the climate targets for 2030 and 2050. At Santander, we are proud to contribute to this joint EBF—UNEP FI project on the taxonomy's application to core banking products. We want to ensure the taxonomy can be used by our customers in their transition, and that it is applied coherently and proportionally so we all abide by the same criteria. This is just a start. More collaboration and coordinated action is essential if we are to accelerate our progress, and seize the opportunities that the green transition offers."

#### Carlos Torres Vila Chair BRVA

"This report is a great resource for banks to further promote sustainability. Converging global standards and definitions are a prerequisite to develop the high quality and comparable information that markets need to operate effectively. This work should not be limited to purely sustainable activities but must also cover transition initiatives, as those will undoubtedly play a key role in our path to zero emissions."

# **Christian Sewing** CEO

Deutsche Bank

"Banks should play a crucial role in accelerating the necessary global transition to sustainable, low-carbon and socially inclusive economies. Our aspiration at Deutsche Bank is to support our clients in their transition. But we also need other stakeholders—and especially the European Union—to pave the way and establish common standards. The EU taxonomy is a welcome step forward, many challenges still remain. We are committed to support standard setting in the EU and globally."

#### Steven van Rijswijk CEO

ING

"Banks have a key role in financing the real economy, and as the economy transitions to a low carbon future, we are committed to financing that transition and to being a positive force in the fight against climate change. Our commitment to achieve net-zero greenhouse gas emissions by 2050 or sooner will be integrated in our Terra approach, meaning we'll steer our loan book towards limiting the rise in global temperatures to a maximum of 1.5 degrees Celsius. We are committed to helping our clients with advice and financing to facilitate their transition to a net-zero world. Steering sustainable finance should be a planned, well-organised and cost-efficient process, supported by detailed data on the sustainable activities, products and services of companies and their supply chains. The EU Taxonomy guides us in our daily efforts to help our clients transition to a net-zero world."

# Johan Torgeby President and CEO SEB

"It is of great importance that the common denominators developed in the EU Taxonomy support the financing of the sustainable transition, without diminishing the positive aspects which a healthy competitive European banking land-scape present. To fulfil the Paris Agreement, we need rules of engagement that are applicable throughout the union, as well as regulations which support free capital movements and a robust competitive environment. As banks continue to play a key role in the transition, SEB is a proud sponsor of the joint UNEP FI and EBF project, aiming to clarify expectations and explanations of the methodology for core banking products."

#### Dr. Johann Strobl CEO Raiffeisen Bank

"More than 30 years ago, RBI played a key role in supporting the transformation in CEE from planned to market economies. Now we want to take a leading role in the transformation of our markets to sustainable economic models. In order to achieve a transition towards the climate goals, it is crucial that banks and their customers speak a common language when talking about green activities. The EBF and UNEP FI initiative makes an important contribution by further developing this common language, the EU Taxonomy Regulation."

# Laurent Mignon CEO Groupe BPCE

"Having taken part in the work aimed at improving application of the European taxonomy, Groupe BPCE fully supports the introduction of this common language vital to achieving a shared reading of the principles used to assess sustainable and transition activities. This is an important stage for the European Union as regards the attainment of carbon neutrality targets by 2050 and for the European financial industry in its action to fight climate change. For the banking industry, the taxonomy represents a tool for supporting businesses in their transformation, this being the main issue for a successful transition to a low-carbon economy and a process to which Groupe BPCE is steadfastly committed. But we must go even further, by better recognising the efforts made by companies, particularly those with high-emission activities, and by having access to a common, pragmatic and reliable methodology for evaluating transition plans and thereby redirecting capital flows toward transition."

#### Christos Megalou CEO Piraeus Group

"The EU Taxonomy will guide the banks in identifying and financing those activities that are environmentally sustainable and can contribute to the transition to a low carbon economy. Piraeus Group has a long track of supporting sustainable development. Over the coming years, the EU Taxonomy will inform our business decisions and enhance the way we engage with our clients as we embark on our common net-zero journey."

#### Gonzalo Gortázar Rotaeche CEO CaixaBank

"Every time that we make a financing or investment decision that factors in environmental and climate aspects, we know that we are contributing to an overall common goal: generating a greater positive impact on the planet and, ultimately, on society and the people. This taxonomy is the most relevant legal initiative for establishing a common language in the environmental sphere of sustainability. It will help us meet our sustainable financing and net-zero strategic objectives and commitments, which we will publish in coming months, since they have been defined in our new Sustainability Master Plan and in our next Strategic Plan."

# **Abbreviations**

**CapEx** Capital Expenditure

CPA Statistical Classification of Products by ActivityCSRD Corporate Sustainability Reporting Directive

**DA** Delegated Act

DNSH Do No Significant HarmEBA European Banking AuthorityEBF European Banking Federation

**EFRAG** European Financial Reporting Advisory Group

**EPC** Energy performance certificate

**ESG** Environmental, Social and Governance

GAR Green Asset RatioGHG Greenhouse gas

ITS Implementing Technical Standards

KPI Key Performance IndicatorMS Minimum Safeguards

**NACE** Nomenclature statistique des activités économiques dans la Commu-

nauté européenne., or Statistical classification of economic activities in

the European Community

**NFRD** Non-Financial Reporting Directive

**OECD** Organisation for Economic Co-operation and Development

**OpEx** Operational Expenditures

PRB Principles of Responsible Banking
RTS Regulatory Technical Standards

**SC** Substantially Contribute

**SEEA** System of Environmental Economic Accounting

**SLL** Sustainability-linked Loan

SME Small and medium enterprisesTSC Technical Screening Criteria

UNEP FI United Nations Environment Programme Finance InitiativeUNGPs UN Guiding Principles on Business and Human Rights

Section A:
Mandatory application
of the EU Taxonomy
to bank lending (loans
and advances)

### A.1 Background

#### A.1.1 Context

The EU Taxonomy Regulation (2020/852) is one of the three core legislative proposals on sustainable finance released following the EU's Action Plan on Financing Sustainable Growth.<sup>3</sup>

As identified in Recital 6 of the EU Taxonomy Regulation, to successfully reorient capital flows toward sustainable investment practices and achieve sustainable and inclusive growth, it was crucial to create a unified classification system for sustainable activities.

A shared and holistic understanding of "environmentally sustainable economic activities" was and continues to be an important prerequisite to reorient these flows, as well as to create new projects with truly sustainable criteria. As <u>stated</u> by Executive Vice-President Dombrovskis at the press conference on the New Sustainable Finance Strategy and a European Green Bond Standard, Europe will need an estimated €350 billion in additional investment each year over this decade to meet its 2030 emissions reduction target in energy systems alone, alongside the €130 billion it will need for other environmental goals.

This is a long-term plan that requires a phased approach to help industries in Europe meet the goal of becoming climate neutral by 2050, a commitment made by EU Member States and put into action through the European Climate Law.

The aim of the EU Taxonomy is to become a significant tool to direct capital so that these goals can be achieved. The EU Taxonomy has since become one of the most significant components of the regulatory agenda on sustainable finance:

- In the first instance, the Taxonomy Regulation, especially through the provisions of Article 8, is expected to deliver standardised **reporting** on the impact of economic activities on the pre-set environmental objectives, as well as on the lending activities of financial institutions.
- In the second instance, and as explored further in Section C of this report, it could serve as a tool for the planning and reporting of **transition pathways** for the real economy, assisting in setting performance targets against which a company's activities can be benchmarked.

Additionally, through its provisions linked to Minimum Safeguards (MS), the EU Taxonomy can also contribute to one of the key principles of the Paris Agreement—to respect internationally recognised human rights laws in the effort to address climate issues. In doing so, it becomes a "net-positive impact" and "just transition" tool.

The EU Action Plan has since been updated under the renewed <u>Strategy for financing the transition to a sustainable economy,</u> which was released in July 2021. It also took into consideration the <u>transition finance report</u> from the <u>Platform on Sustainable Finance</u> and a <u>consultation</u> held from April to July 2020.

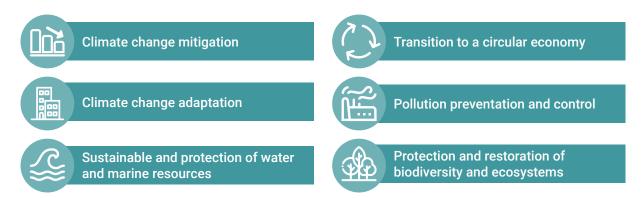
#### 21 April 2021 **July 2018** 6 July 2021 1 January 2024 The European Commission Disclosure of KPIs including any Proposal for the Corporate Publication of the final Article 8 establishes a Technical Sustainability Reporting **Delegated Act** accompanying information; Directive (CSRD) which Expert Group (TEG) on KPIs of non-financial sustainable finance increases the scope of companies become fully companies subject to Article 8 available in 2023 19 June 2019 22 June 2020 7 May 2021 Disclosure requirements for financial institutions from 1 January 2022 until 31 December 2023 (for reporting periods 2021 and 2022) Publication The TEG releases an initial Publication guidance on the use of the of final of Draft Proportion of exposures to Taxonomy non-eligible and Taxonomyeligible economic activities in total assets Taxonomy and proposes TSC for sumstantial contribution Act on Article regulation Proportion of exposures to central governments, central banks, and to CCM for 67 activities, and a 8 Taxonomy supranational issuers, as well as derivates in total assets conceptual approach for CCA Proportion of exposures to undertakings not obliged to publish non-financial information Oualitative information as mentioned In Annex XI Credit institutions shall also disclose the share of their trading portfolio and on demand inter-bank loans in their total assets.

#### A.1.2 The EU Taxonomy Regulation

The EU Taxonomy Regulation sets three broad requirements for an activity to be considered environmentally sustainable. This has been defined by the regulatory text as well as the secondary legislation (Delegated Acts), the latter of which define the more technical parameters:

# The economic activity must **Substantially Contribute** to at least one of the six environmental objectives as defined in Article 9 of the EU Taxonomy Regulation

The EU Taxonomy Regulation sets out certain standards and metrics for various economic activities so that they can qualify as substantially contributing to each of the six environmental objectives:



The Technical Screening Criteria (TSC) for the first two objectives (climate change mitigation and climate change adaptation) are defined in the **Climate Delegated Act** (21 April 2021). The TSC for the other four objectives are still under development and are set to be published in the coming years under the **Environmental Delegated Act**. The focus of this project is on the currently existing EU Taxonomy regulation, thus focusing on climate change mitigation and climate change adaptation.

Activities that Substantially Contribute (SC)—meaning that they comply with the TSC—are classified as follows:

- Own performance: Activities that in and of themselves contribute substantially to one of the six environmental objectives
- **Transitional:** Activities where there are no technologically and economically feasible low-carbon alternatives, but that support the transition to a climate-neutral economy (this is only applicable when the SC is toward climate change mitigation)
- **Enabling:** Activities that enable other activities to make a SC to one or more of the objectives and where the other activity:
  - Does not lead to a lock-in in assets undermining long-term environmental objectives, considering the economic lifetime of those assets
  - Has a substantial positive environmental impact on the basis of life cycle considerations.

# An economic activity must **Do No Significant Harm (DNSH)** to each of the other five environmental objectives

The criteria for determining whether significant harm is being caused are referred to as the DNSH criteria. The DNSH criteria for the first two environmental objectives are also included in the Climate Delegated Act adopted in April 2021.

The DNSH criteria can take different shapes, sometimes directly referencing the kind of measures that should be put in place to avoid harm being done to the specific sectors. This is done with thresholds, metrics, or measurements.

If no specific DNSH criteria are set for a specific activity, generic criteria per objective are available in the appendices of the Climate Delegated Act. For example, regarding climate change mitigation, Criteria 7.7 on acquisition and ownership of buildings only refers to the generic DNSH criteria for climate change adaptation and does not list DNSH considerations for the environmental objectives 3 to 6.

There are different appendices providing these generic criteria for DNSH considerations per environmental objective in the text of the Climate Delegated Act.

#### An economic activity must comply with the Minimum Safeguards

Article 18 of the EU Taxonomy Regulation stipulates that, to comply with the MS, procedures shall be implemented by an undertaking carrying out an economic activity to ensure the alignment with the **OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights**, including the ILO Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights.<sup>4</sup>

#### **Alignment with the TSC**

As briefly introduced above, the Climate Delegated Act that complements the EU Taxonomy Regulation defines the TSC to identify the most relevant potential contributions to the given environmental objective (Substantial Contribution).

Currently, the sectors covered by the EU Taxonomy are:

- Arts, entertainment and recreation
- Construction and real estate activities
- Education
- Energy
- Environmental protection and restoration activities
- Financial and insurance activities
- Forestry
- Human health and social work activities
- Information and communication

Importantly, Recital 35 of the EU Taxonomy Regulation confirms that "Several of those international standards are enshrined the Charter of Fundamental Rights of the European Union, in particular the prohibition of slavery and forced labour and the principle of non-discrimination. Those minimum safeguards are without prejudice to the application of more stringent requirements related to the environment, health, safety and social sustainability set out in Union law, where applicable."

- Manufacturing
- Professional, scientific and technical activities
- Transport
- Water supply, sewerage, waste management and remediation

These sectors are where **Taxonomy-eligible activities can be found**, i.e., when TSC for the assessment exist for these activities.

Article 1(5) of the Article 8Disclosures Delegated Act defines Taxonomy-eligible activities as the economic activities that are described in the Climate Delegate Act (covering Articles 10(3), 11(3), 12(2), 13(2), 14(2) and 15(2) of the EU Taxonomy Regulation), whether or not they fulfil the criteria. Activities not covered in the current Article 8 Disclosures Delegated Act or under the Taxonomy are called **Taxonomy non-eligible**—although, as explained above, they are not necessarily harmful activities. Only power generation activities from solid fossil fuels have been explicitly excluded from the EU Taxonomy. Upcoming editions to the Article 8 Disclosures Delegated Act could cover new sectors, thus making them eligible.

As per the Climate Delegated Act wording, TSC are used both for:

- Assessing SC to one of the six environmental objectives
- Assessing DNSH to the other five environmental objectives

# A.1.3 Article 8 Disclosures Delegated Act: content, presentation and methodology for disclosures

# Regarding the participants to whom the EU Taxonomy Regulation applies, it mandates three user obligations:

- 1. Financial market participants offering financial products in the EU, including occupational pension providers (Article 5 to Article 7 of the EU Taxonomy)
  - How and to what extent the EU Taxonomy was used in determining the sustainability of the underlying investments
  - To what environmental objective(s) the investments contribute
  - The proportion of underlying investments that are Taxonomy-aligned, as a percentage of the investment, fund or portfolio
- 2. Large companies required to provide a non-financial statement under the Non-Financial Reporting Directive (NFRD), covering financial (including banks) and non-financial corporations (Article 8 of the EU Taxonomy Regulation)
  - The proportion of turnover aligned with the EU Taxonomy
  - Capital Expenditures (CapEx) and Operational Expenditures (OpEx) aligned with the EU Taxonomy
  - Other KPIs for financial institutions, including specific KPIs for credit institutions (banks)—defined in the Article 8 Disclosures Delegated Act published on 6 July 2021.

This user obligation is the focus of this report.

3. The European Union and EU Member States (Article 4 of the EU Taxonomy Regulation)

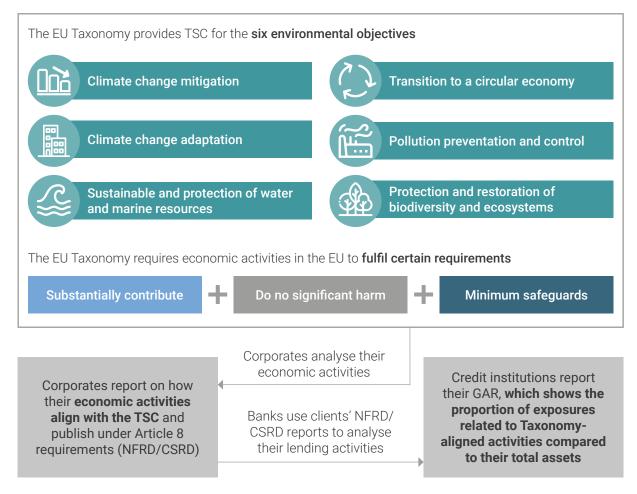
When setting out measures, standards, or labels for green financial products or green (corporate) bonds.

To supplement Article 8 of the EU Taxonomy Regulation, the European Commission released the Delegated Regulation (Article 8 Disclosures Delegated Act) on 6 July 2021 on the disclosures expected from **financial** and **non-financial undertakings**, which included KPIs and reporting templates that financial and non-financial institutions should use to disclose how sustainable their activities really are. These specifically apply to companies that fall under the **NFRD**, which must disclose additional information with respect to the EU Taxonomy.

- Non-financial institutions: to fulfil these disclosure requirements, non-financial institutions have to publish three KPIs—(1) Turnover, (2) CapEx and (3) OpEx—related to environmentally sustainable activities that align with the standards outlined in the Climate Delegated Act. The disclosure template for non-financial undertakings is available here (see Annex II).
- Credit institutions: The main KPI for banks is the Green Asset Ratio (GAR)—which shows the proportion of exposures related to Taxonomy-aligned activities compared

with the total covered assets of those banks.<sup>5</sup> The comprehensive list of KPIs for banks has been specified in Annex V of the Article 8 Disclosures Delegated Act. It is important to note, as per Point 1.1.1 of Annex V of the Article 8 Disclosures Delegated Act: "Credit institutions shall disclose relevant KPIs on the basis of the scope of their prudential consolidation determined in accordance with Regulation (EU) No 575/2013, Title II, Chapter 2, Section 2." The regulation also lists other KPIs for banks, but the GAR (main KPI) is the focus for this section of the paper. The disclosure templates for banks are available in Annex VI of Article 8 Disclosures Delegated Act here.

• For banks, the benefits of having their clients' Article 8 disclosures are two-fold: (a) it helps them understand their client's degree of EU Taxonomy alignment; and (b) it helps them fulfil their obligations under Article 8.6 Based on the above, the flow of the EU Taxonomy disclosure process (as relevant to banks) is depicted below:



It is important to note that the Corporate Sustainability Reporting Directive (CSRD)<sup>7</sup> is set to replace the NFRD from 2023. The draft proposal, which is yet to be adopted by co-legislators and could therefore still be subject to amendments, calls for an extension of the scope to all large companies, as well as to listed SMEs (small and medium enterprises)—the latter following a three-year lead-in period. This would effectively broaden

<sup>5</sup> P. 5, Article 8 Disclosure Delegated Act.

<sup>6</sup> Banks have to disclose their KPIs based on how well their clients perform against the TSC.

As announced by the European Commission in April 2021. Available here.

the scope from corporates above 500 employees to corporates above 250 employees and listed SMEs.<sup>8</sup> The CSRD also suggests that the reports will be subject to limited assurance. It is expected to be adopted by the end of 2022.

While the final scope of the CSRD proposal is not known at the time of writing this report, it is important to note that the final scope of the undertakings subject to reporting under Article 8 of the Taxonomy Regulation will adjust automatically to the changes brought by the CSRD.9 It is worth mentioning that the European Commission has proposed that the CSRD should come into force from January 2023 (January 2026 for provisions applicable for SMEs). However, the final application date is yet to be known.

# A.2 Article 8 Disclosures Delegated Act—EU Taxonomy disclosure expectations by year

#### A.2.1 Overall Expectations

Under Article 8 Disclosures Delegated Act, banks are bound to report their **GAR**. Article 8 is structured in different batches of reporting for different institutions as per the timeline below. For this analysis, the focus is on **loans and advances**.

#### Reporting period

Please see below a table clarifying the reporting expectations by year of non-financial corporations and Credit Institutions.

Entity/year	2022 (for previous calendar year data)	2023 (for previous calendar year data)	2024 (for previous calendar year data)	2025 (for previous calendar year data)
Non-financial corporations (CSRD)	Taxonomy-eligible data	Taxonomy-eligi- ble and taxono- my-aligned data	Taxonomy-eligi- ble and taxono- my-aligned data	Taxonomy-eligi- ble and taxono- my-aligned data
Credit institutionsTaxonomy-eligible dataTaxon data		Taxonomy-eligible data	Taxonomy-eligi- ble and taxono- my-aligned data	Taxonomy-eligi- ble and taxono- my-aligned data*

<sup>\*</sup> Financial companies may include exposures or investments to non-NFRD undertakings in the numerator of their KPIs, including with DNSH estimates for third-country exposures or investments subject to the 2024 review period.

<sup>8</sup> Note that country-level regulations can change this threshold.

<sup>9</sup> As stipulated in the Article 8 Disclosure Delegated Act Disclosures

The FAQ of the European Commission<sup>10</sup> provides the same information in their answer to Question 2:

## As of January 2022

- Non-financial entities report Taxonomy eligibility for the previous calendar year\*
- Financial entities report Taxonomy eligibility fo the previous calendar year\*

### As of January 2023

- Non-financial entities report eligibility and alignment for the previous calendar year
- Financial entities report Taxonomy eligibility fo the previous calendar year

#### As of January 2024

- Non-financial entities report eligibility and alignment for the previous calendar year
- Financial entities report Taxonomy eligibility and alignment for the previous calendar year

## As of January 2025

 Financial entities may include estimates on Taxonomy alignment for DNSH assessments of third-country exposures subject to the 2024 review period

#### As of January 2026

Credit institutions include Taxonomy alignment of their trading book and fees and commissions for non-banking activities

\* Articles 8 (2) and (3) Disclosures Delegated Act stipulates that information disclosed in accordance with the Regulation shall cover the annual reporting period from the previous calendar year of the date of disclosure and that financial undertakings and non-financial undertakings shall provide in the non-financial statement the key performance indicators covering the previous annual reporting period. Therefore, the first reporting period concerns the (fiscal) year of 2021.

For undertakings where the fiscal year is congruent with the calendar year the first report period is there the 1st January 2021 to the 31st December 2021. In the case an undertaking has a diverging fiscal year, only the last annual reporting period has to be covered. For instance if an undertaking has a fiscal year starting on 1st July and ending 30th June it would mean that the fist disclosures according to Article 8 Taxonomy regulation would (only) have to cover the period 1 July 2021 to 30 June 2022 as this would be the previous annual reporting period.

<sup>10 &</sup>lt;u>ec.europa.eu/info/sites/default/files/business\_economy\_euro/banking\_and\_finance/documents/sustainable-finance-taxonomy-article-8-report-eligible-activities-assets-faq\_en.pdf</u>

#### Article 811

#### Disclosure rules common to all financial undertakings and non-financial undertakings

- 1. Financial undertakings and non-financial undertakings shall include all additional disclosures accompanying the key performance indicators laid down in Annexes I, III, V, VII, XI in the same parts of the non-financial statement that contains those indicators, or shall provide cross-references to the parts of the non-financial statements that contain those indicators.
- 2. Information disclosed in accordance with this Regulation shall cover the annual reporting period from the previous calendar year of the date of disclosure.
- 3. Financial undertakings and non-financial undertakings shall provide in the non-financial statement the key performance indicators covering the previous annual reporting period. For the purposes of this paragraph, the first annual reporting period shall cover the year 2023.
- 4. Financial undertakings and non-financial undertakings shall in their disclosures, use the same currency as in their financial statements.
  - Financial undertakings shall use the most recently available data and key performance indicators of their counterparties to calculate their own key performance indicators.
- 5. The key performance indicators shall cover only the objectives of climate change mitigation and climate change adaptation until 12 months after the date of application of the delegated regulations that contain the technical screening criteria for the other environmental objectives and that have been adopted pursuant to Article 12(2), Article 13(2), Article 14(2) and Article 15(2) of Regulation (EU) 2020/852.

The main points that banks need to keep in mind regarding disclosure expectations are:

#### Reporting Taxonomy eligibility and Taxonomy alignment

Prior to January 2024, banks are required to report on Taxonomy eligibility. From January 2024 onward, banks should report both Taxonomy eligibility and alignment.

■ **Taxonomy eligibility** means reporting on exposures per Article 10 of Article 8 Disclosures Delegated Act, which is extracted below, alongside other connected articles for convenience:

Please be mindful that the obligations included in this article may be expanded by the Complementary Climate Delegated Act as regards economic activities in certain energy sectors

#### Article 10

#### Entry into force and application

- 1. This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.
- 2. From 1 January 2022 until 31 December 2022, non-financial undertakings shall only disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible economic activities in their total turnover, capital and operational expenditure and the qualitative information referred to in Section 1.2 of Annex I relevant for this disclosure.
- 3. From 1 January 2022 until 31 December 2023, financial undertakings shall only disclose:
  - (a) the proportion in their total assets of exposures to Taxonomy non-eligible and Taxonomyeligible economic activities;
  - (b) the proportion in their total assets of the exposures referred to in Article 7, paragraphs 1 and 2;
  - (c) the proportion in their total assets of the exposures referred to in Article 7(3);
  - (d) the qualitative information referred to in Annex XI.
  - Credit institutions shall also disclose the proportion of their trading portfolio and on demand inter-bank loans in their total assets.
  - Insurance and reinsurance undertakings shall also disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible non-life insurance economic activities.
- 4. The key performance indicators of non-financial undertakings, including any accompanying information to be disclosed pursuant to Annexes I and II to this Regulation, shall be disclosed from 1 January 2023.
- 5. The key performance indicators of financial undertakings, including any accompanying information to be disclosed pursuant to Annexes III, V, VII, IX, XI to this Regulation, shall be disclosed from 1 January 2024. Sections 1.2.3 and 1.2.4 of Annex V shall apply from 1 January 2026.

#### Article 7

#### Disclosure rules common to all financial undertakings

- 1. The exposures to central governments, central banks and supranational issuers shall be excluded from the calculation of the numerator and denominator of key performance indicators of financial undertakings.
- 2. Derivatives shall be excluded from the numerator of key performance indicators of financial undertakings.
- 3. Exposures to undertakings that are not obliged to publish non-financial information pursuant to Article 19a or 29a of Directive 2013/34/EU shall be excluded from the numerator of key performance indicators of financial undertakings.

#### Annex XI

Qualitative disclosures for asset managers, credit institutions, investment firms and insurance and reinsurance undertakings

The disclosure of quantitative KPIs shall be accompanied by the following qualitative information to support the financial undertakings' explanations and markets' understanding of these KPIs:

- Contextual information in support of the quantitative indicators including the scope of assets and activities covered by the KPIs, information on data sources and limitation;
- Explanations of the nature and objectives of Taxonomy-aligned economic activities and the
  evolution of the Taxonomy-aligned economic activities over time, starting from the second
  year of implementation, distinguishing between business-related and methodological and
  data-related elements;
- Description of the compliance with Regulation (EU) 2020/852 in the financial undertaking's business strategy, product design processes and engagement with clients and counterparties;
- For credit institutions that are not required to disclose quantitative information for trading exposures, qualitative information on the alignment of trading portfolios with Regulation (EU) 2020/852, including overall composition, trends observed, objectives and policy;
- Additional or complementary information in support of the financial undertaking's strategies and the weight of the financing of Taxonomy-aligned economic activities in their overall activity.

**Taxonomy alignment** refers to reporting on exposures to activities that are listed in the Climate Delegated Act and have fulfilled criteria for Taxonomy alignment.

The image below gives an overview of the process leading to alignment reporting and shows the path to alignment reporting that non-financial undertakings would follow, which shows the distinction between **eligible** and **aligned** activities.

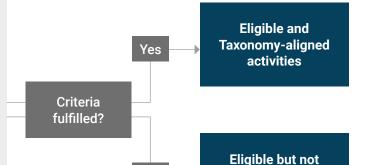
### Taxonomy-eligible economic activities

A 'Taxonomy-eligible economic activity' is an economic activity that is listed in the EU Taxonomy Climate Delegated Act, regardless of whether the economic activity also fulfils all specified Technical Screening Criteria (cf. Art. 2 (5) Draft Delegated Act)

#### **Taxonomy-aligned economic activities**

An 'environmentally sustainable' OR Taxonomy-compliant economic activity' is an economic activity that meets the requirements of Art. 3 in the EU Taxonomy Regulation (cf. Art. 2 (2) Draft Delegated Act). In essence, it complies with the Technical Screening Criteria set by the EC by:

- Making a Substantial Contribution (SC) to at least one of the six environmental objectives of the EU
- Proving to Do No Significant Harm (DNSH) to the other five goals
- Fulfilling certain Minimum Social Standards (MSS) (e.g. OECD guidelines for multinational companies, UN guidelines for companies and human rights).



#### Taxonomy-non-eligible economic activities

A 'Taxonomy-non-eligible economic activity' is an economic activity that is not **listed** in the EU Taxonomy Climate Delegated Act (cf. Art. 2 (6) Draft Delegated Act)

Check

compliance

Non-eligible activities

Taxonomy-aligned

activities

Annex VI <u>template</u> from the Article 8 Disclosures Delegated Act is the reference for GAR disclosures from January 2024 onward. It shows:

- Covered assets (GAR, off-balance)
- GAR—sector information
- GAR KPIs stock
- GAR KPIs flow

The reporting template has three more sheets (which cover Financial guarantees, assets und management, fees and commissions, as well as the trading KPI) but these will not be discussed within this report.

#### Review of Article 8 Disclosures Delegated Act

The <u>Article 8 Disclosures Delegated Act</u> states that the European Commission will review the regulation—particularly the need for any further amendments with regards to the **inclusion** of:

- Exposures to central governments and central banks in the numerator and denominator of KPIs of financial undertakings
- Exposures to undertakings that do not publish a non-financial statement pursuant to Articles 19a or 29a of Directive 2013/34/EU (CSRD) in the numerator of KPIs of financial undertakings. The inclusion of SME exposures will be considered based on an impact assessment outcome regarding the administrative burden, access to finance and the potential impact on SMEs.

#### Use of estimates

The Article 8 Disclosures Delegated Act does **not** allow the use of estimates for mandatory disclosures, which should be based on information provided by the relevant counterparty. This is in the context of eligibility reporting and not alignment when actual data obtained through client engagement for specified use of proceeds exposures is recognised as suitable for mandatory disclosures.

Exposures that are not fully supported by published Taxonomy reporting of the company receiving the financing, or in bilateral engagement for specified use of proceeds exposures, will only be included in the denominator of the GAR and will be assigned a null value when it comes to inclusion in the GAR numerator. They may, however, be included in voluntary disclosures where the bank chooses to do so.

As stated in the Answer to Question 12 in the Article 8 FAQ published by the EC in December:

"In the case where an underlying undertaking has not yet disclosed its taxonomy eligibility, a financial undertaking may choose to estimate the proportion of eligibility of economic activities. Such estimated values may only be reported on a voluntary basis and must not form part of the mandatory disclosures. Moreover, voluntary disclosures should be prepared on the basis that they do not contradict or misrepresent the mandatory information pursuant to the Disclosures Delegated Act and these should not be given more prominence than the mandatory disclosures. Where an undertaking includes voluntary

disclosures, this disclosure should be accompanied by supporting detail setting out the basis for this disclosure and methods used for its preparation along with a clear explanation of how it differs from mandatory reporting.

Further guidance on voluntary reporting and use of estimates for eligibility reporting in the first year(s) of reporting is provided by the Platform on Sustainable Finance in its Appendix."

#### **Voluntary reporting**

The possibility of voluntary reporting is mentioned by the European Commission in the Article 8 FAQ<sup>12</sup> in order to complement regulatory disclosures under Article 8 Disclosures Delegated Act. The European Commission states: "Entities are free to provide additional voluntary disclosures where they consider that this is relevant to investors to gain a better understanding of the entity's Taxonomy-eligibility for the first year of reporting and Taxonomy alignment thereafter."

Given that estimates and proxies are **not allowed for the mandatory reporting** under Article 8 of the Taxonomy Regulation, banks can leverage such voluntary disclosures based on estimates and proxies in order to contextualise their mandatory reporting.

In the context of the EU Taxonomy Regulation, "estimates" refers to any data and information that is **not published** by companies subject to EU Taxonomy disclosure obligations. There is no implication in terms of the methodology used to calculate figures. The qualification of "estimates" comes with the source of the information and the publication rather than the methodology used to produce a particular figure.

Requirements for voluntary disclosures are as follows:

- They should not contradict or misrepresent the mandatory information.
- They should not be given more prominence than the mandatory disclosures.
- They should include supporting details setting out the basis for voluntary disclosures.
- They should include details on methods used for their preparation, with a clear explanation of how this differs from mandatory reporting.

The following statement is important to highlight: "... as a general principle for all undertakings, voluntary disclosures are not part of the mandatory disclosures under Article 8 of the Taxonomy Regulation and entities should always explain the reasons for making such disclosures." <sup>13</sup>

Further insights can be found as well in the second FAQ published by the European Commission.<sup>14</sup>

Voluntary reporting must be disclosed separately from the Article 8 disclosures and clearly identify the **use of estimates and/or proxies**.

<sup>12</sup> Q4, Article 8 FAQ, European Commission

<sup>13</sup> P. 5–6, Article 8 FAQ, European Commission.

Draft Commission notice on the interpretation of certain legal provisions of the Taxonomy Regulation Article 8
Disclosures Delegated Act on the reporting of eligible economic activities and assets

Further guidance on voluntary reporting and use of estimates for eligibility reporting is provided in Annex I of the EC FAQ on Article 8 disclosures.<sup>15</sup> We note that this guidance is provided for eligibility reporting and that further guidance for alignment will most likely be provided in due course.

#### Use of NACE codes

On the use of NACE codes, Annex VI of the disclosures for the Article 8 Disclosures Delegated Act lays out the requirement for credit institutions to report their Taxonomy alignment KPIs against their respective NACE codes. One possible approach is therefore to classify banks' exposures by assigning NACE codes and comparing them with the Taxonomy-eligible NACE codes (see the EU Taxonomy Compass).

However, it is important to note that Recital 6 of the Climate Delegated Act states that references to NACE codes are to be understood as an indicative guidance as it is a widely use classification system in Europe. It is therefore the activity description that determines the eligibility, as NACE codes do not provide a perfect match for all eligible economic activities or even a perfect match in terms of description of the activity. The use of NACE codes is therefore a convenient start, but it should not limit the scope of eligible exposures. The default reference for the scope of eligible assets to be reported in 2022 and 2023 is the economic activity description in Annex I and Annex II of the Climate Delegated Act. It should also be noted that identifying exposures' eligibility, much like alignment, is strictly based on clients' published data.

When assessing the information that clients provide to banks, it should be noted that activities that meet the description of the annexes but do not have a NACE code could be taxonomy eligible. The same applies to NACE codes that have a larger scope than the activity described—the latter prevails over the code. Also, if there are NACE codes not mentioned explicitly in the Climate Delegated Act but the activity under the code is eligible as per the activity description, it should be considered as eligible.

For clients undertaking activities with a description that is not fully aligned with the text in the annexes of the Climate Delegated Act, the activity may be segmented to fit into the description.

The following tools can be useful to banks in this regard:

■ The <u>EU Taxonomy Compass</u> (especially in its Excel format <u>here</u>) is the most up-to-date and complete repository of all TSC and requirements per economic activity. It can therefore be the official frame of reference for banks¹6 to check against eligibility.¹7 It enables them to check which activities are included in the EU Taxonomy (Taxonomy-eligible activities), to which objectives they SC and what criteria they must meet. The EU Taxonomy Compass also aims to make it easier to integrate the criteria into business databases and other IT systems.

<sup>15</sup> See Platform considerations on voluntary information as part of Taxonomy-eligibility reporting.

However, note that the EU Taxonomy Compass is strictly based on the content of the Taxonomy Delegate Act; therefore, the ultimate reference in the event of lack of clarity is the Climate Delegated Act.

Note that this check can also cover retail products, as the use of proceeds will be known and the relevant activity can be looked up on the <u>EU Taxonomy Compass</u>.

- In some cases, the Taxonomy Regulation uses "extended" NACE codes with two more digits. This entails a six-digit code (Prodcom) instead of the more common four-digit NACE code (CPA code) (Statistical Classification of Products by Activity, CPA v. 2.1. 2014). The use of this more concrete coding system comes through in the definition of the TSC for certain economic activities. Therefore, banks may wish to consider classifying their clients' economic activities beyond the four-digit NACE code in their internal systems, as this can help with long-term adaptation. This will be addressed again in Section C, which covers transition finance.
- However, it is important to stress that Recital 6 of the Climate Delegated Act clarifies that NACE codes are not the primary determining factor for eligibility or alignment reporting. The primary reference is the description of the economic activity that can be found in Annex I and II of the EU Taxonomy Regulation. As mentioned above, banks should not only rely on NACE codes but also overlay their client base screening with economic activity descriptions. For banks that are familiar with the <u>UNEP FI Portfolio Impact Analysis Tool for Banks</u>, its latest version can be leveraged here to assess the bank's portfolio through the NACE codes of the activities financed within it. This in turn shows how much of the portfolio consists of Taxonomy-eligible NACE codes, thus allowing banks to extract relevant information for Taxonomy eligibility reporting.

### A.2.2 Reporting expectations—2022 and 2023

Information shall be reported alongside financial statements in accordance with Article 19 of the NFRD.<sup>18</sup>

For the Article 8 disclosures in 2022 and 2023, banks are not expected to report on the Taxonomy alignment of their total assets but **on their eligibility** to the EU Taxonomy instead. As a general principle, eligibility reporting in the first year(s) of reporting, as per Article 10 of the Article 8 Disclosures Delegated Act, should serve to help undertakings prepare for their alignment disclosures.

As referred in Article 10 of the final Article 8 Disclosures Delegated Act,<sup>19</sup> banks are expected to report:

- The proportion in their total assets of exposures to Taxonomy non-eligible and Taxonomy-eligible economic activities
- the proportion in their total assets of the exposures referred to in <a href="Article 7">Article 7</a>, paragraphs 2 and 3—these address (1) exposures to central governments, central banks, and supranational issuers, and (2) derivatives.
- the proportion in their total assets of the exposures referred to in <a href="Article 7(3)">Article 7(3)</a>—these refer to exposures to undertakings which are not obliged to publish non-financial information

<sup>18</sup> P.3, Article 8 FAQ, European Commission.

<sup>19</sup> Paraphrased from Article 10(3) of the final Article 8 Delegated Act.

 the qualitative information referred to in <u>Annex XI</u>—this lists qualitative disclosures for asset managers, banks, investment firms, and insurance and reinsurance undertakings
 Banks are also expected to disclose the proportion of their trading portfolio and on-demand interbank loans in their total assets.

#### **Reporting format**

Article 10(3) of the Article 8 Disclosures Delegated Act does not require the use of the reporting templates for the reporting of eligibility information, except for the reporting of qualitative information.<sup>20</sup>

The European Commission, however, suggests the use of the following templates.<sup>21</sup>

#### For eligibility reporting

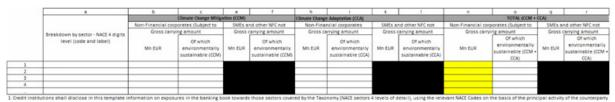
			Taxonomy eligible	Taxonomy non eligible	% coverage (over total assets)***
Art 10	2a	total assets			
		of which trading portfolio and on demand inter-bank loans			
		in total assets.			
		total exposure to central governments, central banks and			
	2b	supranational issuers			
		total exposure to derivatives			
	2c	total exposure to non-NFRD companies			
rt 10	2d	Annex XI disclosures			
		Contextual information towards quantitative indicators incl			
		scope of assets and activities covered, data sources and			
		limitation.			
		Starting from second year of implementation only:			
		Explanations of the nature and objectives of Taxonomy-			
		aligned economic activities and the evolution of the			
		Taxonomy-aligned economic activities over time,			
		distinguishing between business-related and			
		methodological and data-related elements.			
		Description of the compliance with Regulation (EU)			
		2020/852 in the financial undertaking's business strategy,			
		product design processes and engagement with clients and counterparties.			
		for credit institutions that are not required to disclose			
		quantitative information for trading exposures:			
		qualitative information on the alignment of trading			
		portfolios with Regulation (EU) 2020/852, including overall			
		composition, trends observed, objectives and policy;			

<sup>\*\*\* %</sup> of assets covered by the KPI over banks' total assets

Note 1: Across the reporting templates: cells shaded in black should not be reported.

#### To prepare for alignment reporting

Since information may not be provided by the underlying counterparty, in 2022, banks may estimate eligibility per environmental objective using NACE or alternate classification. In the case of estimating turnover for adaption, only enabling activities count.



2. The counterparty NACE sector allocation shall be based exclusively on the nature of the immediate counterparty. The classification of the exposures incurred jointly by more than one obligor shall be done on the basis of the characteristics of the obligor that was the more relevant, or determinant, for the institution to grant the exposure. The distribution of jointly incurred exposures by NACE codes shall be driven by the characteristics of the more relevant or determinant obligor. Institutions shall disclose information by NAC codes with the level of disaggregation required in the template.

<sup>20</sup> P. 6, Article 8 FAQ, European Commission.

<sup>21</sup> See P. 15, Platform considerations on voluntary information as part of Taxonomy-eligibility reporting.

### A.2.3 Reporting expectations—2024 and beyond

From 2024 onwards, banks are expected to disclose relevant KPIs under the Taxonomy Regulation as follows (extracted from Article 8 Disclosures Delegated Act Annex VI):

Main KPI	Additional KPI
Green Asset Ratio (GAR) stock	GAR (flow)
	Trading book*
	Financial guarantees
	Assets under management
	Fees and commissions income**

<sup>\*</sup> For credit institutions that do not meet the conditions of Article 94(1) of the CRR or the conditions set out in Article 325a(1) of the CRR

Note with regards to \*\*: Fees and Commissions (Sheet 6) and Trading Book (Sheet 7) KPIs shall only apply starting 2026. SMEs inclusion in the numerator of the GAR will only apply subject to a positive result of an impact assessment in June 2024.

The main KPI for banks is the **Green Asset Ratio (GAR).** 

#### A.2.3.1 Understanding Article 8 disclosures of clients in scope of NFRD/ CSRD regulation

This section provides guidance on interpreting the turnover reporting template<sup>22</sup> for non-financial undertakings. The template is part of the overarching NFRD/CSRD disclosures. Below is a screenshot of the table along with a few indicators.

<sup>\*\*</sup> Fees and commissions income from services other than lending and AuM

The table is titled Proportion of turnover from products or services associated Taxonomy-aligned economic activities. Access is <a href="here">here</a> (under Annex II).

				Subs	stantia	al con	tributi	on cr	iteria	('Do	es No	NSH t Sigr	criteri ifican	a tly Ha	arm')					
Economic activities (1)	Code(s) (2)	Absolute turnover (3)	Proportion of turnover (4)	Climate change mitigation (5)	Climate change adaptation (6)	Water and marine resources (7)	Circular economy (8)	Pollution (9)	Biodiversity and ecosystems (10)	Climate change mitigation (11)	Climate change adaptation (12)	Water and marine resources (13)	Circular economy (14)	Pollution (15)	Biodiversity and ecosystems (16)	Minimum safe- guards (17)	Taxono- my-aligned proportion of turnover, year N (18)	Taxono- my-aligned proportion of turnover, year N-1 (19)	Category (enabling activity or) (20)	Category '(transitional activity)' (21)
(1)		Ссу	%	%	%	%	%	%	%	y/n	y/n	y/n	y/n	y/n	y/n	y/n	%	%	Е	Т
A. TAXONOMY-ELIGIBLE ACTIVI	IES			,								,								
A.1. Environmentally sustainable activities (Taxonomy-aligned)																				
Activity 1		C		D	%	%	%	%	%	E	у	у	у	У	У	у	F %			
Activity 2			%	%	%	%	%	%	%	у	у		у	У	у	у	%			
Turnover of environmentally sustainable activities (Taxono- my-aligned) (A.1)			%	%	%	%	%	%	%								<b>G</b> %			
A.2 Taxonomy-Eligible but not environmentally sustainable activities (not Taxonomy-aligned activities)																				
Activity 1			%																	
Activity 3			%																	
Turnover of Taxonomy-eligible but not environmentally sustainable activities (not Taxonomy-aligned activities) (A.2)			%																	
Total (A.1 + A.2)		T.	%														%		%	
B. TAXONOMY-NON-ELIGIBLE AC	TIVITI	ES K																		
urnover of Taxonomy-non-eligible activities (B)			%																	
Total (A + B)			%																	

# Proportion of turnover from products or services associated Taxonomy-aligned economic activities<sup>23</sup>

- **a.** List of **eligible and aligned activities** under the EU Taxonomy.
- **b.** List of **eligible but non-aligned activities** under the EU Taxonomy. The blacked-out cells refer to the criteria (DNSH and MS) and other classifications (enabling, transitional and own performance) that only pertain to Taxonomy alignment. This information need not be reported if the result is that the activity is not Taxonomy aligned.
- **c. Proportion of turnover** of a given activity against the total turnover of the company.
- **d.** Proportion of turnover of a given activity that substantially contributes to one of the environmental objectives. While a given activity can Significantly Contribute to multiple environmental objectives, only one of these cells is expected to be populated.<sup>24</sup>
- **e.** Alignment of activity 1 with DNSH and MS (in this case, "Y" means the criteria have been fulfilled).
- **f. Taxonomy-aligned proportion of turnover** of a given activity.
- g. Sum or total of all Taxonomy-eligible activities' Taxonomy-aligned proportion of turnovers.
- **h. Proportion of turnover of all Taxonomy-eligible activities** (including those that failed the Taxonomy alignment check).
- i. Sum or total of all the Taxonomy-eligible activities' Taxonomy-aligned proportion of turnovers (hereby referred to as the **total Taxonomy-aligned proportion of turnover**). Note that it will always equal the figure listed in G.
- **j. Non-eligible activities** under the EU Taxonomy.
- **k. Proportion of turnover of non-eligible activities** under the EU Taxonomy.
- **I. Total turnover** of the company, in percentage (always 100%).
- m. Categorisations based on whether an activity is transitional (only for climate change mitigation) or enabling.<sup>25</sup> Information in these columns is only to be selected if officially classified as such and the activity does not substantially contribute by its own performance.

The figures in this list that have been underlined **(F and I)** are of most significance to banks, as they will be used to calculate a loan's degree of Taxonomy alignment.

There are two more tables in the Article 8 disclosure template for non-financial undertakings that also have Taxonomy-relevant information: the split of CapEx, listing SC by activity; and the split of OpEx, listing SC by activity.<sup>26</sup>

<sup>23</sup> Access is here (under Annex II).

This is because the EU Taxonomy only requires each economic activity to substantially contribute to at least one of the six environmental objectives. Even if an economic activity contributes to multiple economic objectives, only the one with the highest contribution will be considered.

<sup>25</sup> Please refer to the Climate Delegated Act or the EU Taxonomy Compass to check this information.

<sup>26</sup> See Table II in Annex I for CapEx breakdown—the same guidance can be applied for opex table.

## A.2.3.2 Understanding requirements for banks' Article 8 disclosures

The Article 8 Disclosures Delegated Act requires banks to disclose their GAR from 2024. The GAR represents the proportion of banks' financings and investments in Taxonomy-aligned economic activities as a proportion of total covered assets.

The breakdown includes information on stock and flows, transitional and enabling activities, and specialised and general-purpose lending:

- The GAR should cover the stock of loans, advances and debt securities, and equity holdings. Within the scope of this project, the guidance is for loans and advances only.
- The flow of loans is covered by GAR flow (Sheet 4 of the GAR disclosure template)

Credit institutions will have to disclose all of the following:

- The aggregate GAR for covered on-balance sheet assets
- The breakdown by environmental objective (climate change mitigation and climate change adaptation) and by type of counterparty

#### All KPIs have:

- A numerator representing the relevant type of financing (e.g., loans) that is Taxonomy-aligned based on the turnover KPI and CapEx KPI of underlying assets
- A denominator, defined as the "total covered assets"

In addition to the GAR, credit institutions shall disclose the percentage of their total assets that is excluded from the numerator of the GAR per the table below extracted from Annex V of the Article 8 Disclosures Delegated Act.

Environmental objectives	First step	Second step	Green asset ratio (GAR)			
Climate change mitigation	Proportion of loans and advances/debt securities/equity instruments financing taxonomy-eligible economic activities for the objective of climate change mitigation as compared to total loans to/debt securities/equity instruments of non-financial undertakings and all other covered on-balance sheet assets	Proportion of loans and advances/debt securities/equity instruments financing taxonomy-aligned economic activities for the objective of climate change mitigation, compared to loans and advances/debt securities/equity instruments financing economic activities in sectors covered by the taxonomy for the objective of climate change mitigation.  Of which: enabling activities ities Of which transitional activities				
Stock and flow						
Climate change adaptation	Proportion of loans and advances/debt securities/equity instruments financing Taxonomy-eligible economic activities for the objective of climate change adaptation compared to total loans to/debt securities/equity instruments of non-financial undertakings and all other covered on-balance sheet assets	Proportion of loans and advances/debt securities/equity instruments financing taxonomy-aligned economic activities for the objective of climate change adaptation compared to loans and advances/debt securities/equity instruments financing economic activities in sectors covered by the taxonomy for the objective of climate change adaptation	Proportion of loans and advances/debt securities/equity instruments financing taxonomy-aligned economic activities for the objective of climate change adaptation compared to total loans and advances/debt securities/equity instruments of non-financial undertakings and all other covered on-balance sheet assets			
		Of which: enabling activities ities Of which adaptation actional activities	-			
Stock and flow						
Other environmental activities		Same ratios for each of the other four environmental objectives should be disclosed, once the screening criteria are defined. That is: the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; the protection and restoration of biodiversity and ecosystems.				

27

<sup>27</sup> P. 20–21, Annex V of Article 8 Disclosures Delegated Act.

It is worth highlighting that:

- Banks are expected to disclose subsets of transitional and enabling economic activities.
- The main GAR KPI applies to the **stock of assets on banks' balance sheets** and shows the proportion of exposures related to Taxonomy-aligned activities compared to the total assets of banks,<sup>28</sup> including assets where the use of proceeds is specified and those where it isn't (general purpose). Most importantly, it is computed from the turnover and CapEx KPI published by clients in the NFRD and, subsequently, CSRD scope.
- GAR stock is based on assets on the balance sheet as of the disclosure reference date
- **GAR flow** covers new assets acquired during the year prior to the disclosure reference date (net flow).
- For loans where the **use of proceeds is unknown** (general-purpose loans), the regulation maintains the use of both turnover and CapEx KPI (for each environmental objective). This may be counterintuitive for banks that may consider that if the client doesn't specify the use of proceeds of a loan, it is not suitable to assume the proceeds would be allocated toward capital expenditure. However, the current legal expectation as per point 1.2.1.1.1. of Annex V of the Article 8 Disclosures Delegated Act remains that banks would apply clients' published KPIs in a dual manner (turnover KPI and CapEx KPI) consistently and systematically across any type of exposures. Citation: "For the purposes of [ loans and advances where the use of proceeds is unknown (general loans)], credit institutions shall rely on the CapEx and turnover KPI that the counterparty shall disclose for each environmental objective in accordance with this Regulation. The amount of loans and advances to non-financial undertakings shall be the sum of the gross carrying amount of the total loans and advances with unknown use of proceeds to non-financial undertakings weighted by the proportion of Taxonomy-aligned economic activities with a breakdown for transition and enabling activities for each counterparty."

Practically, this means that Taxonomy-aligned exposures should be calculated twice. They are the sum of the gross carrying amount of the total loans and advances, debt securities and equity holdings, with unknown use of proceeds to non-financial undertakings. The result should be then weighted by the proportion of Taxonomy-aligned economic activities reported by the client:

- The turnover KPI (share of the turnover that is aligned)
- The CapEx KPI (share of the CapEx that is aligned)
   Credit institutions assign the published CapEx KPI of the underlying counterparty to the relevant general-purpose loan, debt security or equity holding in the same manner as the turnover KPI.<sup>29</sup>

<sup>28</sup> In this regulatory context, banks refer to credit institutions.

<sup>29 &</sup>lt;u>Further insights can be found in the Draft Commission notice on the interpretation of certain legal provisions of the Taxonomy Regulation Article 8 Disclosures Delegated Act on the reporting of eligible economic activities and assets</u>

- In the case of **transactions where the use of proceeds is known,** i.e., specialised finance, information regarding alignment with the EU Taxonomy shall be based on information provided by the counterparty on the project or activities to which the proceeds will be applied.
  - As per the reporting templates found in the CRR Annexes, and the Annex VI template, specialised lending is the category of reporting data that should be used in order to inform this KPI. Citation: "For the purposes of [loans and advances where the use of proceeds is known, including specialised lending—project finance loans as referred to in Annex V to Commission Implementing Regulation (EU) No 680/2014<sup>30</sup>] credit institutions shall consider the gross carrying amount of the project finance exposures to the non-financial undertaking to the extent and proportion that the project funded finances a Taxonomy-aligned economic activity. The assessment of whether that requirement has been complied with shall be based on information provided by the counterparty on the project or activities to which the proceeds will be applied. Credit institutions shall provide information on the type of economic activity that is funded." Further information on the split categories for specialised lending can be found in the EBA ITS on institutions' public disclosures of the information referred to in Titles II and III of Part Eight of Regulation (EU) No 575/2013 (Annex XXIII).<sup>31</sup>
- Banks should provide a breakdown of GAR by households' products eligible to the EU Taxonomy—i.e., mortgages, house renovation loans and car loans. Residential building renovation and acquisition, and car loans, are eligible under climate change mitigation only.<sup>32</sup>
- Banks may look out for potential double counting since it is specifically mentioned in the regulation as not allowed. This means that if an economic activity contributes to two different objectives and hence has two different degrees of alignment, it may be counted only once in the GAR.
- Where the same specialised lending exposure is relevant for two environmental objectives, banks should allocate it to the **most relevant objective**.
- The exposures to central governments, central banks and supranational issuers are excluded from the numerator and the denominator as per Article 7 of the Article 8 Disclosures Delegated Act text. This will be reviewed by June 2024 as per Article 9 of the Article 8 Disclosures Delegated Act text.

Specialised lending is defined in the European Commission's FAQ following the definition included in Article 147(8) CRR (Regulation (EU) 575/2013(CRR)—exposures that possess the following characteristics:

<sup>(</sup>a) The exposure is to an entity that was created specifically to finance or operate physical assets or is an economically comparable exposure.

<sup>(</sup>b) The contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate.

<sup>(</sup>c) The primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

<sup>&</sup>lt;u>eba.europa.eu/regulation-and-policy/transparency-and-pillar-3/its-of-institutions-public-disclosures-of-the-infor-mation-referred-to-in-titles-ii-and-iii-of-part-eight-of-regulation-eu-no-575-2013.</u>

<sup>32</sup> GAR for retail exposures 1.2.1.3 pp25–26 Annex V Article 8 Delegated Act.

**Derivatives** are excluded from the numerator. Exposures to undertakings not obliged to publish non-financial information,<sup>33</sup> namely **SMEs**<sup>34</sup> **and non-EU based companies**, shall be excluded from the numerator of the KPIs. However, from 2025, SMEs exposures (listed SMEs and non-listed SMEs that disclose Taxonomy-related information voluntarily) and certain non-EU exposures may be included in the numerator, provided they disclose information equivalent to the Taxonomy KPIs if such inclusions will be allowed after the envisaged review of the regulation by the European Commission in June 2024.<sup>35</sup> For **non-EU exposures**, **the use of estimates to assess compliance with the DNSH criteria** will be allowed as per article 7(7) of the Article 8 Disclosures Delegated Act. Compliance with all other criteria must be demonstrated as outlined in the EU Taxonomy Regulation. It is important to note that disclosures of these exposures should be filed separately from the GAR. It is worth highlighting that banks will have to formalise, document and publish the methodology of the estimates that they use.<sup>36</sup> Section B addresses the topic further.

An explanation—depending on the contents of the FAQ—may be needed in this point, to say: "Article 7i(4) of the Article 8 Disclosures Delegated Act allows for non-NFRD companies' use of proceeds bonds or investment products to be counted toward the GAR; the same is not true for specific use of proceeds products."

# Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR

In addition to the abovementioned process to comply with Article 8 disclosure obligations, it should be noted that the European Banking Authority has recently released its final draft implementing technical standards on prudential disclosures on Environmental, Social and Governance (ESG) risks<sup>37</sup> (hereafter in this document "the Pillar 3 ITS") At the time of writing this report, the Pillar 3 ITS remained to be adopted by the European Commission, and therefore could not be considered final. Based on Article 449a of the CRR (as amended in 2019), the Pillar 3 ITS is mandatory for large institutions which have issued securities that are admitted to trading on a regulated market of any EU Member State. These institutions will need to comply with disclosure obligations under both Article 8 of the EU Taxonomy, and the Pillar 3 ITS which includes EU Taxonomy alignment metrics.

The final draft Pillar 3 ITS includes different provisions on the disclosure of quantitative information on climate physical and transition risks, mitigating actions (including EU Taxonomy metrics as presented in templates 6, 7, 8, 9 and 10 of the Pillar 3 ITS), as well as qualitative information on Environmental, Social and Governance risks.

Within Section A, this means all non-EU companies and all SMEs. Although the CSRD is expected to increase the scope of companies subject to disclose non-financial information, this regulation is still in its nascent stages and will not be finalised until the end of 2022.

Note that, in this context, the reference is to non-listed SMEs. Listed SMEs will fall into the scope of the GAR if the CSRD is adopted as it is current proposed. Additionally, non-listed SMEs that voluntary disclose under Article 8 through the simplified reporting template may also be included, but this will need to be confirmed.

<sup>35</sup> See Article 9 of the final Article 8 Delegated Act.

<sup>36</sup> See Article 7(7) of the final Article 8 Delegated Act.

<sup>37 &</sup>lt;u>eba.europa.eu/eba-publishes-binding-standards-pillar-3-disclosures-esg-risks</u>

Templates 7 and 8 contain information that credit institutions are already expected to disclose under Article 8 of the EU Taxonomy, using the same format and structure of content. Yet there is an important difference regarding general purpose lending:

- Under Article 8 of the EU Taxonomy: "[credit institutions] are required to disclose the GAR twice: the GAR using the turnover alignment of their non-financial counterparties as the metric to determine the alignment of their general purpose lending exposures; and the GAR using the CAPEX alignment of their non-financial counterparties as the metric to determine the alignment of their general purpose lending exposures.<sup>38"</sup>
- Under the Pillar 3 ITS: "institutions will be required to disclose the GAR only once, based on the turnover alignment of their counterparties to determine the level of Taxonomy alignment of their general purpose lending exposures.<sup>39"</sup>

Therefore, the draft Pillar 3 ITS is potentially generating a difference between Article 8 and Pillar 3 GAR reports.

In addition to this, the Pillar 3 ITS introduces a new reporting obligation for institutions bound to Pillar 3 reporting (i.e. exclusively banks)—namely the Banking Book Taxonomy Alignment Ratio (BTAR), to be reported through Template 9:

"In addition to the information on the GAR in templates 6, 7 and 8, institutions must provide additional and separate information on the level of alignment of exposures towards non-financial corporates **not subject to NFRD disclosure obligations**, information which will be used for the computation of the BTAR. Institutions must assess these exposures on a best effort basis and based on information collected on a bilateral basis from their counterparties or calculated using estimates for those counterparties that do not have disclosure obligations, taking into account that these ITS can never lead to disclosure obligations for those counterparties.<sup>40</sup>"

Practically speaking, Template 9 requires credit institutions to disclose the Taxonomy alignment ratio of non-NFRD companies against the total covered assets of the financial institution (exclusions to the denominator being the same as for GAR calculation in Template 7, i.e. sovereigns and trading book assets).<sup>41</sup>

Additionally, credit institutions bound to Pillar 3 reporting will also need to disclose information on debt instruments (bonds and loans in the current Annex I to the draft Pillar 3 ITS) that are defined as "green" or "sustainable" under standards other than EU standards (e.g. a Green Bond under the ICMA Green Bond Principles, or a Green Loan or Sustainability-linked loan under the LMA Green Loan/Sustainability-linked loan Principles). This additional mandatory disclosure (similar to the voluntary disclosure under Article 8 of the EU Taxonomy—see section A.2.1 point 4 above) is described in Template 10 of the ITS as follows:

P.22, Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR (Pt. 58)

<sup>39</sup> Ibid.

<sup>40</sup> P.24, Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR (Pt. 63)

For more detailed references on the instructions to fill-in the templates, please see Annex II of the Pillar 3 draft ITS

"The purpose of this template is to provide information on other actions put in place by the institution to mitigate climate-change-related risks. It covers other activities of the institutions that are not included in Template 7 and Template 8. Institutions must include in the narrative accompanying this template detailed explanations on the nature and type of mitigating actions reflected in this template, including information on the type of risks that they aim to mitigate, on the related counterparties and on the term, i.e. the timing of the actions. They should also explain why these exposures are not considered under the Green Asset Ratio and any other relevant information that may help to understand the risk management of the institution."

Banks are expected to use <u>Annex VI—Template for the KPIs of credit institutions</u> (i.e., Annex VI of the Article 8 Disclosures Delegated Act) to disclose their KPIs from 2024. In addition to this, the following should be noted:

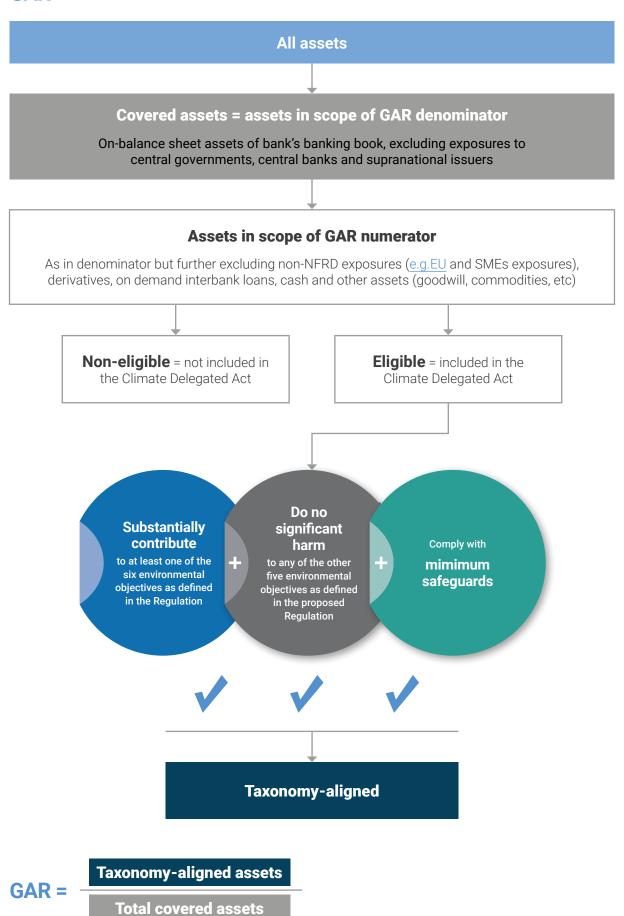
- In Sheet 1 (covered assets (GAR, off-balance)), many of the cells have been blacked out as they refer to exposures that should be included in the denominator but not the numerator.
- In Sheet 2, columns relevant to SMEs and non-financial corporations not subject to NFRD have been blacked out as they do not apply to the GAR.
- In Sheets 1, 3 and 4, cells on equity instruments and the transitional activity classification have been blacked out. However, please note that this is an error in the Excel template. In sheet 1, the specialised lending column is blacked out (as equity is not linked to the financing of a specific project). Sheets 3 and 4 should do the same, but the transitional column has been mistakenly blacked out instead of the specialised lending column.

Disclosure expectations for the years 2024 and beyond have not been finalised, as several regulatory changes in the coming years will impact the reporting standards:

- The **Environmental Delegated Act** will define the TSC of the four other environmental objectives (protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems) and thereby broaden the scope of the information to be reported.
- The **final version of the CSRD** will impact the number of companies that will be obliged to report under the Article 8 requirements, which in turn will impact—in some cases, significantly—the proportion of a bank's portfolio eligible to be in the GAR numerator.
- In June 2024, the **scope of the Article 8 Disclosures Delegated Act** will be reviewed to consider the inclusion of non-EU exposures in the GAR (as outlined in Article 9 of the Article 8 Disclosures Delegated Act).

Keeping the above in mind, the process of calculating the GAR based on counterparties is as follows:

#### **GAR**



Banks' clients s	ubject to Article 8 disclosures	Retail exposures (residential rand car loans)	eal estate lending
Step 1:	Non-financial corporations have a regulatory requirement to disclose	Residential real estate lending	Car loans
data coming from Article 8 regula- tory disclosure (for non-financial undertakings)	<ul> <li>using the tables in Annex II of the final Delegated Act:</li> <li>Turnover KPI</li> <li>CapEx KPI</li> <li>OpEx KPI, where relevant</li> </ul>	TBC Further information on data required to count toward alignment to be confirmed.	TBC Further information on data required to count toward alignment to be confirmed.
Step 2:  pre-existing information/information from client engagement that can be used for voluntary reporting	Pre-existing information or information that is <b>not</b> part of clients' mandatory disclosures:  Banks' internal data Loan documentation Market data Data bought from ESG data providers Publicly disclosed data (and, if possible, centralised though the European Single Access Point (ESAP))	TBC Will likely rely on information regarding the purchased property in the loan application. EPC provided and public EPC registers are the primary source of information.	TBC Will likely rely on information regarding the purchased vehicle in the loan application and compare it with the TSC defined in the Climate Delegated Act.
	<ul> <li>Potential additional information coming from the customer:</li> <li>Data collected in the loan monitoring process</li> <li>Existing KPIs or investment targets of the company, company-wide transition plans, concrete KPIs or SPTs if dealing with a KPI linked loan or KPI loan</li> <li>CapEx plan for new loans (new origination/flows)—part of the mandatory disclosures for non-financial corporations under the Article 8 Disclosures Delegated Act</li> </ul>		
	For specified UoP new origination loans, banks are expected to look at the information that comes from the counterparty to assess Taxonomy compliance of the activity before the Article 8 disclosures of the counterparty are published. <sup>42</sup>		

<sup>42</sup> See Annex V, Section 1.2.1.1.1.1 (1)(c)(1) of the final Article 8 Delegated Act.

Step 3: type of loan	Specified use of proceeds UoP	Unspecified use of proceeds	Residential real estate lending	Car loans
Criteria for compliance with TSC (SC, DNSH and MS)	specifics:  Whether the activity(ies) is Ta Segmentation figures per Ann	nex II template <b>using both turnover and</b> d and unspecified use of proceeds) and, financing provided (exposure),	For mortgage loans, only SC to climate change mitigation is considered. <sup>43</sup> For SC: EPC of the building compliant with TSC included in the Climate Delegated Act. Follow the DNSH calculation included in the Climate Delegated Act and consider appendices on DNSH calculation of the Annexes to the Climate Delegated Act. The same applies to the MS requirements. Cf. Articles 7.1, 7.2, 7.3, 7.4, 7.5, 7.6, 7.7 of Annex I—Climate Act	Automobile specifications comply with the TSC laid out in the Climate Delegated Act. Note that only climate change mitigation's TSC are applicable to car loans to households.  Cf. Article 6.5 of Annex I—Climate Act
Calculating compliance	If the financed activity is Taxonomy-aligned (n>0%) based on the client's specific information provided, whether through Article 8-related disclosure or provided directly by the counterparty in the case of specified use of proceeds transactions), the loan is n% aligned.44	Apply the total Taxonomy-aligned proportion of turnover to the loan (as a common market practice). <sup>45</sup> Use KPI where relevant.	If the TSC are met through the relevant EPC certificates, the loan is 100% aligned. <sup>46</sup>	If the TSC are met, the loan is 100% aligned. <sup>47</sup>

<sup>43</sup> See Annex V, Section 1.2.1.3 (1)c)(2) of the Article 8 Disclosures Delegated Act.

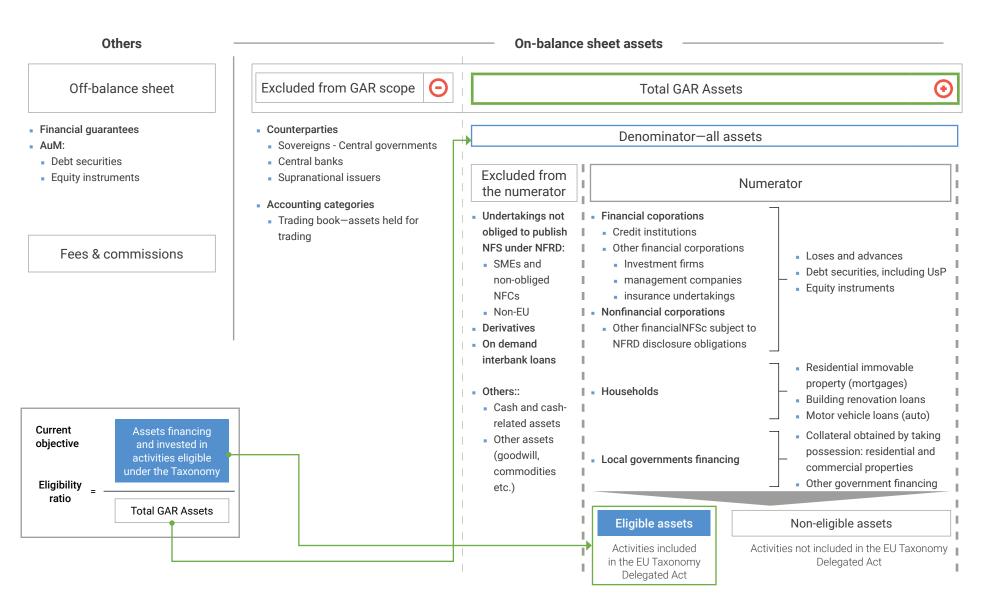
<sup>44</sup> See Annex V, Section 1.2.1.1.1.1 (1)(c)(1) of the Article 8 Disclosures Delegated Act.

<sup>45</sup> See Annex V, Section 1.2.1.1.1.1 (1)(c)(2) of the Article 8 Disclosures Delegated Act.

<sup>46</sup> See **Annex V**, Section 1.2.1.1.1.1 (1)(c)(2) of the Article 8 Disclosures Delegated Act.

<sup>47</sup> See Annex V, Section 1.2.1.1.1.1 (1)(c)(2) of the Article 8 Disclosures Delegated Act.

# A.3 Understanding the Green Asset Ratio



#### Example (simplified balance sheet)

			Ban	k A	Ban	k B
			Exposure (Eu bn)	of which taxonomy aligned	Exposure (Eu bn)	of which taxonomy aligned
tor	ig T		70	35	190	35
ina	Numerator	Financial corporations	40	20	90	25
OM	Ĕ	NFCs subject to NFRD/CSRD disclosure obligations	20	10	80	5
Denominator	ĺź↓	Households	10	5	20	5
		Excluded from numerator	120	45		
		Activities non-assessed by EU taxonomy & Non-Significant Impact (NSI)	20	10		
		NFCs not subject to NFRD/CSRD disclosure obligations	40	10		
		Non-EU country counterparties	50	20		
		Derivatives & others	10	5		
		Total Assets Covered	190	80	190	35
		Other Assets excluded from GAR scope	90		90	
		Sovereigns	40		60	
		Central banks	20		10	
		Trading book	30		20	
		Total balance sheet	280		280	
		Green Asset Ratio (GAR)	35/190	= 18%	35/190	= 18%

This simplified example illustrates how two credit institutions with different sustainable exposures and balance sheets can report the same GAR. While the percentage of Taxonomy-aligned activities of Bank A is more than double that of Bank B (42% (80/190) compared with 18%), they will both report 18% GAR. This is due to the configuration of the GAR where the numerator and denominator have different scope and some exposures cannot be currently evaluated for Taxonomy alignment and count toward GAR: namely, non-EU exposures and the exposures to SMEs outside the NFRD or CSRD. The higher the exposure of a bank to SME and non-EU or non-NFRD companies, the lower their reportable GAR will be. The GAR may, however, be complemented by additional voluntary reporting when a ratio on SMEs and non-EU exposure alignment can be shown separately. The composition of the GAR numerator will be reassessed from 2024 onward (see the review clause in Article 9 of the Article 8 Disclosures Delegated Act).

As GAR will not be disclosed in isolation as the additional metrics disclosed need to be analysed to understand the portfolio composition of financial institutions. The GAR should therefore not be considered in isolation to understand the sustainability endevours of a bank, nor should they be compared without analysing the balance sheet compositions and therefore understanding the context leading to a particular GAR figure.

# Section B: Adapting internal frameworks to the EU Taxonomy—How to use the Taxonomy as a way to Gather EU Taxonomy information from non-NFRD/CSRD counterparties

The content in this section only refers to application of the EU Taxonomy with respect to counterparties outside of the scope of mandatory Article 8 Disclosures Delegated Act in particular to SME and non-EU exposures. As per the Article 8 Disclosures Delegated Act , these exposures are not considered in the GAR numerator. However, it is worth noting that Article 9(3) of the Article 8 Disclosures Delegated Act addresses a review that is set to take place in June 2024 During this period, the EC will clarify if it allows the inclusion of SMEs and non-EU counterparties in the GAR numerator. Please also note that the upcoming implementing technical standards (ITS) on Pillar 3 disclosures on Environmental, Social and Governance (ESG) risks of the European Banking Authority (EBA), if adopted by the European Commission as proposed by the EBA in the final draft of the ITS,<sup>48</sup> will complement Article 8 Disclosures Delegated Act and introduce additional disclosure obligations for banks, including EU Taxonomy alignment of non-NFRD exposures for banks while there shall be no disclosure obligation on the non-NFRD companies themselves.

Until then, banks could use the guidance in this section as an internal framework that is anchored in the EU Taxonomy for their lending activities to SMEs and non-EU exposures. This is not for the purpose of reporting under Article 8 Disclosures Delegated Act's requirements or ITS Pilar 3 reporting, but in the event banks wish to align their internal processes in order to apply the EU Taxonomy across clients and portfolios of assets not yet under the regulatory scope.

Depending on the strategy and the business models of the bank, benefits of early alignment may be firstly in familiarising staff with the Taxonomy and its requirements and secondly in helping to raise awareness and facilitates engagement with clients on the topic early on.

Banks whose lending portfolios are largely dedicated to non-EU transactions would benefit from developing the methodology to analyse non-EU transactions as defined in Article 7(7) of the Article 8 Disclosures Delegated Act. Keeping in mind that non-EU transactions could also become part of the Green Asset Ratio (GAR) numerator after the June 2024 review (see Article 9(1) of the Article 8 Disclosures Delegated Act, other banks could also benefit from developing this approach ahead of possible mandatory application.

Banks may consider collecting the necessary information through questionnaires and self-assessment forms to be included in the loan origination guideline. These can generically address Taxonomy-relevant topics or be tailored to the clients.

<sup>48</sup> EBA final draft ITS on Pillar 3 disclosures on ESG risks published on 24 January 2022

# B.1 The EU Taxonomy as an Environmental, Social and Governance (ESG) framework

Lending to both SMEs and non-EU counterparties is a considerable part of the total lending credit institutions in Europe disburse to SMEs and non-EU counterparties. As observed from EBA FINREP data<sup>49</sup> for total financial assets excluding the trading book of a total exposure to NFCs of 33.1%, exposures to SMEs stands at 12.9%, thus signifying that almost **40%** of EU credit institutions' NFC financing exposures are towards SMEs (See Figure 6). In addition to this, a quarter of EU credit institutions' exposures is to entities outside of the EU (77.2% is to entities in the EU). Banks may benefit from introducing an internal **framework to check the Taxonomy-alignment of their SME** and non-EU exposures for various reasons:

- Internal management and information purposes
- Consistency purposes (inconsistent treatment of retail real estate exposures, which
  are fully assessed from the beginning, while commercial real estate to SMEs are not
  assessed for disclosure purposes under Article 8 DA but just assumed that a 0% eligibility weigh is applied, when the treatment should be the same)
- To encourage institutions' support and funding to this type of counterparties in their transition towards sustainability
- Voluntary disclosures (outside of GAR or Pilar 3 ITS )
- As a preparation for the possible inclusion of these exposure in GAR numerators from 2025 or Pilar 3 ITS.<sup>50</sup>

The recommendations in this section for the **voluntary application of the EU Taxonomy to non-NFRD exposures** are rooted in the voluntarily public disclosure of non-NFRD/CSRD companies or relevant Taxonomy-alignment information of non-NFRD/CSRD companies on a bilateral basis in the context of the loan origination and monitoring process.<sup>51</sup>

For the existing financed assets, data collection can be leveraged during the yearly monitoring and review process in which transaction-specific information is usually updated and ESG data can therefore be requested from the client. Such a process is however operationally demanding, dependent on the willingness of the customer to cooperate or on the possibility for an incentive in the form of discount linked to ESG provision etc. For new transactions, it is recommended to specify future data update requirements (data specifics, frequency) in the loan agreement via transaction-specific wording based on the applicable EU Taxonomy regulation. Relevant data could also be obtained from third-party providers.

<sup>49</sup> P. 41, Consultation paper on draft ITS on Pillar 3 disclosures on ESG Risks, EBA

While the exposures to undertakings that are not obliged to publish non-financial information under the NFRD are currently excluded from the numerator of the bank's GAR KPIs, the Article 8 Disclosures Delegated Act envisages for the inclusion of these exposures in the numerator, subject to a positive assessment in June 2024. If the assessment is positive, banks could include these exposures (SMEs and non-EU exposures) in the GAR numerator from 2025 onwards.

Column h, page 24, Annex II to the EBA Consultation paper on draft ITS on Pillar 3 disclosures on ESG risks, available <a href="here">here</a>

#### Use of estimates

The Article 8 Disclosures Delegated Act envisages the use of estimates on DNSH compliance (compliance with the SC and MS criteria still needs to be proven) only for exposures to non-EU transactions **from 2025 onwards**<sup>52</sup> subject to the review to be carried out by June 2024 and, provided that the conditions listed in the article are satisfied:

- Taxonomy-aligned exposures based on estimates should be reported separately from the main GAR KPI<sup>53</sup>
- Banks must formalise, document, and publish the methodology of the estimates that they will use to base their estimations for these exposures. This information has been given in the context of disclosing these exposures separately from the main KPIs relevant to regulation.<sup>54</sup>

# The EBA final draft ITS considers the use of the following simplified approach for non-NFRD exposures:

"When assessing **general purpose lending/financing** with unknown use of proceeds, institutions shall follow a simplified approach and focus their assessment on the **main economic activity** of the corporate, that is, on their main source of turnover, in order to determine the overall alignment of the exposures with the Taxonomy Regulation" <sup>55</sup>

Furthermore, for exposures to **non-NFRD** entities collateralised by commercial immovable property with a climate change mitigation objective (renovation, acquisition or ownership), taxonomy alignment shall only be assessed following a simplified approach based on the energy efficiency of the underlying collateral.

#### The EBA recommends use of proxies if the client is not able to provide the relevant data:

"Only if the counterparty is not able to provide the relevant data, credit institutions shall make use of internal estimates and proxies and explain in the narrative accompanying the template the extend of use of these estimates and the kind of estimates applied Where institutions are unable to collect on a bilateral basis or estimate relevant information, or are unable to do it in a reasonable way that is not overburdensome for them or their counterparties, they shall explain it in the narrative accompanying the template, explaining the reasons and counterparties affected" 56

<sup>52</sup> See Article 7(7) of the final Article 8 Disclosures Delegated Act

<sup>53</sup> See Article 7(7) of the Article 8 Disclosures Delegated Act

<sup>54</sup> See Article 7(3) of the Article 8 Disclosures Delegated Act

P.42, Annex II of the Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR

<sup>56</sup> Ibid

# The EBA ITS furthermore allows for use of the following proxies for the disclosure of information on non-EU exposures on a best-effort-basis:

- **a.** "using banks' own models and the classification of exposures according to them. In this case institutions shall explain the main features of the models applied;
- **b.** where available, counterparties' public disclosures based on international standards (e.g. TCFD); institutions shall in this case explain the type of information available and the standards applied;
- **c.** Other publicly available data."57

Although the European Banking Authority is supportive of banks estimating data when information is not available, or for non-EU entities including through internal models as they do in other instances, we **recommend that banks consider** that the use of estimates is **not envisaged in the Article 8 Disclosures Delegated Act for potential inclusion of SMEs to GAR nominators and only envisaged for DNSH assessment of non-EU entities.** Given such potential future developments of Article 8 Disclosures Delegated Act, we recommend banks to proactively collect data on SME and non-EU exposures whenever possible and use the estimates with caution.

For transparency purposes we propose that, should banks decide to voluntary disclose the alignment of their SME portfolios or non-EU exposures with the EU Taxonomy **before 2025**<sup>58</sup> (or June 2024 based on EBA ITS), exposures based on estimates should be separately disclosed from exposures based on companies published 'data and accompanied by the disclosure of the methodology for estimates used.

#### **Example of estimates**

In the case of commercial real estate, some banks will estimate the energy efficiency of their collaterals based e.g. on the year of construction, renovations etc. This is for example the case in Austria for 15% top national stock. Buildings from year 2010 (with the exception of Salzburg province) belong to top 15%.

<sup>57</sup> P.43, Annex II of the Final draft implementing technical standards on prudential disclosures on ESG risks in accordance with Article 449a CRR

<sup>58</sup> Or before any possible mandatory disclosure requirements by EBA (e.g. in ESG Pillar III ITS)

#### Example of use of estimates based on public data

#### Information processing engines

A pre-programmed information processing engine to search for news/ articles can be introduced to scan for ESG controversies or sanction monitoring. This could serve as an early warning system in general to reduce the risk of the financing potentially harmful projects.

The collated information from the web is then aggregated into informative E, S, and G scores based on the list of keywords to assess DNSH. Based on the predefined ranges for E, S, and G scores (acceptable ranges), a conclusion will be reached on the alignment of the financed business transactions with DNSH/MSS, within the currently applicable EU Taxonomy regulation. Should information processing engine be implemented within the financial institution, its usage and underlying methodology (incl. acceptable ranges, keywords definition) should also be defined within the scope of the institution's ESG policy. Such solutions can be employed until proper client data is available.

Further guidance on voluntary reporting and use of estimates is provided in Annex I of the EC FAQ on Article 8 Disclosures Delegated Act. Whilst this document is specifically focused on eligibility reporting only in the context of Article 8 Disclosure Delegated Acts, suggestions and examples provided may be adaptable to application of estimates for the purposes of voluntary assessment of Taxonomy alignment.

# B.2 Leveraging Self-assessment forms and EU Taxonomy questionnaires

#### **SMEs**

For specified use of proceeds transactions to SMEs, we recommend applying the same principle that applies to specified use of proceeds transactions for corporates disclosing information under Article 8 of the EU Taxonomy. The activity linked to the exposure needs to be assessed against the EU Taxonomy criteria. If all criteria are fulfilled, the activity is aligned with the EU Taxonomy, and the financing can be considered as X% Taxonomy aligned. For new loan origination, banks should be able to trace this information by directly engaging with the SME before providing financing, asking similar information to be able to fulfill Taxonomy-alignment checks.

For unspecified use of proceeds transactions, the recommendation of this paper is to focus on the "main economic activity" principle **that is, on their main sources of turnover, rather than assessing all the activities that they carry out.** Thus, for a general-purpose loan provided to an SME counterparty where the SME does not disclose the different Taxonomy-alignment levels of its underlying activities voluntarily, the main activity that

the SME undertakes (i.e. its most relevant NACE code) can be used as the only activity being financed by the exposure. This means equating the full performance of the SME to a single activity and matching the full amount of the exposure as a "use of proceeds" transaction to that single activity.

#### Non-EU

For non-EU exposures, it is recommended that the same principles used for corporates disclosing information under Article 8 of the EU Taxonomy are followed, with the flexibility envisaged for the use estimates to check for DNSH compliance.

For specified use of proceeds transactions to non-EU exposures, the same principle that applies to specified use of proceeds transactions for corporates disclosing information under Article 8 of the EU Taxonomy will be used. The activity linked to the exposure needs to be assessed against the EU Taxonomy criteria. If all criteria are fulfilled, the activity is aligned with the EU Taxonomy, and the financing can be considered as X% Taxonomy aligned. For new loan origination, banks should be able to trace this information by directly engaging with the non-EU counterparty before providing financing and ask for similar information to be able to fulfill Taxonomy-alignment checks.

For unspecified use of proceeds transactions to non-EU exposures, the EBA does not distinguish between SMEs and non-EU exposures and allows the application of the "main activity approach" also for non-EU exposures. **However, for large non-EU corporates, it is advisable to seek information on all activities of companies wherever possible.** 

# B.3 Assessing compliance with the Minimum Safeguards (MS)

# What are the responsibilities linked to MS compliance under the Taxonomy Regulation?

According to **Recital 3** and Articles 3 and 18 of the EU Taxonomy Regulation, non-financial corporations/non-financial undertakings directly undertaking the economic activities should comply with MS, ensuring that these activities are undertaken while respecting the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights (UNGPs), including the principles and rights set out in the eight fundamental conventions identified in the ILO Declaration on Fundamental Principles and Rights at Work and the International Bill of Human Rights. Additionally, according to Article 8 of the EU Taxonomy Regulation and the Article 8 Disclosures Delegated Act that accompanies it (especially Annex II—amending the NFRD obligations), non-financial undertakings need to disclose the proportion of turnover, CapEx and OpEx aligned with the EU Taxonomy, as well as their compliance with DNSH considerations and MS. If not, the activities would not be considered Taxonomy-aligned, despite potential compliance with the TSC and DNSH. This applies to activities of both EU- and non-EU-based companies.

Banks, under Article 8 of the EU Taxonomy Regulation, should also disclose the degree of Taxonomy alignment of their lending portfolios (composed mainly of lending to non-financial undertakings) in 2024. It is therefore important to ensure that banks have a practical way to do so, to allow for Taxonomy alignment—including with the MS.

For CSRD clients, if the current provisions of the CSRD are to be maintained throughout the ongoing legislation process between the European Parliament and the European Council, the information provided concerning their compliance with the MS should be available through their public reporting and subject to limited assurance.

For non-CSRD clients and retail clients (who are not subject to disclosure obligations and from whom public sustainability information may not be available), banks may need to employ a separate process to assess client performance and compliance with the MS in case they are interested in assessing their Taxonomy alignment (e.g., banks with large SME portfolios). One such tool could be the provision of a **self-declaration form** or **questionnaire**.

Banks may wish to assess their clients' MS alignment because:

- i. The information provided as part of the self-declaration forms may be incomplete and require a more specific effort on behalf of the financing bank for the assessment of MS compliance.
- **ii.** Banks may soon have binding due diligence requirements as part of the Sustainable Corporate Governance initiative, and are increasingly influenced by domestic legislation linked to due diligence (e.g., the Netherlands).
- **iii.** Banks need an accurate understanding of their clients' MS compliance in order to encourage Taxonomy alignment for clients who are not yet fully aligned (please see Section C).

As such, whether relying on self-declaration forms and questionnaires or not, banks need a basic, practical, and straightforward process to assess the information provided by non-CSRD clients. Elements of the OECD's approach to risk-based due diligence may be useful in this regard.

## Due diligence, according to the OECD

Risk-based due diligence is the process that enterprises should carry out to identify, prevent, mitigate and account for how they address actual and potential adverse impacts in their own operations, their supply chain and other business relationships.

It is comprised of six main steps:

- 1. Embedding responsible business conduct into policies and management systems
- 2. Identifying and assessing adverse impacts
- **3.** Ceasing, preventing or mitigating adverse impacts
- 4. Tracking implementation and results
- 5. Communicating how impacts are addressed
- **6.** Providing for or cooperating in remediation, when appropriate

The main distinction between the kind of due diligence necessary to assess compliance with the OECD Guidelines for Multinational Enterprises and the UNGPs is that it is an ongoing process unlike usual financial due diligence (i.e., not strictly undertaken before, for example, a certain loan is extended).

It is also a process that is meant to identify actual or potential adverse impacts on people, the environment and society—not ESG risks that the bank may be exposed to. This approach is aligned with the EU's "double materiality" principle. It should thus be noted that the term "risk" in this context actually refers to "impacts on people."

In its draft report on social taxonomy,<sup>59</sup> the Platform on Sustainable Finance has identified the difficulties involved in ensuring that clients meet the MS requirement, from the perspective of an ESG rating provider. A distinct gap has been identified, which calls for, according to the Platform, "proactive alignment with MS requirements."

The Platform also recommends the development of "generic DNSH criteria" that would apply horizontally and assess compliance with the UNGPs and OECD Guidelines for Multinational Enterprises. Nonetheless, it should be noted that this recommendation refers to the responsibilities of bank clients in assessing their own compliance and is not so much linked to the issue of ensuring banks have a practical tool in assessing compliance themselves.

# Considering the responsibilities for assessing compliance, what is the most appropriate format of a tool for enquiring about MS?

When adequate public reporting is not available, which currently is likely in the majority of cases, banks may consider asking their clients to complete a self-declaration form or a questionnaire. A questionnaire may imply more responsibility on behalf of the banks for assessing that the information provided by clients is accurate before entering a contractual relationship with the bank (a process more closely related to active due diligence). A self-declaration (refer to Annex II) form may be more convenient, but it should be noted that the information provided may not be enough to practically assess compliance or be able to verify it. As such, banks have identified the possible solution to be the provision of self-declaration forms, accompanied by an independent verification mechanism that would allow them to assess the reliability of a smart sample of their clients.

# A basic two-step process for assessing client compliance with the MS

#### Step 1: Determining salient human rights impacts based on sector and geography

The first step could be a screening based on sector and geography. Certain sectors are associated with specific human rights impacts (e.g., the garment sector may be associated with occupational health hazard). Additionally, certain risks may be more prevalent in jurisdictions where the local legal regime is not aligned with international conventions on human rights issues—the socioeconomic context may be such that the risk for human rights violations may be exacerbated (e.g., high poverty rates, low education rates) and the political context may also contribute to possible human rights violations (E.g. armed conflict).

This first layer of screening can allow banks to already focus on the potential human rights impacts that are the most salient and adverse. The UNEP FI Portfolio Impact Analysis Tool for Banks could be a way by which banks can begin this analysis.

#### Step 2: Assessing compliance with the OECD Guidelines and UNGPs

Following the identification of the most salient human rights impacts to focus on, banks can proceed to create a questionnaire that is able to help them gauge the performance of their clients. It could follow a simple Y/N approach, with the option to provide supporting documentation to help banks assess the specific point. The content of a basic questionnaire could be based on the second pillar of the UNGPs (please see Annex II<sup>60</sup>). In the long run, banks can also look into tools such as the Environmental and Social Management System<sup>61</sup> developed by the International Union for Conservation of Nature (IUCN) to implement a process addressing common environmental, occupational health and safety, labor and community risks on the level of loan origination.

While the content in Annex II can be used independently, it can also be integrated into existing risk management screening processes.

<sup>61</sup> Environmental and Social Management System | IUCN

# B.4 Explanatory example on adaptive frameworks: alignment of construction of new buildings with EU Taxonomy requirements (known and unknown use of proceeds)

# General description

This example applies to clients that intend to seek financial support for the construction of new buildings in EU Member States either for their own use or for real estate purposes. The bank could provide a premium to interest rate margin, if all EU Taxonomy requirements are satisfied. The potential financing of a real estate company for the construction or the acquisition and ownership of existing buildings, either for project expenditures or working capital, is EU Taxonomy eligible. The financing of a client, belonging to other sectors, for the construction of a new, or acquisition and ownership of existing, buildings is not clearly EU Taxonomy eligible. For example, in financing a hospitality company for the construction of a new hotel building, if the construction and the new building satisfy the EU Taxonomy requirements, the hospitality company enjoys a beneficial pricing.

# TSC compliance assessment

#### Requirements:

- "The net primary energy demand of the new construction must be at least 10% lower than the primary energy demand resulting from the relevant net-zero energy building (NZEB) requirements."
- Taking into account the EU norms, off-site energy generation is "limited to district heating and cooling systems and local renewable energy sources."

The assessment should be take advantage of a building's **energy design study** (prior to the construction) and **energy performance certificate** (EPC—issued after the construction).

For buildings larger than 5000m², traceable quality control processes are expected to be in place during the construction process. Therefore, a detailed report covering the construction period is expected (including construction photo or documentation and BIM design model).

For buildings larger than 5000 m<sup>2</sup>, a numerical estimation of the global warming potential (GWP) for each stage of the building's life cycle is expected to be available. The relevant numerical estimation should be done in accordance with EN 15978 or an equivalent international standard.

# DNSH compliance assessment

Water: invoices, technical sheets, site inspection

**Circular economy:** invoices (recycling), report and site inspection for other issues **Pollution:** measurements from accredited laboratory, invoices and technical sheets, and site inspection

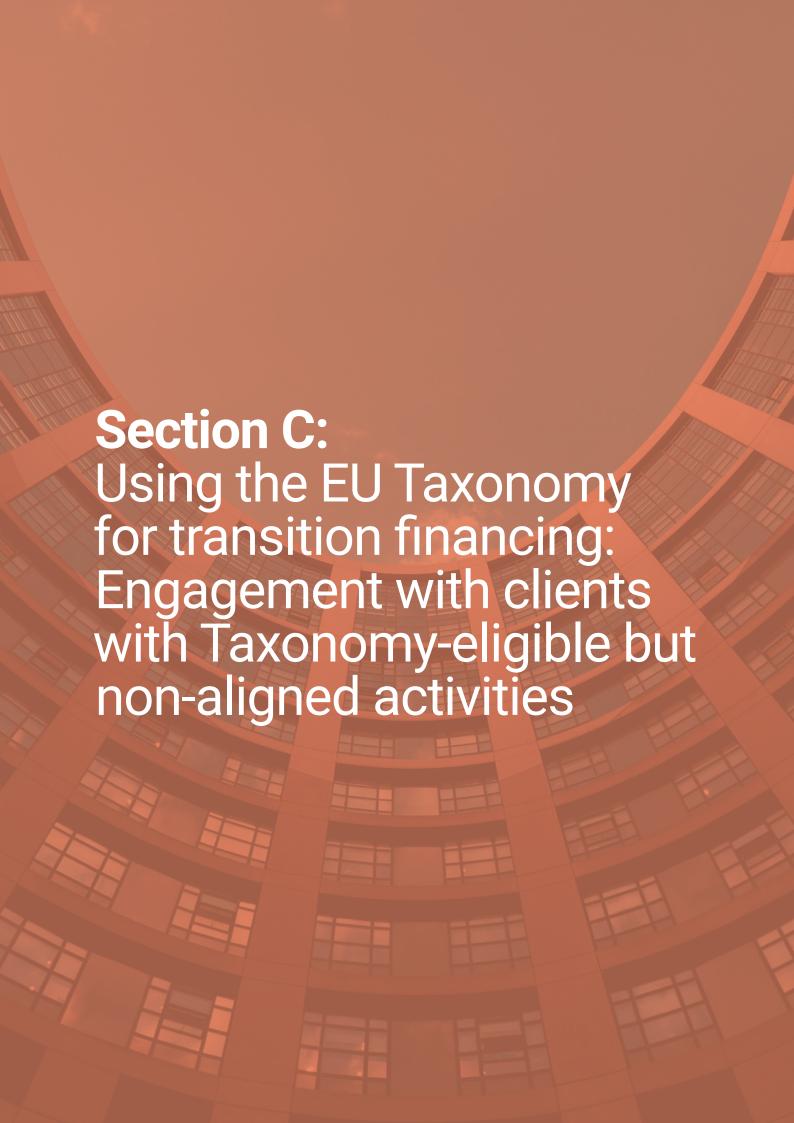
**Ecosystems:** (a) and (b) topographic plan, (c) invoices, technical sheets, site inspection

# MS compliance assessment

Self-declaration from the construction company or team and the asset owner (if different).

Concerns/ challenges/ opportunities	The assessment of the project is expected to be more time-consuming compared with conventional financing, while a smaller interest rate margin would be accepted. For small projects (wide application), a relevant procedure or product should be developed. The appropriate investment size for classing a project as "small" should be defined.
Data availability	Based on the energy design study. <sup>62</sup>
Internal processes	For small projects (wide application), the requirements related to site inspections, and the technical assessment of the projects, should be updated.

Actual energy performance data is missing in the case of new construction. As the buildings are yet to be constructed, the EPC assessment cannot be verified at the moment of granting the loans. A direct link with the EPC database could be a solution, where information could automatically be submitted to the banks once an EPC audit has been conducted and a value is known.



The EU Taxonomy is a science-based tool that provides clarity on what economic activities can be considered environmentally sustainable. This classification system has been developed in line with the EU climate goals of reducing greenhouse gas (GHG) emissions by 55% before 2030 and achieving climate neutrality by 2050. The TSC for economic activities to meet the 2030 and 2050 targets developed under the Taxonomy will guide economic policies and regulations stemming from the EU Green Deal and may become part of broader legal documents, enshrining these activities into law (similarly to the Climate Law mandating the achievement of the 2030 and 2050 goals by the EU and Member States). In this scenario, activities not aligned with the Taxonomy may at some point also become misaligned with the environmental regulations. The Taxonomy criteria could be used as one of the tools to plan and report on transition pathways and for setting clear performance targets.

As highlighted in Section A of this report, the main aim of the GAR is to show the percentage of banks' financing of Taxonomy-aligned activities. However, the objective of Section C is to explore how Taxonomy-compliance assessments can be **complemented by a system that facilitates engagement with clients active in Taxonomy-eligible sectors whose activities were assessed as not aligned with the Taxonomy.** Given that different counterparties have different starting points to become more sustainable or aligned with the Taxonomy, banks could benefit from further assessment of the non-alignment—primarily to prioritise clients' engagement and offer or design financing solutions. Such assessments could also assist banks' own target setting and portfolio alignment strategies and policies.

# C.1 Assessment of Taxonomy-eligible but non-aligned activities

Given that credit institutions will need to classify their exposures to activities covered by the EU Taxonomy (Taxonomy-eligible activities), they will be able to understand whether the exposures in their portfolio are:

- Taxonomy-eligible and Taxonomy-aligned
- Taxonomy-eligible but not Taxonomy-aligned

For a Taxonomy-eligible activity to be Taxonomy-aligned, it needs to *Substantially Contribute (SC)* to one of the six environmental objectives (complying with the relevant TSC), as well as to comply with the *Do No Significant Harm (DNSH)* and *Minimum Safeguards (MS)* criteria. An activity that is **Taxonomy-eligible but not Taxonomy-aligned** is an activity that is listed in the Climate Delegated Act but does not comply with one or more of the criteria indicated above.

The Article 8 Delegated Act does not require corporates to disclose the specific activities that are not aligned with the Taxonomy, e.g., there is no requirement to disclose the reason why an activity isn't Taxonomy-aligned—whether it does not comply with the TSC, DNSH criteria, MS criteria, or a mix or all these. However, being able to process this information in the internal systems will enable banks to identify and prioritise clients'

engagement in line with the bank's objectives and strategy. It will also allow banks to understand clients', and therefore their own, contribution to the climate neutrality objective even if the activity cannot be considered Taxonomy-aligned. If an activity complies with one or more (but not all) of the criteria to be considered Taxonomy-aligned, the activity can be recorded (internally) as being **Taxonomy-eligible with different levels of possible alignment.** Such a classification system will only be relevant for **internal tracking purposes**. For the disclosure purposes outlined in Article 8 Disclosures Delegated Act, such activities will not be Taxonomy aligned.

The objective of introducing such additional internal tracking system is to enable banks to evaluate how they can engage with the client to provide financial solutions that best meet their needs and transition of their activities or business models to be in line with the EU objectives. Given the potential need for bilateral engagement, depending on the business model and strategy of the bank, banks may decide to introduce such a tracking system only for certain portfolios, clients or sectors, or none at all.

Non-financial corporations have a regulatory requirement to disclose, using the tables in Annex II of the final Article 8 Delegated Act, the percentage of their turnover, and CapEx and OpEx that is aligned with the EU Taxonomy. This means disclosing the SC, DNSH, and MS compliance.

Non-financial corporations can voluntarily disclose information on the percentage of alignment with the SC criteria or the alignment or non-alignment with DNSH and MS for Taxonomy-eligible but not Taxonomy-aligned activities. Given that they have to mandatorily disclose on their alignment, they should have a good understanding of the level of non-alignment of their activities.

Credit institutions interested in financing the transition of their customers to more sustainable outcomes will need to work on this actively. On one hand, banks could study the counterparty's transition plans and make decisions accordingly. However, they could also engage bilaterally with their clients when such public information is not available to obtain the relevant information. Understanding their clients' **distance to alignment** is key to the topic of transition finance.

Based on the degree of misalignment, it is proposed to classify activities into those that are:

- Not likely to transition to the EU Taxonomy
- Likely to transition to the EU Taxonomy

and allocate managerial attention depending on the results of the analysis. Introducing timelines for the activities that are capable to fully transition to the EU Taxonomy is highly recommended. Further clustering based on time could also be considered. To evaluate the likelihood to transition, it is proposed to use the current level of performance of the activity against the level of *Substantial Contribution* required for Taxonomy alignment. If the distance is considered significant, the activity would be allocated in the "not likely to transition" bucket. However, if the company can provide the bank with a credible strategy **for the particular activity** to become Taxonomy aligned, this gap may be considered less severe. The distance to transition metric is then an "organic" measurement stemming from corporate Taxonomy disclosures and bank-client engagement.

The tool proposed below has been developed to provide banks with voluntary guidance on the key aspects they can consider to classify exposures' levels of misalignment with the EU Taxonomy.

Misalignment can happen in different areas (SC, DNSH or MS) and at different levels. This depends entirely on the factors that cause the misalignment and the distance of each of them to alignment. The distance to alignment is not meant to be a complex and burdensome evaluation. The objective of such an assessment is to be able to assign the activity to one of the buckets to further consider managerial attention and client engagement.

The tool considers the disclosure obligations for corporates under the Article 8 Disclosures Delegated Act complementing Article 8 of the EU Taxonomy Regulation, as well as the need to rely on voluntary information and direct client engagement. This is because Taxonomy-eligible but not Taxonomy-aligned information is not mandatorily disclosed and is not expected to be widely available.

The information is then classified in a table that shows the areas and levels of Taxonomy misalignment followed by a set of recommendations for engagement. Section B.3 has suggestions on how to engage on MS.

Please note that the tool below has been elaborated as provisional guidance on transition engagement with the information currently available on the EU Taxonomy. It will likely have to change as the regulation evolves. Guidance on DNSH is based on a similar understanding of compliance, as DNSH compliance can also be linked to transition plans. Guidance on MS is elaborated on the basis of the MS requirements and is exemplified in the "four-step process for assessing client compliance with the MS" in Section B.

# Understanding the level of misalignment and choosing the appropriate strategy for engagement—transition engagement tool

# Step 1—Identify the type of transaction and KPI needed for disclosure (Turnover, CapEx, OpEx)

Taxonomy alignment of unspecified use of proceeds would be the sum of the levels of alignment of range of activities the counterparty performs (generally observed through turnover). It will therefore be more difficult to understand the fundamentals of non-alignment for unspecified use of proceeds transaction.

Specified use of proceeds exposures would normally refer to only one activity. Understanding the level of misalignment would therefore be easier for specified use of proceeds.

# Step 2—Identify the level of Taxonomy-alignment of the activity(ies) relevant to the not-aligned portion of the exposure

Identify from the voluntary disclosures under Annex II of the Article 8 Delegated Act of the EU Taxonomy Regulation (as and when available) or via direct engagement with the customer (E.g. through a detailed self-declaration form) the area or areas in which the activity or activities related to the exposure do not meet the criteria for Taxonomy alignment—Significant Contribution/Do No Significant Harm/Minimum safeguards.

# Step 3—Exposure and activity information, Taxonomy-alignment information sourcing and area/level of misalignment

#### Identify exposures and activities

Exposures structured as specified use of proceeds transactions generally refer to one specific activity. Exposures structured as general-purpose loans finance the counterparty as a whole, for what revenue streams (turnover) in general serve as the KPI.

Activities pertaining to the same exposure should be grouped together to understand the linkages of non-alignment on the exposure.

#### Alignment with SC, DNSH and MS data

Assign a Y/N value to the level of compliance with the criteria as per the voluntary disclosures or information collected from direct engagement with the customer. Then assess the areas and levels of misalignment.

The results could be presented in a table such as the one below

sure	ity	Alignment v	Alignn	nent wi	th DNS	Align- ment	Area/level of misalignment				
Exposure	Activity	ССМ	CCA	ССМ	CCA	Pol	CE	Wat Eco		with MS	
А	A.1	No = 0%			N	N	N	N	N	N	Full SC+DN- SH+MS
В	B.1	No = 0%			Υ	Υ	Υ	Υ	Υ	Υ	TSC only
С	C.1	Yes > 0%			N	N	N	N	N	N	DNSH+MS
D	D.1	Yes > 0%			N	N	N	N	N	Υ	Full DNSH
	D.2	Yes > 0%			Υ	N	Υ	Υ	Υ	Υ	Individual DNSH
Е	E.1	Yes > 0%			Υ	Υ	Υ	Υ	Υ	N	MS

#### Step 4-Action depending on the Level of misalignment with the EU Taxonomy criteria

- With regards to SC TSC misalignment, it is recommended to banks to undertake the 'likelihood to transition' analysis based on the transition plans. Engagement with clients is recommended to understand their transition plans at activity level and the way forward of Taxonomy alignment of the activity and thus the exposure. The % of alignment may be useful to provide guidance on the engagement.
- With regards to **DNSH misalignment**, either partial or full, it is proposed to banks to assess the compliance of the activities with the DNSH criteria laid out in the Climate DA. Engage with the client in order to establish a baseline of performance on that level that can be useful for the discussions to evolve, and understand how this is tackled in their transition plan.
- With regards to **MS misalignment**, it is proposed that banks match the activities against the sample questionnaire for assessing compliance with the MS in Annex II below. Activity vs company-level nuances can be specified during client engagement.
- With regards to **combined misalignment** (1 or more areas of misalignment), it is recommended that banks use the approaches reflected above as relevant. When dealing with general-purpose loans, various levels of misalignment on different criteria are expected to emerge more often.

# C.2 Engagement strategies based on the Transition Engagement Tool

The following sections C.2.1 to C 2.4 are representing in an exploratory way on how the EU Taxonomy could be used by banks that wish to engage with clients whose economic activities are eligible for analysis under the EU Taxonomy, but are not yet aligned with the listed Technical Screening Criteria (TSC). Such an application of the EU Taxonomy for client engagement (e.g. using the TSC to set targets or financing based on transition plans) is still very much in the preliminary stage. This section provides the participating banks' initial thoughts on the matter.

The Transition Engagement Tool can be used by banks on a voluntary basis to understand clients' performance against Taxonomy-specific targets or EU policy objectives and plan the engagement with customers for different purposes (alignment with the EU Taxonomy, transition finance based on transition plans at the company level, divesting, capital restructuring, etc.).

The tool can also be used for engagement in the context of various climate commitments. Information can be extracted on the overall level of performance with the SC criteria of the Taxonomy, which marks the clear pathway to 2050 enshrined in the European Climate Law. It is worth noting that an activity can contribute to the race to net zero and be compliant with the objectives of climate neutrality by 2050 without being Taxonomy-aligned.

Finally, the tool could also be considered a baseline for **marking engagement with counterparties that are not bound to disclose any kind of information** as per the current reading of the Article 8 Disclosures Delegated Act (SMEs and non-EU). This way, the EU Taxonomy can be used as the baseline against which to compare performance. It can also be useful to mark further transitional actions that banks may want to voluntarily disclose.

At this stage, the tool excludes mortgages and car loans, given the complexity attached to engaging in transition discussions with retail customers and the different measurements that need to be used for assessing Taxonomy alignment in these cases. However, the tool could still be adapted for other types of exposure under specific circumstances.

# C.2.1 Target-setting financing solutions based on the EU Taxonomy-aligned KPIs

Understanding the degree of misalignment can help banks plan the engagement strategy and financing solutions. There are several options that can be envisaged for clients' engagement activities that are likely to transition. As a first step, the banks could establish the degree of misalignment and the specific criteria that the company should focus its efforts on to become Taxonomy aligned.

Setting clear KPIs based on the EU Taxonomy has the potential to positively impact both the customer and the bank, as they could both benefit from a higher Taxonomy alignment and allow for target setting/planning for both the company and the bank.

As per the guidance offered in the <u>Sustainability Linked Loan Principles</u> (SLLP), a SLL is any type of loan instrument and/or contingent facility (such as bonding lines, guarantee lines, or letters of credit) which incentivises the borrower's achievement of ambitious, predetermined sustainability performance targets or KPIs.<sup>63</sup>

In the context of this project, the topic of leveraging the TSC outlined in the EU Taxonomy to set the KPIs in such loans was discussed as a credible way to show how banks can support the EU's climate goals and finance the transition to sustainable operations across industries. Although target setting is completely voluntary and each bank is free to choose its own KPIs together with clients, such move will complement each bank's efforts to develop sustainable finance.

There are two kinds of KPIs that banks can set based on the TSC:

KPIs on:	Description	Alignment
Taxonomy-align- ment at company level	<ul> <li>This refers to provision of financing to a company linked to the increase of company's share of Taxonomy-aligned revenues by a certain %.</li> <li>This may refer to:</li> <li>Addressing the level of Substantial Contribution in the company's share of economic activities undertaken; E.g. A production plant that complies with DNSH and MS criteria but does not comply with the TSC for SC. In this case, the KPI would be to set a timeline for compliance without losing DNSH/MS compliance.</li> <li>Ensuring compliance with DNSH criteria E.g. A power plant compliant with the TSC for SC but not with the DNSH on water and marine resources would establish appropriate water DNSH compliance. In this case, the KPI will satisfy all the DNSH criteria as defined in the Climate DA.</li> </ul>	Alignment is assessed through turnover compliance data and engagement can be undertaken thanks to the Article 8 Disclosures and recommendations provided in section C.2
	<ul> <li>Ensuring compliance with MS criteria</li> <li>E.g. making sure the company establishes a good Human Rights policy in their value chains (at company level, see suggestions in Annex II).</li> <li>Closing down operations in sectors that are not Taxonomy-aligned</li> <li>E.g. Closing down a production plant that accounts for 20% of the company revenues but does not comply with TSC, DNSH or MS—thus effectively increasing their overall Taxonomy-alignment (reduction of non-alignment by expansion of % of Taxonomy-aligned activities in the overall mix of company activities).</li> <li>This provides for a holistic approach to the whole company split by Taxonomy-alignment of different economic activities. This effectively increases the Taxonomy-aligned turnover of the enterprise within a certain period of time.</li> </ul>	
Alignment at individual activity level—CapEx and/ or OpEx figures.	KPIs focused on a specific economic activity Taxonomy-alignment, tackling its level of alignment as per TSC, DNSH or MS criteria compliance.	Alignment is assessed through CapEx/OpEx levels of Taxonomy-align- ment

# C.2.2 Explanatory example: Transition finance to a client manufacturing steel based on real transaction, applying the Taxonomy Regulation and the tools provided in this report

# Explanatory example—transition financing of manufacturing of iron and steel

This example showcases the work of a member bank in providing transition finance to a client manufacturing steel. As a disclaimer, all of the information in this example has been provided by the banking member confidentially and anonymously, it reflects a very specific approach bound to the specific case-study analysed and encompasses and array of steps and information used as valid while there is still uncertainty on the final shape of disclosures of regulation. With all these caveats we endorse this example as a critical insight into banking processes for applying the EU Taxonomy.

## A. Eligibility/alignment assessment

#### 1. Sector

The activity performed by the customer is eligible as it falls under point 3.9 of the Climate Delegated Act "Manufacture of iron and steel" more concretely NACE code C24.51.

#### 2. TSC compliance assessment

Not aligned with EU Taxonomy (data provided by the customer).

#### 3. DNSH compliance assessment

Aligned with EU Taxonomy (data provided by the customer). The company complies with BAT (best available techniques) regarding pollution prevention and control (according to appendix C, Emissions are within the emission levels associated with the best available techniques (BAT-AEL) ranges set out in the latest relevant BAT conclusions, including the BAT conclusions for iron and steel production)

#### 4. MS compliance assessment

Data provided by the customer. Final alignment with the EU Taxonomy confirmed, information provided by the company on social practices and compliance with relevant local and EU regulation indicates alignment with MS.

After this initial eligibility/alignment check, the bank decides to provide financing to the customer—the purpose of the loan: to help the company to become aligned with the specific objectives of the clean steel association to become carbon neutral by 2050 using the Taxonomy as a tool. In this case the activity has been deemed highly likely to transition to Taxonomy compliance, and a plan for financing has been set up with the customer in order to tackle some of the key areas of impact in order to deliver on the relevant goals.

## B. Extra considerations for ensuring alignment and approach to transition

- 5. Concerns/Challenges/Opportunities related to the type of financing provided (known vs unknown UoP) and how you overcome this
- 5.1 Concerns on TSC compliance assessment
  - a) No data to proof the company complies with 0.382 tons of CO<sub>2</sub> equivalent per ton of special steel produced. No data available to proof the intensity of emissions by production phase for fine steel and no data on the production mix
  - b) Steel production in electric arc, as defined in Commission Delegated Regulation (EU) 2019/331, and when the entry of steel scrap with respect to production is not less than:
    - i. 70% of the production of fine steel.
    - ii. 90% of carbon steel production. The company gets it at 90%. 100% target.
  - Technology or research on CCUS. The client is not part of the IOGP that carries out a research project at CCUS

#### 5.2 Concerns on DNSH compliance assessment

- Circularity; Scrap. It uses it as a raw material. But in this case the Taxonomy explains that it is not applicable (there is no other way to produce steel when it is produced with an electric arc)
- Prevention of pollution (MTD); the client proves by crying out a follow on the best available technologies implemented, according to Commission Implementing Decision 2012/135/EU of 28 February 2012 establishing the best available techniques (BAT) conclusions under Directive 2010/75/EU of the European Parliament and of the Council on industrial emissions for iron and steel production (OJ L 70, 8.3.2012, p. 63).
- 5.3 **MS compliance assessment:** The company complies with local European laws where operates and has a strong report on social practices.
- 5.4 **Other concerns**: The Group has published its last Sustainability Report in 2016. However, they are preparing a sustainability report and a sustainable strategy
- 5.5 **Challenges**: Reflect the path of the loan through the company's structure. European steel propose to reduce their CO<sub>2</sub> emissions by 30% by 2030 and up to 80–95% by 2050. A KPI linked loan might work. An agreement with an Energy Service company might be desirable

Explanation on the approach followed by the bank to work out the feasibility of alignment for transition and establishing KPIs. Using both the tool provided by this report and the preliminary information from the EU Platform on Sustainable Finance on transition pathways, including intermediate levels of Taxonomy performance and significant harm.

The customer is bound to NFRD reporting—all of the available information in order to manually assess compliance has been provided by the customer itself. This information includes all relevant information to make a Taxonomy-alignment assessment possible—CO<sub>2</sub> emissions, DNSH (water usage and prevention of pollution) and MS.

The company is committed to become net zero by 2050 and it has decided to follow the pathway established by the Clean Steel Partnership Roadmap (while not indicated in the EU Taxonomy Regulation or Climate DA, this is a project endorsed by the European Commission: estep.eu/clean-steel-roadmap/).

The pathways in that roadmap for this particular activity would be as follows:

- Develop technologies reducing CO<sub>2</sub> emissions from steel production by 50% by 2030;
- Develop deployable technologies that can reduce CO<sub>2</sub> emissions by 80-95% by 2050, ultimately achieving climate neutrality.

All of this while preserving the competitiveness and viability of the EU steel industry and making sure that EU production will be able to meet the growing demand for steel products. This general objective is in line with the climate ambitions and commitments set by the European Green Deal, the UN's 2030 Sustainable Development Goals, and the Paris Agreement.

To perform a Taxonomy-compliance assessments has helped the bank to establish the metrics and the thresholds on  $\mathrm{CO}_2$  emissions, DNSH and MSS **as a baseline**, so the bank can elaborate a KPI plan with the company, following up the metrics and so the distance to get the level of Substantial Contribution required. The Non-Financial information reports that should be published and verified by a reliable third party will demonstrate that this happens, stepping towards levels of compliance with SC/DNSH and MS.

At this stage, the information provided by the customer on their non-financial report shows that TSC they would be in the "intermediate performance" level as per the draft report of the EU Platform on Sustainable Finance on the extension of the EU Taxonomy beyond "green". The KPIs will use the EU Taxonomy in order to monitor the transition of the company from that lower level of performance to compliance with the Technical Screening Criteria.

For this, the bank has used the tool provided in this section of the report in order to match the areas of engagement, effectively measuring the level of misalignment and choosing the appropriate strategy for engagement—EU Taxonomy as a Transition Engagement tool.

# Step 1—Identify the type of transaction and KPI needed for disclosure (Turnover, CapEx, OpEx)

The activity of the company is eligible (3.9)—NACE C24.51

# Step 2—Identify the level of Taxonomy-alignment of the activity(ies) relevant to the not-aligned portion of the exposure

We have identified through the Non-Financial information report published that the activity related to the exposure do not meet the Taxonomy-alignment needs for Substantial Contribution and DNSH criteria.

# Step 3—Exposure and activity information, Taxonomy-alignment information sourcing and area/level of misalignment

Alignment with SC, DNSH and MS data

Exposure	Activity	Alignm with So		Align	ment w	vith DN	Align- ment	Area/ level of			
Ехро		ССМ	CCA	ССМ	CCA	Pol	CE	Wat	Eco	with MS	misalign- ment
X	3.9 NACE C24.51	No = 70% level of alignment	N/A	YES	YES	YES	YES	YES	YES	YES	TSC

### Step 4—Action depending on the Level of misalignment with the EU Taxonomy criteria

The 'likelihood to transition' of the company is high, engagement with the company is positive and is expected to remain this way given their commitment to transition, analysis. Engagement with clients is recommended to understand their transition plans at activity level and the way forward of Taxonomy alignment of the activity and thus the exposure. The % of alignment may be useful to provide guidance on the engagement

As the client does not comply with the required levels of Substantial Contribution, but does comply with DNSH for Climate Change Mitigation, the activity falls under intermediate performance at a level of 70% of alignment with TSC, the activity would be falling in the level of intermediate performance at a quite high rate, being able to transition to substantial contribution.

#### C. KPIs

Relevant KPIs are set so the company and the bank can monitor level of performance/ achievement of the targets using the Taxonomy metrics on TSC, DNSH and MSS as a baseline

Ambitious and material sustainability KPIs connected to the EU Taxonomy and the Clean Steel Partnership Roadmap:

- A 30% reduction in greenhouse gas emissions by 2030 compared to 2018 levels (this would be equivalent to a 55% reduction in emissions compared to 1990 levels). Electricity from renewables with a special contract or self-consumption through an ESE for certain steelmaking processes, such as secondary steel from an electric arc furnace
- Reduction of between 80 and 95% of greenhouse gas emissions by 2050. Developing, testing and scaling innovative technologies for the production of clean steel consistent with the 2050 climate neutrality target. Implementing Digital solutions to monitor the evolution of the CO<sub>2</sub> emissions

Ensure the construction by 2030 of at least two demonstrations of a technology pathway (Direct Carbon Avoidance, Process Integration, Carbon Capture and Use, Circular Economy) leading to an 80% reduction in CO<sub>2</sub> emissions compared to 1990 levels for plants where demonstration projects are implemented.

The Taxonomy criteria for steelmaking are setting a long-term "gold standard", encouraging investment in new cutting-edge technologies that markets are not yet familiar with, and leaving room for transitional investments that help the industry of steel to advance towards the objectives of the European Green Deal.

The KPIs set will be measured comparing the baseline established before year on year verified by third party. Following the box bellow so we can see the evolution to the green side. The KPIs have followed the proposed approach in the report as indicated above:

KPIs on:	Description	Alignment
Taxonomy-alignment at company level This provides for a holistic approach to the whole company split by Taxonomy-alignment of different economic activities. This effectively increases the Taxonomy-aligned turnover of the enterprise within a certain period of time	This refers to provision of financing to a company linked to the increase of company's share of Taxonomy-aligned revenues by a certain %.  This may refer to:  Addressing the level of Substantial Contribution in the company's share of economic activities undertaken;  Ensuring compliance with DNSH criteria  AND/OR  Ensuring compliance with MS criteria  Closing down operations in sectors that are not Taxonomy-aligned	Alignment is assessed through turnover compliance data and engagement can be undertaken thanks to the Article 8 Disclosures and recommendations provided in section C.2
Alignment at individual activity level—CapEx/ OpEx figures.	KPIs focused on a specific economic activity Taxonomy-alignment, tackling its level of alignment as per TSC, DNSH or MS criteria compliance.	Alignment is assessed through CapEx/OpEx levels of Taxonomy-alignment

# D. Further considerations on data, internal systems and customer engagement

6. Type of data used (e.g. internal data, public data, data providers, client's data (not public))

Criteria and thresholds: Data provided by the client.

DNSH assessment: Data provided by the client.

Social Safeguards Assessment: They already have an implemented plan

Turnover/CAPEX/Opex: Financial information

### 7. Extent to which internal processes could be used/had to be adjusted

As data was not available in accordance with Taxonomy, the analysis by the bank had to be done manually.

### 8. Extent to which bilateral engagement was necessary

Client engagement was fundamental in order to obtain data, plan the approach and commitments. The Client is willing to be Taxonomy aligned and work with us to get there by 2050. The approach was complementary—client willing to transition and demonstrate compliance and bank able to provide financing after assessing the relevant conditions of the customer on both risk appetite and sustainability transition angles.

Still there are some concerns for this particular activity that should be tackled with a more comprehensive approach:

- Production costs are estimated to increase by 35–100% per tonne of steel produced by 2050 as a result of the costs of using new technology and more energy.
- The additional energy requirements are estimated at 400 TWh of CO<sub>2</sub>-free electricity by 2050, which is seven times more than the electricity currently purchased by the entire sector.
- Competitiveness concerns.

# C.2.3 Financing solutions based on transition plans at companies' level

As in the previous subsection, this section is based on early-stage approaches amid further developments and discussion on solutions to finance the sustainability transition.

It is important that the banking sector finances: (a) activities that can already be considered EU Taxonomy aligned; and also (b) activities that are performing at intermediate level and can accelerate companies' transition. The thresholds set by the European Commission in the EU Taxonomy (for climate objectives) are ambitious and aligned with the final Paris Agreement objective of 1.5°C and 2030–50 decarbonisation targets, both incorporated into the European Climate Law agreed by all EU Member States. The EU Taxonomy criteria are set to achieve these goals by specifying levels of performance for activities in line with these targets.

In this paper, the term "financing transition" means financing pathways to meet these targets. There are several publications from established organisations that emphasize a similar approach for Taxonomies:

- At international level, in its A taxonomy of sustainable finance taxonomies report (Oct 2021), the Bank for International Settlements states the following: "To recognise and promote transition activities, taxonomies can also utilise forward-looking measures, which are expected impacts inferred from firms' past performance. These measures assess whether the characteristics of the activity and the trajectory of emission reduction are sufficient to achieve pledged environmental benefits. As an example, the Science Based Targets initiative (SBTi) promotes a science-based standard for net-zero target setting, to guide companies in how to translate the objective of a carbon-neutral economy by 2050 into tangible actions." In its Principle 4, the BIS emphasizes that: "A Taxonomy that ignores entity-based information runs the risk of encouraging greenwashing in the mild sense... It is important that taxonomies be effective and affect incentives on the level of the entity, at which most investment decisions are made... taxonomies should incorporate entity-based information whenever possible." "Transition taxonomies must cover transition pathways at the entity level."64 The transition pathways at the entity level could complement the information provided by the alignment to the EU Taxonomy.
- The <u>TCFD report on metrics and transition plans</u> (Oct 2021) also emphasizes the need to better recognize entities' investments in intermediary steps on the pathway toward sustainability.
- The G20 Sustainable Finance Working Group made several recommendations on transition in Oct 2021 and states the following: "Action 1: The G20 encourages jurisdictions that intend to develop their own alignment approaches to refer to a set of voluntary principles: [...] Principle 3: Be dynamic in adjustments reflecting changes in policies, technologies, and state of the transition; [...] Principle 6: Address transition considerations." "Action 4: Better integrate transition finance considerations into sustainable finance alignment approaches."

<sup>64</sup> P. 8, A taxonomy of sustainable finance taxonomies, Bank for International Settlements

The European Commission looks at transition finance both through the Taxonomy and from the strategic perspective.

- The EU Taxonomy already recognizes that certain activities that contribute to climate change mitigation can be considered "transitional." This means their performance would not be at the full level of performance expected from an activity considered to be fully compliant with the Paris Agreement objectives; nevertheless, they are important to the transition objectives. Such activities can already be considered Taxonomy aligned even though their performance is only partially aligned with 2050 goal. Additionally, as announced in the European Commission's Strategy for financing the transition to a sustainable economy, and in line with the work program of the Subgroup 3 of the EU Platform on Sustainable Finance, there is ongoing work to consider extending the EU Taxonomy to activities that do not have a significant impact on environmental objectives and economic activities that significantly harm environmental sustainability. The Platform is also considering complementing the EU Taxonomy with intermediate threshold of performance for economic activities eligible for the EU Taxonomy. The European Commission will publish a report describing the approach in the near future (expected in H1 2022).
- From a strategic perspective, the European Commission's <u>Strategy for financing the transition to a sustainable economy</u> emphasizes the transition and the mandate given to <u>EFRAG</u> to define the transition plans for the companies under the CSRD. Common principles and standards (consistent with international frameworks) will be provided by the European Commission following the EFRAG technical standards work on transition plans, as required by the CSRD. Transition plans will be a critical step to accompany the EU Taxonomy reporting, allowing for a synergetic and concrete approach to companies' transition.

A transition plan should normally cover the efforts to be made by companies to meet the SC criteria of the Taxonomy Regulation on the companies' activities, in line with the transition pathway for the sector in which the company operates, based on recognised scenarios and sectorial standards.

The transition plan that will be further defined by EFRAG should therefore not only include the targets at corporate level, but also define and evaluate realistic and ambitious decarbonisation strategies and actions of the corporates, as well as their alignment to the sectorial strategies consistent with the Paris Agreement mitigation goals. The consistency of the transition plan components with the corporate's objectives, as well as the consistency of the methodologies from one year to another, could be validated by third parties (e.g., audit or certificate). This approach would also allow some convergence at international level (ISSB/IFRS).

It could take the form of, for example: (i) intermediate threshold; or (ii) "reduction target" (EU objective of 55% reduction in 2030) in line with the low-carbon plan developed by the EU Member States and the review of EU sectorial regulation. Some of these thresholds at an activity level are already included in the EU Taxonomy for mitigation as "transitional" performance activities (where there is no 2050 screening criteria). For climate objectives, the transition plan would refer to a set of KPIs allowing a company to meet net zero by

2050. The work of the Platform on Sustainable Finance on intermediate targets could be useful in this context.

A transition plan should include all the necessary components (past, present and future) to assess a corporate's level of transition and to compare its decarbonisation curve with its sectoral and geographical decarbonisation curve.

### **Examples of components of a transition plan**

- The company's starting point, transition speed and decarbonisation objectives—including Taxonomy-relevant data that can help understand how the company will move with regards the activities it undertakes.
- Forward looking capex forecasts and past actual capex allocated to activities aligned with the EU Taxonomy
- The geographical location of its assets, as transition ambitions and technological developments differ across geographical areas.
- Information on the commitments taken by the company. These commitments should be reliable in terms of governance and transparency (results, pathway adjustments)
- Information on the resources (financial and human) a company uses to reach its objectives, E.g. credible financing plan, monitoring tools, CapEx
- Impact on indebtedness, projected cash flows and projected P&L
- As the transition plan based on the 1.5°C pathway can only cover the climate objective, it would be complemented by the remediation plans targeting to meet the "Do Not Significant Harm" and "Minimum Social Safeguards" criteria. This ensures that the Taxonomy approach that will be used to monitor the evolution of the company performance on the activity side, is tackled at the whole of the company level, with concrete actions to mitigate any negative impacts that may be happening holistically.

## Example: Climate-related Disclosures Prototype—03.11.2021— Recommendations from the Technical Readiness Working Group (TRWG) for consideration by the International Sustainability Standards Board (ISSB) for a climate-related disclosures standard

- "8 An entity shall disclose information that enables users of general purpose financial reporting to understand its assessment of the impact of significant climate-related risks and opportunities on management's strategy and decision making, including its transition plans. Specifically, the entity shall disclose:
- (a) how it is responding to significant climate-related risks and opportunities including but not restricted to:
- (i) how it plans to achieve any climate-related targets it has set, including how these plans will be resourced, the processes in place for review of those targets, and assumptions about the use of carbon offsets in achieving the target, including minimum quality or certification thresholds for the offsets.
- (ii) how it is advancing research and development related to climate-change mitigation, adaptation, or opportunities.
- (iii) whether it is adopting new technologies.
- (iv) what direct adaptation and mitigation efforts it is undertaking (for example, through workforce, changes in materials used or product specifications, or introduction of efficiency measures).
- (v) what indirect adaptation and mitigation efforts it is undertaking (for example, through working with customers and supply chains or use of certification schemes (for example, an internationally recognised scheme providing certification for the sustainability of a commodity such as lumber or palm oil)).
- (vi) the extent to which mitigation efforts rely on offsetting strategies and the factors affecting the choice of any offsetting strategy; for example, following an assessment of multiple schemes, a technology company has decided to offset residual emissions within its value chain via an afforestation programme to meet its strategic commitment to mitigate climate risk. The company selected [] offset programmes because they led to permanent and additional outcomes, and met an accredited verification standard. The entity described each project, the geography in which the projects operate, the number of metric tonnes of offsets, the cost per metric tonne, the year in which the emission reduction occurred and the verification standard applying to the scheme.
- (b) plans and critical assumptions for legacy assets, including strategies to manage carbon energy- and water-intensive operations, and to decommission carbon- energy- and water-intensive assets.
- (c) quantitative and qualitative information about the progress of plans previously disclosed in accordance with paragraphs 8(a) and 8(b).
- (d) how significant climate-related risks and opportunities are included in the entity's financial planning decision making (for example, in relation to investment decisions and funding)."

Financing of companies based on credible transition plans is linked to the EC's ambition to accelerate the contribution of the financial sector to transition efforts, by translating EU'S sustainability goals into long-term financing strategies and decision-making processes of financial institutions. The Commission is also looking into possible further guidance and monitoring of voluntary commitments of the financial institutions towards achieving net-zero objectives, including the possibility of using the EU Taxonomy and other sustainable finance tools to progress towards achieving financial institutions 'objectives at entity or portfolio level. Alignment approaches like the Guidelines for Climate Target setting, used by the members of the UNEP FI Net-Zero Banking Alliance<sup>65</sup> and PRB Collective Commitment for Climate Action<sup>66</sup> could also be used to underpin commitments by clear guidelines that can be applied using different methodological approaches. It will allow banks to combine Taxonomy approach and alignment approaches to their portfolios.

To finance transition, it is critical for banks to actively engage with corporates, exploring the most appropriate financing solution to address the transition needs of companies. Companies' transition plans may either be disclosed by them, or become available through bilateral engagement or as part of the loan origination process. Such transition plans may, in several instances, be at the level of the company as opposed to at the level of activity, and would reflect on several activities of the company.

Banks may wish to design financial products and solutions for companies based on their transition plans. These financing products could be considered complementary to the financing of EU Taxonomy-aligned activities or lending solutions based on Taxonomy-aligned KPI targets at activity level. Such an approach could also be considered for sectors haven't been listed in the Climate Delegated Act for climate change mitigation and adaptation. In banking, activities with this type of financing could be either covered by: (i) a sustainability or KPI-linked loan; or (ii) based on alignment methodology such as PACTA. In all cases, the targets should be in line with EU climate targets (net zero by 2050).

## **Using KPI loans**

To avoid "transition washing," it is necessary to provide evidence on how a KPI loan linked to a transition plan at the company level contributes to the realisation of the investment plan. There should also be a requirement that a company cannot raise more sustainable funding than the amount of sustainable investments it undertakes (within a given timeframe). Companies should be encouraged to make their own emissions reduction engagement based on scientific targets (e.g., by referring to a science-based climate scenario or adopting objectives aligned with science-based targets) and implement robust governance.

Banks have developed common tools to define a common methodology on assessing alignment with the EU targets. In the frame of the Net-Zero Banking Alliance, more than 90 banks have agreed to refer to a sector-based approach as, for example, used in the PACTA methodology. Similarly, the Financial Services Taskforce, part of the Sustainable

<sup>65</sup> unepfi.org/net-zero-banking/

 $<sup>\</sup>underline{\text{unepfi.org/wordpress/wp-content/uploads/2021/04/UNEP-FI-Guidelines-for-Climate-Change-Target-Setting.pdf}\\$ 

Markets Initiative, published a methodological guide to support implementation of a net-zero strategy.

## C.2.4 Engagement with clients based on NACE sub-activities

Banks and investors will want to automate mapping of exposures to EU Taxonomy with the help of activity, sub-activity, and product codes of companies.

- In Europe, the first four digits are called NACE, which is the main activity code (NACE 4-digit). This main activity or sector code is the level of detail that most banks and investors use.
- The first six digits are Classification of Products by Activity (CPA). This is the sub-activity (or sub-industry) level: 6-digit CPA = NACE 4 digit + 2-digit.
- The first eight digits are PRODCOM or Combined Nomenclature (CN), depending on use. This is the product level: 8 digit PRODCOM = NACE + CPA + 2 digit).

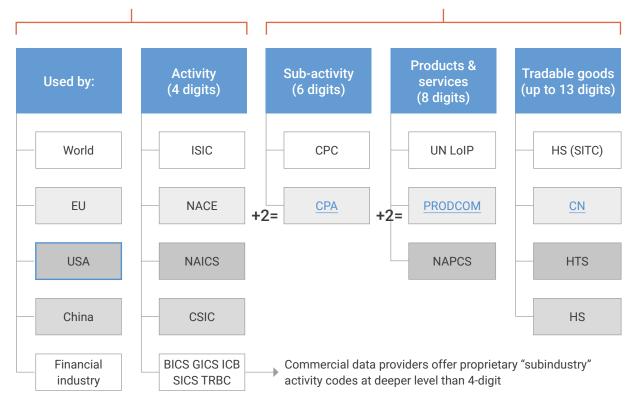
A multi-digit economic activity classification system is used globally, as shown in the image below.

### Global activity and sub-activity coding systems

Banks do not know the sub-activity a client is in. Structured data are not publicly available.

Banks only know the main activity (=sector) a client is active in

This makes Taxonomy eligibility and alignment screening manual and time consuming.



It is relevant to note that:

- Banks and investors do not classify the sub-activities of a client, or the products and services of a client, in their systems. External commercial data providers use their own proprietary sub-activity codes.
- Structured data at this sub-activity level (such as PRODCOM) is not publicly available at the company level. It is mandatory for EU Member States to collect these data via statistical authorities. Companies report production and trade data for that reason at PRODCOM and CN sub-activity levels.

Within the EU Taxonomy Regulation, many of the TSC and DNSH criteria are actually not defined at NACE level but instead at the CPA or PRODCOM sub-activity or product levels. It often captures the entire product group or product class. These can be relatively homogenous (e.g., cement, steel or cars), but this is not always the case (e.g., chemicals). Many environmentally friendly "enabling" products have specific PRODCOM or CN codes in daily economic life, as well as the individual components of these products. The EU Taxonomy Compass only provides information about the activity level (NACE 4-digit) but not at the sub-activity level, which makes it insufficient for a machine-readable activity classification.

The fact that EU product codes may not distinguish sustainable products from their non-sustainable versions should not be an issue. The EU Taxonomy TSC can still be used as a "sustainability" identifier—through specific CO<sub>2</sub> emissions thresholds for commodities, and through certifications for forestry or agricultural products for those sub-activities. The EU already takes this approach in the System of Environmental Economic Accounting (SEEA) and collects data at product or product-class level.

Banks and investors could automate mapping of exposures to EU Taxonomy with the help of activity, sub-activity and product codes of companies to actively steer toward financing sustainable activities and sub-activities. A combination of a directory of companies with sub-activity and product codes such as PRODCOM or CN would allow banks to identify eligible companies in an automated way as sub-activities are machine-readable.

For this, banks would need at least two of the following:

- **1.** A Taxonomy Compass maintained centrally by the EU that would include sub-activities (CPA, PRODCOM and CN)
- 2. A directory of all companies and their (sub-)activities (NACE, CPA, PRODCOM and CN)
- 3. Ideally, production data (amount or proportion of production or revenues) although 1) and 2) would its absence already allow for an automated screening process

Since banks engage with clients across supply chains, the use of CPA or PRODCOM sub-activity codes would help them immensely in identifying and classifying activities correctly. This would include companies in the supply chain of clean mobility, such as electric motor vehicles (29.10.24.50), electric motors (27.11.2x), charging stations (27.12.40), and fuel cells (27.90.42/44).

To support automatisation, the EU should consider expanding the number of sub-activities that the EU Taxonomy covers, without causing issues for the users of the Taxonomy. An example of sub-activities for clean mobility is shown in Figure 2. This will also facilitate international supply chains since there are detailed tables available to map EU activity classifications with similar non-EU classifications.

With the proper tools (a compass and a directory that both contain sub-activities), it would be possible for banks to actively strengthen the entire supply chain of certain sustainable activities, including the financing of SMEs that play a key role in the supply chain for that activity.

An SME often has only a very limited number of products or services and plays a small role in the supply chain. For example, SMEs that produce glues or essential metals and minerals for batteries, or air filters for high-speed charging stations, can only be identified if there are machine-readable data available on their sub-activities or products.

For large international conglomerates this is equally useful. Without machine-readable data on sub-activities, it would be difficult to know how they contribute to various sustainable supply chains.

Example: Eurostat has published a guidance note for electric and more resource efficient transport equipment<sup>67</sup> that includes the sub-activity codes PRODCOM and CN codes. The EU Taxonomy compass should contain the same codes.

 $<sup>\</sup>frac{\text{ec.europa.eu/eurostat/documents/1798247/12177560/Guidance+note+on+electric+transport+equipment+-+technical+note.pdf/2ddec6dc-8ca9-1736-0f36-18ed2233af0b?t=1609859296315}$ 

Equipment	Description	PRODCOM code	CN code	Major environ- mental impacts	Distinct technical features	Rationale for reporting as environment product
Essential infras	structure					
Recharging infrastructure	Charging stations and other essential infrastructure for recharging electric transport equipment	27.12.40 27.90.44	85 04	Improving urban air quality and potentially decreasing CO <sub>2</sub> emissions from transport	Specific design (e.g., plug) to charge electric vehicles	Essential for electric transport equipment
Technical comp	onents of electric vehicles					
Fuel cells	see PRODCOM/CN code	27.90.42.00	85 01 31-34	(see fully electric cars)	Electrical equipment	Essential for electric vehicles
Batteries	see PRODCOM/CN code	27.20.11-24	8 06; 85 07	(see fully electric cars)	Electrical equipment	Essential for electric vehicles
Electric motors	see PRODCOM/CN code	27.11.10; 27.11.21.00; 27.11.25.30	85 01 10; 85 01 20 00; 85 01 31 00; 85 01 32 00; 85 01 33 00; 85 01 34 00; 85 01 40; 85 01 51 00; 85 01 52; 85 01 53 50	(see fully electric cars)	Electrical equipment	Essential for electric vehicles
Other electric equipment	see PRODCOM/CN code	27.90.41; 27.90.45; 29.31.10; 29.31.30; 29.32.30	85 35-36; 85 44	(see fully electric cars)	Electrical equipment	Essential for electric vehicles

Equipment	Description	PRODCOM code (numbers in parentheses to be verified)	CN code	Major environ- mental impacts	Distinct technical features	Rationale for reporting as environment product
Electric unicycles	Vehicles touching the ground with only one wheel and driven by an electric motor	(30.91.13.00)		Relatively energy intensive production;	Electric motor,	Electric trans- port equipment;
Electric scooters	Stand-up rollers/scooters with a large deck in the centre driven by an electric motor	30.91.13.00	87 11 20 10	highly energy effi- cient and no tail-pipe emissions during	inverter, and small traction	no tail-pipe emissions
Pedal assisted e-bikes, e-tricycles, and e-quadricycles	Powered cycles categorised as L1e-A vehicles with an electric motor of a maximum rated power of 250 W, whose operations does not require a driver's licence	30.91.13.00	87 11 60 10	use; mitigate local air pollution and expo- sure to NO <sub>x</sub> , particles, hydrocarbons; large	battery	
Small electric scooters and mopeds	Two-wheelers categorised as L1e-B vehicles14 without pedal assistance, having a maximum speed of 45 km/h, and being propelled solely by electric motor(s) of a maximum rated power of >0.25-4 kW	30.91.13.00	87 11 60 00; 87 11 60 90	climate benefits, that are, however, sensi- tive to mode shift and the carbon intensity of electricity; renew-		
Large electric scooters and motorcycles	Two-wheelers categorised as L3e and L4e vehicles with a maximum speed of >45 km/h, being propelled solely by electric motor(s) of a maximum continuous rated power of >4 kW	30.91.13.00	87 11 60 00; 87 11 60 90	able electricity and second-life battery use can decrease climate impacts considerably		
Electric three- and four- wheelers	Three- and four-wheelers designed for passenger transport or utility purposes, categorised as L2e, L5e, L6e, L7e vehicles, being solely propelled by electric motor(s)	29.10.24.50	87 11 60 00; 87 11 60 90			

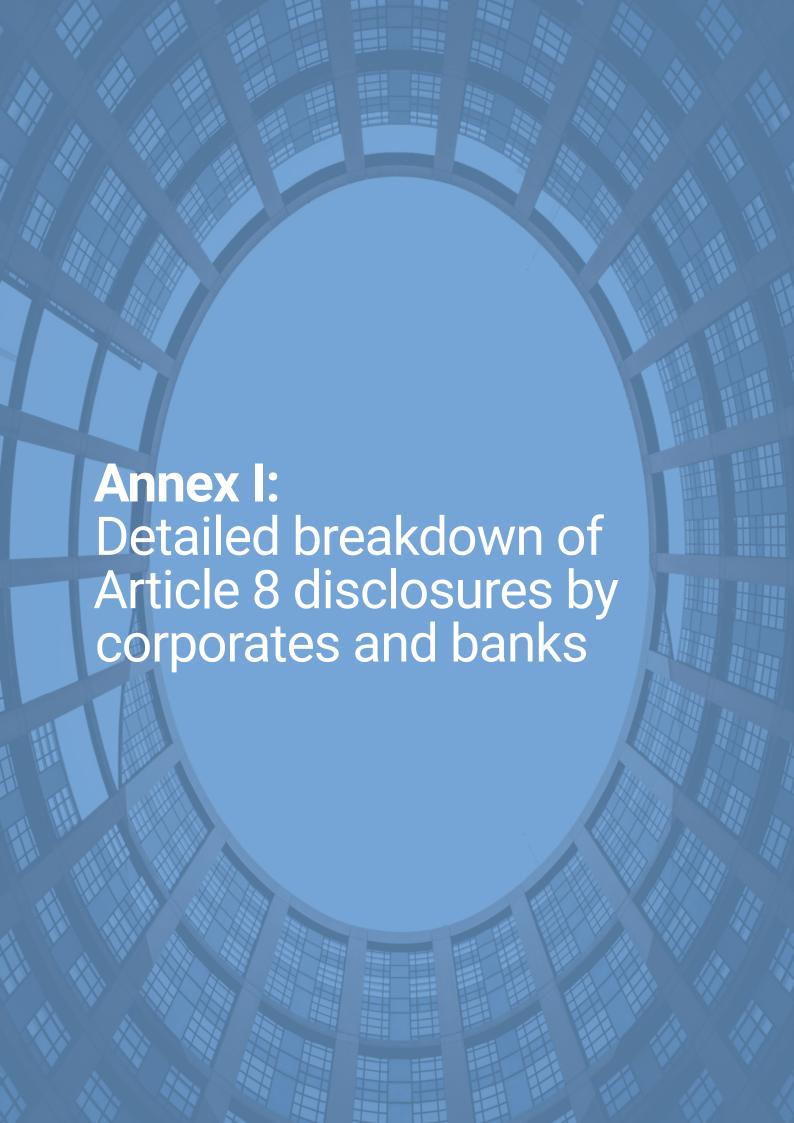


Table I

				Sul	ostanti	al con	tributio	n crite	eria	('D	oes No	DNSH ot Siar	criteria ificant	ly Har	m')					
Economic activities (1)	Code(s) (2)	Absolute turnover (3)		Clir	, Climate change adaptation (6)	, Water and marine resources (7)		Pollution (9)	Biodiversity and ecosystems (10)	Climate change mitigation (11)	Climate change adaptation (12)	Water and marine resources (13)	Circular economy (14)	Pollution (15)	Biodiversity and ecosystems (16)	Minimum safe- guards (17)	Taxono- my-aligned proportion of turnover, year N (18)	Taxono- my-aligned proportion of turnover, year N-1 (19)	Category (enabling activity or) (20)	Category '(transitiona activity)' (21)
		Ссу	%	%	%	%	%	%	%	y/n	y/n	y/n	y/n	y/n	y/n	y/n	%	%	Е	Т
A. TAXONOMY-ELIGIBLE ACTIVITION	TES								1											
A.1. Environmentally sustainable octivities (Taxonomy-aligned)																				
Activity 1				D	%	%	%	%	%	B	у	у	у	у	у	у	F %			
Activity 2			%	%	%	%	%	%	%	у	у		у	У	у	у	%			
Turnover of environmentally sustainable activities (Taxono- my-aligned) (A.1)			%	%	%	%	%	%	%								<b>G</b> %			
A.2 Taxonomy-Eligible but not environmentally sustainable activities (not Taxonomy-aligned octivities)																				
Activity 1			%																	
Activity 3			%	-																
Turnover of Taxonomy-eligible but not environmentally sustain- able activities (not Taxono- my-aligned activities) (A.2)			%																	
Total (A.1 + A.2)		F	%														%		%	
B. TAXONOMY-NON-ELIGIBLE A	TIVIT	IES _																		
urnover of Taxonomy-non-eligible activities (B)			%													•		1		1
Total (A + B)			%																	

- **a.** List of **activities eligible and aligned** under the EU Taxonomy.
- **b.** List of **activities eligible but not aligned** under the EU Taxonomy. The blacked-out cells refer to the criteria (DNSH and MS) and other classifications (enabling, transitional and own performance) that only pertain to Taxonomy alignment. This information need not be reported if the results is that the activity is not Taxonomy-aligned.
- **c. Proportion of turnover** of a given activity against the total turnover of the company.
- **d.** Proportion of turnover of a given activity that SCs to one of the environmental objectives. While a given activity can SC to multiple environmental objectives, only one of these cells is expected to be populated.<sup>68</sup>
- **e. Alignment of Activity 1 with DNSH and MS** (in this case, Y means the criteria have been fulfilled).
- **f.** Taxonomy-aligned proportion of turnover of a given activity.
- g. Sum or Total of all eligible activity Taxonomy-aligned proportion of turnovers.
- **h. Proportion of turnover of all activities** (including those which failed the Taxonomy Alignment Check).
- i. Sum or Total of all the activities' Taxonomy-aligned proportion of turnovers (hereby referred to as the **total Taxonomy-aligned proportion of turnover**). Note that it will always equal the figure listed in G.
- **j. Non-eligible activities** under the EU Taxonomy.
- **k.** Proportion of turnover of non-eligible activities under the EU Taxonomy.
- **I. Total turnover** of the company in percentage (always 100%).
- m. Categorisations based on whether an activity is transitional (only for climate change mitigation) or enabling. Information in these columns is only to be selected if the activity does not SC by its own performance.

This is because the EU Taxonomy only requires each economic activity to SC to at least one of the six environmental objectives. Even if an economic activity contributes to multiple economic objectives, only the one with the highest contribution will be considered.

Table II

				Sul	ostanti	al con	tributio	on crit	eria	('D		DNSH ot Sign			m')					
Economic activities (1)	Code(s) (2)	Absolute CapEx (3)	Proportion of turnover (4)	Climate change mitigation (5)	Climate change adaptation (6)	Water and marine resources (7)	Circular economy (8)	Pollution (9)	Biodiversity and ecosystems (10)	Climate change mitigation (11)	Climate change adaptation (12)	Water and marine resources (13)	Circular economy (14)	Pollution (15)	Biodiversity and ecosystems (16)	Minimum safeguards (17)	Taxono- my-aligned proportion of CapEx, year N (18)	Taxono- my-aligned proportion of CapEx, year N-1 (19)	Category (enabling activity) (20)	Category (transitiona activity (21)
( )		Ссу	%	%	%	%	%	%	%	y/n	y/n	y/n	y/n	y/n	y/n	y/n	%	%	Е	Т
A. TAXONOMY-ELIGIBLE ACTIVI	TES																			
A.1. Environmentally sustainable ctivities (Taxonomy-aligned)																		N		
Activity 1				D	%	%	%	%	%	E	у	у	у	У	у	У	F %			
Activity 2			%	%	%	%	%	%	%	у	у		у	у	у	у	%			
CapEx of environmentally sustainable activities (Taxono- my-aligned) (A.1)			%	%	%	%	%	%	%								<b>G</b> %			
A.2 Taxonomy-Eligible but not environmentally sustainable activities (not Taxonomy-aligned activities)																				
Activity 1			%																	
Activity 3			%																	
CapEx of Taxonomy-eligible but not environmentally sustainable activities (not Taxonomy-aligned activities) (A.2)			%																	
Total (A.1 + A.2)		U	%														%		%	
B. TAXONOMY-NON-ELIGIBLE A	TIVIT	IES																		
urnover of Taxonomy-non-eligible activities (B)			%																	
Total (A + B)			%																	

- **a.** List of **eligible and aligned CapEx activities** under the EU Taxonomy.
- **b.** List of **eligible but not aligned CapEx activities** under the EU Taxonomy.
- **c. The proportion of CapEx** of a given activity against the total CapEx of the company.
- **d.** The proportion of CapEx of a given activity that to one of the environmental objectives. While a given activity can significantly contribute to multiple environmental objectives, only one of these cells is expected to be populated.<sup>69</sup>
- **e.** Alignment of activity 1 with the DNSH and MS principles. In this case, "Y" means the criteria have been fulfilled.
- **f.** The Taxonomy-aligned proportion of CapEx of a given activity.
- g. Sum of all eligible activities' Taxonomy-aligned proportion of CapEx.
- h. The proportion of CapEx of all activities (aligned and unaligned).
- i. Total Taxonomy-aligned proportion of CapEx. Note that it will always equal the figure listed in G.
- **j.** Non-eligible activities under the EU Taxonomy.
- **k.** The proportion of CapEx of non-eligible activities under the EU Taxonomy.
- **I. Total CapEx** of the company in percentage (always 100%).
- m. Categorisations based on whether an activity is transitional (only for climate change mitigation) or enabling. Information in these columns is only to be selected if the activity does not SC by its own performance.

This is because the EU Taxonomy only requires each economic activity to SC to at least one of the six environmental objectives. Even if an economic activity contributes to multiple economic objectives, only the one with the highest contribution will be considered.

**Table IIIA: Numerator and denominator** 

							Disclosure refere	nce date T						
		(	Climate Chang	e Mitigation (	CCM)		Climate Change	Adaptation (	CCA)			TOTAL (C	CM + CCA)	
	Total	Of wh	nich towards ta: Taxono	xonomy releva my-eligible)	nt sectors	Of w	hich towards tax	conomy releva my-eligible)	nt sectors	Of which towards taxonomy relevant sector (Taxonomy-eligible)				nt sectors
Million EUR	gross		Of which envir	, , ,	ıstainahle		Of which enviro	, , ,	stainahle	Г	0		onmentally su	stainahle
	carrying			nomy-aligned				nomy-aligned)			O		nomy-aligned)	
	amount		Of which	Of which	Of which		Of which	Of which	Of which			Of which	Of which	Of whic
			specialised	transitional	enabling		specialised	adaptation	enabling			specialised	transitional/	enabling
A			lendina				lending					lending	adaptation	
GAR - Covered assets in both nu denominator	imerator and													
Loans and advances, debt secuinstruments not HfT eligible for														
Financial corporations														
Credit institutions														
Loans and advances														
Debt securities, including Uc	P													
Equity instruments														
Other financial corporations														
of which investment firms														
Loans and advances														
Debt securities, including Uc	P P													
2 Equity instruments														
of which management comp	panies													
Loans and advances														
Debt securities, including Uc	P P													
6 Equity instruments														
7 of which insurance undertak	tings													
B Loans and advances														
Debt securities, including Uc	P													
Equity instruments														
Non-financial corporations														
NFCs subject to NFRD disclo	sure obligations													
B Loans and advances	-													
Debt securities, including Uc	P													
5 Equity instruments														
6 Households														
of which loans collateralised immovable property	l by residential													
of which building renovation	loans													
9 of which motor vehicle loans														
0 Local governments financing														
Collateral obtained by taking pos														
and commercial immovable prop		C D	E											

- **a.** Lending activities on which input must be submitted.
- **b.** Total amount relevant to these kinds of transactions—**feeds into the denominator.**
- **c.** Total amount relevant to **Taxonomy-eligible activities** in these kinds of transactions.
- **d.** Total amount relevant to **Taxonomy-aligned activities** in these kinds of transactions.
- **e.** Total amount relevant to **Specialised lending** activities in these kinds of transactions.
- **f.** Total amount relevant to **Transitional** activities in these kinds of transactions.
- **g.** Total amount relevant to **Enabling** activities in these kinds of transactions.
- **h.** Input for transactions relevant to **Climate Change Adaptation** (note that the guidance from B–G was for climate change mitigation).
- i. Input for transaction relevant to **both Climate Change Mitigation and Adaptation** (summation).

## **Table IIIB: Denominator only**

								isclosure refere	ence date T						
			С	limate Change	Mitigation (C	CCM)		Climate Change	Adaptation (	CCA)			TOTAL (C	CM + CCA)	
		Total	Of whi	ch towards tax (Taxono	onomy releva my-eligible)	nt sectors	Of w	hich towards tax (Taxono	onomy releva my-eligible)	nt sectors	С	f whic	h towards taxo (Taxonon	onomy relevan ny-eligible)	t sectors
	Million EUR	gross carrying		Of which envir	onmentally su nomy-aligned)			Of which envir	onmentally su nomy-aligned)			Of which environmentally sustaina (Taxonomy-aligned)			
		amount		Of which specialised lending	Of which transitional	Of which enabling		Of which specialised lending	Of which adaptation	Of which enabling			Of which specialised lending	Of which transitional/ adaptation	Of which enabling
33	ther assets excluded from the numerator for GAR calculation (covered in the denominator)	В	C												
34	Non-financial corporations														
35	SMEs and NFCs (other than SMEs) not subject to NFRD disclosure obligations														
36	Loans and advances														
37	of which loans collateralised by commercial immovable property														
38	of which building renovation loans														
39	Debt securities			-											
40	Equity instruments														
41	Non-EU country counterparties not subject to NFRD disclosure obligations														
42	Loans and advances														
43	Debt securities														
44	Equity instruments														
45	Derivatives														
46	On demand interbank loans														
47	Cash and cash-related assets														
48	Other assets (e.g. Goodwill, commodities etc.)														
49	Total GAR assets														
50	Other assets not covered for GAR calculation														
51	Sovereigns														
52	entral banks exposure	F													
53	Trading book														
54	Total assets														

- **a.** Lending activities on which input must be submitted.
- **b.** Total amount relevant to these kinds of transactions—**feeds into the denominator.**
- c. Input for the numerator relevant to these transactions (Taxonomy-eligible activities, Taxonomy-aligned activities, transitional activities and specialised lending)—not mandatory.
- **d.** Total amount relevant to GAR denominator (including input in this column from the previous image).
- **e.** Lending activities excluded from the GAR—input is not mandatory.
- **f.** The total amount relevant to these kinds of transactions—feeds into the denominator.



The following sample questionnaire is meant to act as a guide for the kind of information banks may require of their clients to accurately assess compliance with the MS. It is based on Pillar II of the UN Guiding Principles on Business and Human Rights, which addresses the responsibilities of business in terms of compliance.

The questions are separated into "key questions" and "additional questions" to reflect a proportional use of the information required, depending on the client.

	Questions	Y	N	Provision of related links/ documentation
Internal policy	Do you have an internal policy commitment in place to respect human rights?			
commitment	Is it reflected across operational policies and procedures, and embedded throughout the business enterprise?			
	Additional questions			
	Is the internal policy commitment approved at the most senior level?			
	Is it informed by relevant internal and external expertise?			
	Does it stipulate clear expectations of personnel, business partners and other partners linked to operations, products and services?			
	Is it publicly available internally and externally?			
	Is it reflected across operational policies and procedures, and embedded throughout the business enterprise?			
Due dili- gence	Do you have a well-defined due diligence process to identify, prevent and mitigate human rights impacts?			
processes	Is it appropriate and proportionate to the complexity of your operation and the severity of your impacts?			
	Additional questions			
	Is it ongoing, considering the evolving nature of human rights impacts?			
	Do you have a process through which to identify and assess actual or potential human rights impacts that draws on internal and/or independent external human rights expertise?			
	Does it involve meaningful consultation with potentially affected groups and other relevant stakeholders?			

Embedding across functions and	Do you integrate the findings of your impact assessments across relevant internal functions and processes, and take appropriate action?		
processes	Is responsibility for addressing the impacts assigned to the appropriate level and function within the business enterprise?		
	Are internal decision-making, budget allocations and oversight processes enabled to provide effective responses to such impacts?		
	Are you tracking the effectiveness of your response to the human rights impacts identified?		
	Additional questions		
	Is your tracking based on appropriate qualitative and quantitative indicators?		
	Does it draw on feedback from internal/external sources, including affected stakeholders?		
Communica- tion	Do you communicate externally about how you address human rights impacts, especially when they are raised by affected stakeholders?		
	Additional questions		
	Is it with a form and frequency that reflects the impact, and is accessible to its intended audience?		
	Does it provide information that is sufficient to evaluate the adequacy of the response to the impact?		
	Does your communication strategy pose any risk to affected stakeholders or personnel, or to legitimate requests of commercial confidentiality?		
Remediation	If there has been a formal identification that you have caused or contributed to adverse impacts, are you providing for or cooperating with their remediation through legitimate processes?		



United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between the UN and the global financial sector to mobilize private sector finance for sustainable development. UNEP FI works with more than 450 members—banks, insurers, and investors—and over 100 supporting institutions—to help create a financial sector that serves people and planet while delivering positive impacts. We aim to inspire, inform and enable financial institutions to improve people's quality of life without compromising that of future generations. By leveraging the UN's role, UNEP FI accelerates sustainable finance.

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