Green Asset Ratio cannot be to sustainability what CET1[1] is to capital

Staff paper

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Summary

The primary objective of the Green Asset Ratio (GAR), established under the Article 8 Delegated Act of the EU Taxonomy Regulation (2020/852)[2] was to help stakeholders understand financial undertakings' contribution to European environmental and climate objectives.

While the Green Asset Ratio is a step towards improving transparency, **it will not be able to tell the whole story of the transition efforts** of banks. As also recognized by the European Banking Authority (EBA) in its recent report on green loans and mortgages[3], at the current juncture, technical screening criteria of the EU Taxonomy are strict and exclude a large volume of activities contributing to the transition of the economy. The GAR will only show a small portion of banks' efforts to finance the transition. Due to its coverage, its design, the challenges to document compliance and the limitation in its usability, the GAR **cannot and should not be considered an indicator of progress on meeting institutions' sustainability commitments.**

For example, a bank can be making significant progress in helping clients in high emitting sectors to reduce their environmental impact, but this will, in most cases, not be reflected in the GAR. Similarly, the financing of a renovation loan for a building with low energy efficiency will not be reflected in the GAR unless a high energy efficiency level is achieved after the renovation and all DNSH (Do No Significant Harm) criteria of the EU Taxonomy are met. Financing of governments, regardless of their "greenness" will also not lead to a higher GAR as sovereign exposures are excluded from the GAR calculation.

[1] Common Equity Tier 1 capital
[2] Also to be disclosed as part of Pillar 3 reports: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32022R2453
[3] https://eba.europa.eu/sites/default/files/2023-12/e7bcc22e-7fc2-4ca9-b50d-b6e922f99513/EBA%20report%20on%20green%20loans%20and%20mortgages_0.pdf

Asymmetry of GAR

Green lending towards SMES (Small and Medium-sized entities) or an enterprise outside the EU[4] will also not contribute to increasing the GAR. To the contrary: the higher the financing to SMEs and non-EU companies, the lower the ratio. This is because, unlike the exposures to sovereigns, that are excluded symmetrically, these exposures count towards the denominator but not the numerator of the GAR, lowering the GAR numbers. Similarly, activities that aren't covered by the EU Taxonomy will also be excluded from the numerator but not the denominator.

The above are examples of the structural features of the GAR that will lead to divergence in the value of the green asset ratios, depending on a bank's business model, client-base and geographical footprint. A simple comparison of GAR numbers between banks could therefore be misleading. Banks predominantly financing SMEs and clients in third countries will show structurally lower green asset ratios compared to banks predominantly financing large undertakings.

Room for interpretation and non-availability of documentation

The GAR comparison will be further hampered by the **large room for interpretation and by the difficulties in assessing and documenting Taxonomy alignment.** Banks finance the economy as a whole, not just a limited number of activities, and depend on their customers' information to classify transactions as sustainable. It can be particularly challenging to document the Taxonomy alignment of their retail portfolios. EPC certificates for example, are largely unavailable, outdated or do not contain the necessary information.

In addition, based on the Commission's clarification included in the late FAQs of December 2022, banks have to obtain adequate documentary evidence ascertaining that companies producing goods and providing services that are purchased by retail clients comply with the relevant Technical Screening Criteria (TSC) and with minimum safeguards (MS) to compute their exposures as Taxonomy-aligned. In most cases banks do not have sufficient information to make this determination. This will likely be the case when attempting to retrieve evidence of compliance with MS from SME suppliers- which do not report Taxonomy information. It is not likely that banks will obtain evidence on the EU Taxonomy compliance directly from the clients or via verification from a third party. The challenge to collect satisfactory evidence from retail customers is likely to have a negative impact on the GAR of financial institutions. The financing of electric cars or mortgages are thus, in many instances, not going to be included in the GAR due to the lack of documentation.

Apart from the lack of data and documentation, there are different interpretations on how certain Taxonomy criteria must apply. Despite the publication of several FAQs of the European

[4] Entities not required to report under the Non-Financial Reporting Directive/Corporate Sustainability Reporting Directive (NFRD/CSRD)

Commission, divergences are expected also in 2024 reporting, when banks will have to report their EU Taxonomy alignment for the first time. **The December 22nd 2023 FAQ of the Commission was published very late and does not allow sufficient time for financial institutions preparing to disclose their GARs in early 2024 to make adjustments based on the guidance provided via the FAQ**. Whie the FAQ does not aim to create new requirements, the clarification provided by the Commission limits the interpretation options and in key instances results in in a more restrictive interpretation.

The approaches taken by individual companies will highly depend on the reporting entity's interpretation and the degree of conservatism, particularly of assurance providers. The divergent approaches envisaged will also have an impact on the ability to compare GARs.

Managing expectations

The overall expectations on the GAR and its information value therefore have to be managed as GAR numbers of banks will be hard to compare**. In addition, GARs are not only expected to be low given the structural features of the GAR, but there will also be relevant challenges for companies and households in documenting alignment with the EU Taxonomy – even for those activities that are generally considered "green".** In conclusion, the GAR cannot and should not be taken as the key metric to portray the financing of the green transition and the ratios of the different banks should not be compared without understanding the context and other relevant information on banks' efforts to finance transition.

Given the methodological limitations of the GAR and the practical usability issues, the planned revision of the GAR in 2024 is welcome and the EBF will be actively contributing to the discussion to improve both the GAR's usefulness and usability. However, the GAR will always be limited to the EU Taxonomy alignment and will need to be complemented with other information to understand the progress of the financial sector.

1. Introduction

The primary objective of the GAR was to help stakeholders **understand financial undertakings' contribution to European environmental and climate objectives and their trajectory towards sustainability**.

However, while the Green Asset Ratio is a step towards improving transparency, it will **not tell the whole story of the transition** efforts of banks. This is due to two key issues:

1) The limitation in the GAR design and
2) The difficulty to implement the EU Taxonomy criteria in key use cases.

In principle, the GAR is a simple ratio quantifying EU Taxonomy-aligned assets as a percentage of total covered assets (please see the Annex). While it may be **tempting to look at it as a simple metric** to understand the sustainability of banks, it will only show **a small portion of institution's efforts to finance the transition**.

A bank's environmental performance and trajectory towards sustainability can be tracked for example by following the compliance with its decarbonization targets in terms of financed emissions, the improvement in energy-performance of the real estate in their mortgage portfolio and the bank's comparison of actual performance against its transition plan. The GAR lacks these important bits of transition information.

It is important that the banking sector not only finance activities that can already be considered EU Taxonomy aligned, but also activities that are performing at different levels and which can accelerate the transition. As stated by EBA in the above mentioned report on green loans and mortgages, the EU Taxonomy framework does not capture the existing large volume of economic activities improving their existing conditions and which are supporting the transition, but are not aligned with all the relevant TSC.

The Taxonomy only applies to a limited number of sectors in a substantial manner. The coverage of the EU economy by the EU Taxonomy eligible activities itself is low as also evidenced by the average eligibility disclosed in various studies on 2023 NFRD corporate reporting, showing an average eligibility between 22-30%[5]. Those sectors and activities are typically already the focus of discussions around sustainability, such as real estate, energy or automotive.

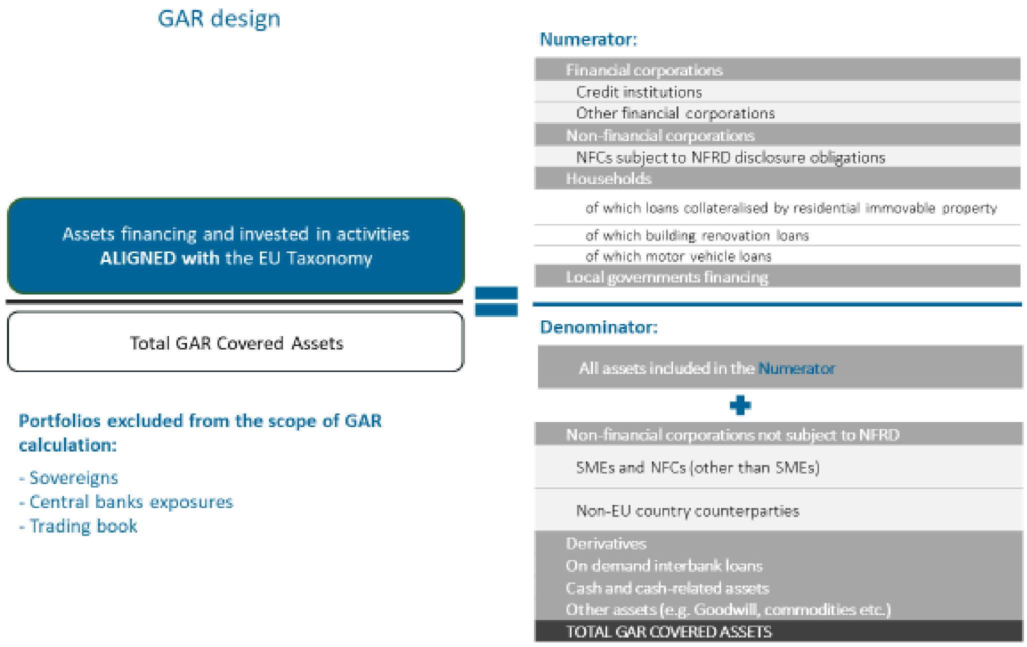
The EU industry is largely still at the beginning of its transition. This is even the case for those sectors that are covered by the Taxonomy - only 7 percent of the analyzed corporates' turnover currently fulfils the Taxonomy's criteria and is thus Taxonomy aligned as evidence in a study[6] of the Association of German Banks' analyzing the taxonomy profile of 450 corporates. In addition, an EBA recent analysis of 83 credit institutions shows an average share of green loans and advances of 4,5% of their total loans (11% for household loans). The identification of green loans is based on credit institutions' internal standards. It can therefore be assumed that GAR numbers will be even lower, as only 7 institutions out of 83 indicated they are using both the substantial contribution (SC) and do no significant harm (DNSH) criteria of the EU Taxonomy as the main standard to define their green loans in at least one business line.

As the GAR is expected to be closely monitored by banks' supervisors, institutional investors, clients, NGOs and media, there is a risk **of misleading conclusions** (e.g., a binary consideration of the GAR, considering the rest of the activities as brown) and critical perception of the low level of ratios that risks affecting the reputation of banks and undermine their efforts to finance transition.

2. The first key issue: Limitations in the GAR design

The GAR has been designed prioritizing its use for investors and capital markets. This results in a number of application issues for banks. Also, the reflection of the lack of data and practical difficulties in evaluating the Taxonomy alignment of companies that do not report under the NFRD/CSRD resulted in an asymmetry in scope of its numerator and the denominator.

[5] EY, KPMG, Clarity AI & CDP
[6] https://bankenverband.de/en/files/2023-11/2023%2009%2004%20taxonomy%20profile%20industry%20vfinal_eng.pdf



While exposures to governments and central banks are excluded from the GAR calculation symmetrically, from the numerator and the denominator, the financing of enterprises that do not fall under the scope of the NFRD/CSRD - even when all the Taxonomy criteria are met - can not qualify as Taxonomy aligned in the calculation of the GAR. This is due to the exclusion of exposures to non NFRD/CSRD-corporates in the numerator and their inclusion in the denominator, resulting in an asymmetry.

Also, activities that are not covered by the EU Taxonomy will be excluded from the numerator but not the denominator of the GAR. These structural features of the GAR will lead to divergences in the value of the green asset ratios of banks, depending on a bank's business model, client-base and geographical footprint.

The implications of exclusions of certain exposures from the GAR numerator

99% of **SME**s in Europe are not subject to CSRD reporting, and thus are excluded from the numerator of the GAR. Even if they comply with the EU Taxonomy, they will not be counted as such.

Enterprises outside the EU count towards the denominator but not the numerator, so they will drag GAR levels down, regardless of their sustainability performance.

Inclusion in the numerator would be possible at the moment that these financed entities or bodies would apply the CSRD and disclose their sustainability performance.

Financing through **Special Purpose Vehicles (SPV) structures** is commonly used in project finance and, more broadly, financing commercial real estate or sustainable energy infrastructure financing. EU Taxonomy aligned financing through SPVs can only be included to the numerator of GAR when the ultimate beneficiary or its parent company are subject to NFRD/CSRD reporting requirements, excluding large number of project financing through SPVs.

Lending to both SMEs and non-EU counterparties is a considerable part of the total banks' lending in Europe. As observed by the EBA FINREP data, almost 40% of EU banks' exposures to non-financial companies are towards SMEs and a quarter of EU credit institutions' exposures is to entities outside of the EU - **this implies that major parts of the economy, financed by banks, are not tracked at all.**

2.1 Need for assessment of additional metrics

A simple comparison of different banks' GARs is, by definition, misleading and should be avoided. The below simplified example illustrates how two banks with different sustainable exposures and balance sheets can report the same GAR.

Example

While Bank A's balance sheet carries 50 percent more exposures to EU Taxonomy-aligned activities than Bank B, the methodological setup of the GAR will lead both banks to report a GAR of 5%. This is precisely due to the fact that the GAR numerator and denominator have different scopes and some exposures cannot be evaluated for Taxonomy alignment and count towards the GAR.

Also while Bank C and D report the same percentage of EU Taxonomy alignment (5%), the GAR of Bank D is almost double (5%) that of the GAR of Bank C (2,75%)).

		Bank A		Bank B		Bank C			Bank D		
		Exposure (Eur bn)	EU Taxo aligned (bn)	Exposure (Eur bn)	EU Taxo aligned	Exposure (Eur bn)		aligned (bn)	Exposure (Eur bn)		EU Taxo aligned
Denominator	Numerator	**Included in Numerator (if 'green')**									
		110	**10**	**200**	**10**	**110**	5%	**5,5**	**200**	5%	**10**
	Financial Corporations	20	2	50	3	20	5%	1	50	5%	2.5
	NFCs subject to NFRD/CSRD disclosure obligations	60	5	100	5	60	5%	3	100	5%	5
	Households	30	3	50	2	30	5%	1.5	50	5%	2,5
	Excluded from Numerator	**90**	**5**			**90**	5%	**4.5**			
	Activities not in the scope of the EU taxonomy & Non Significant Impact (NSI)	20	0			20	5%	1			
	NFCs not subject to NFRD/CSRD disclosure obligations	40	3			40	5%	2			
	Non-EU country counterparties	20	1			20	5%	1			
	Derivatives in the banking book & Others	10	1			10	5%	0,5			
	Total Assets Covered	**200**	**15**	**200**	**10**	**200**		**10**	**200**		**10**
	Other Assets excluded from GAR scope	**60**		**60**		**60**			**60**		
	Sovereigns	40		50		40			50		
	Central Banks	20		10		20			10		
	Total Balance Sheet	**260**		**260**		**260**			**260**		
	GREEN ASSET RATIO (GAR)	**10/200=5%**		**10 / 200 = 5%**		**5,5/200=2,75%**			**10 / 200 = 5%**		

Note: The numbers in the example are purely illustrative and are not intended to project real numbers

The GARs therefore cannot and should not be compared without understanding the Key Performance Indicators' (KPIs) limitations, the individual bank's business model and its balance sheet composition. **Additional metrics disclosed in the GAR templates need to be analyzed** to understand the portfolio composition of financial institutions and the GAR itself as several methodological particularities of the GAR may impact its value. While the GAR may be complemented by **additional voluntary reporting** where a ratio on SMEs and Non-EU exposure alignment can be shown separately, the data to assess the EU Taxonomy alignment of SMEs and non-EU exposures is not necessarily available and could be estimated at best. Moreover, given the EU Taxonomy's character[7], it cannot, and is not meant to capture all efforts of companies to finance the transition or indicate progress on meeting their net-zero commitments.

As stated by the European Commission,[8] decisions cannot be made purely on the basis of Taxonomy-related disclosures of companies, because not having Taxonomy-aligned activities does not, in itself, reveal the company's overall environmental performance. Instead, other disclosures, such as the **company's disclosures under the CSRD** (for those companies that are subject to the CSRD reporting or reporting voluntarily) will help inform markets about the company's environmental performance and the company's environmental direction of travel as well as for other sustainability matters.

Example of additional voluntary reporting: Banking Book Taxonomy Aligned Ratio

To address the limitations of the GAR, the EBA introduced the Banking Book Taxonomy Aligned Ratio (BTAR). The BTAR[9] is extending the numerator to include Taxonomy-aligned activities referred to counterparties not covered by the NFRD/CSRD. This complementary metric, **that banks may choose to report on**, is intended to give a more comprehensive picture of banks' taxonomy alignment and incentivize the provision of green finance to SMEs. As the EBA recognized the data challenges, given that non-listed SMEs are not subject to any mandatory data provision or reporting obligation, the EBA envisages that the reporting will primarily rely on estimates and proxies when calculating the BTAR. Nevertheless, even the production of estimates and proxies remains a challenge, particularly outside the EU where standards are very different from those in the EU.

[7] Taxonomy alignment refers to activities already taxonomy aligned, the capital expenditures of an activity that is either already taxonomy-aligned or is part of a credible plan to extend or reach taxonomy alignment. It also includes a limited amount of transitional are activities for which there are no technologically and economically feasible low-carbon alternatives, but that support the transition to a climate-neutral economy consistently with a 1,5 degrees Celsius pathway

[8] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022R2453&from=EN

3. The second major issue: Operational difficulties to implement the EU Taxonomy criteria in key use cases

The percentage that banks will provide for their GAR will further be affected by the challenge of companies and households to assess and document alignment with the criteria of the EU Taxonomy (particularly MS and DNSH), even for activities that are generally considered

"green". In cases of financing where the use of proceeds is known, banks are expected to check whether the information concerning Taxonomy alignment of economic activities provided by their clients includes adequate documentation. The overall expectations on the GAR and its information value must therefore be managed.

As stated in the Article of Lucia Alessi and Stefano Battiston published in Science Direct in 2022, **"….***preliminary evidence based on larger companies indicates that DNSH criteria are particularly stringent when tested against current reality: as of today, it is virtually impossible to find a corporate making a substantial contribution to climate change mitigation and being also in full compliance with all relevant DNSH criteria"*.

While acknowledging progress since 2022, understanding the extent of the operational difficulties to assess and document Taxonomy alignment is **important in the context of use of proceed loans, where financing is provided for a known purpose and the Taxonomy alignment will need to be checked for this individual transaction[10] and documented**.

Also, in the case of households, banks will have to calculate the alignment of the related financing themselves. Based on the recent clarification of the Commission included in the December 2023 FAQ, banks have to obtain adequate documentary evidence ascertaining that companies producing goods and providing services that are purchased by retail clients comply with the relevant Technical Screening Criteria (TSC) and with minimum safeguards (MS) to compute their exposures as Taxonomy-aligned.

Retail exposures – challenges to document EU Taxonomy alignment

Example of car loan financing

DNSH criteria for cars requires that the tyres meet a specific rolling noise and resistance criteria (DNSH 5 – one of the 8 DNSHs to be met for motor vehicles). It is challenging to access this information, as banks are not allowed to rely on a mere declaration of clients and the information is also not widely available by leasing companies and car manufacturers either.

Example of mortgages

Considering real estate financing, it is assumed that banks will obtain evidence on the TSC and DNSH compliance directly from the clients or via verification from a third party or EPC certificates. Such information is however rarely available for existing exposures.

[10] The Taxonomy alignment ratios disclosed under Article 8 of the Taxonomy Regulation by companies in the scope of NFRD/CSRD can only be used for the general purpose loans, e.g. Loan of 100 000 provided for operational purposes to a company that reports 7% GAR can be taken towards bank's GAR in the amount of 7000 (7000 in the numerator of GAR against 1 a00 000 in denominator)

Homeowners do not possess the required information and EPC certificates are largely unavailable, outdated or do not contain the necessary information.

It is also challenging to assess the substantial contribution criteria for new buildings (built after 2021) as banks have to assess, based on documentation, if the building energy efficiency is below the 10% net zero threshold.

Apart from the lack of data and documentation, there are different interpretations for example on how the outcome of physical adaptation risk studies must be considered for DNSH assessment.

The approaches taken by individual banks on their mortgage portfolios, depending on the reading of the Article 8 DA and degree of conservatism, will further weaken the comparability of GARs. As mortgages represent a significant proportion of banks' eligible exposures, the divergent approaches envisaged will impact the ability to compare GARs between banks.

In addition, the approach of the European Commission for assessment of Taxonomy alignment of retail mortgage portfolios under the Taxonomy Delegated Act is at odds with the instruction of the EBA for GAR calculation under Pillar 3, where the EBA allows Taxonomy Alignment assessment of households for the objective of climate change mitigation based on a simplified approach according to the energy efficiency of the underlying collateral.

Example of renovation – solar panel installation financing

Banks will be able consider the financing of solar panel installation for its retail clients upon obtaining evidence that the producer of the solar panel is meeting the Taxonomy criteria, including the required social safeguards.

Considering methodological uncertainties, the comparability of GARs will be hampered by the room for interpretation. PWC[11] analyzed the Taxonomy eligibility reported by 17 banks in the Netherlands, Germany, Belgium, France, and Spain last year. The study shows that there are roughly five different ways to determine 'total assets' and four different definitions of 'non-eligibility' and that only some banks include 'cash held at central banks' in their eligibility score. Despite the publication of several FAQs of the European Commission on some of the identified issues, **divergences are expected also in 2024 reporting, when banks will have to report their EU Taxonomy alignment for the first time.** Moreover, regardless, the late issuance of the FAQ does not provide banks with sufficient time to adjust their approaches with the GAR disclosure taking place in Q1 of 2024**.**

4. Beyond the GAR: How to understand banks' transitioning efforts

The Green Asset Ratio will not be able to tell the whole story of the transition efforts of banks and has only limited steering value and should be used with caution both by investors and policymakers as a benchmark or for regulatory measures.

[11] https://viewpoint.pwc.com/dt/gx/en/pwc/esg/external/esg-external/eu-sustainability/EU-Newsletter-3/EU-newsletter-3-Sustainability-reporting-Part-C.html#:~:text=Our%20research%20among%2017%20banks,'potentially%20sustainable'%20assets)

It is important that the banking sector not only finances activities that can already be considered EU Taxonomy aligned[12], **but also activities that are performing at different levels and which can accelerate companies' transition**. The thresholds set by the European Commission in the EU Taxonomy for climate objectives are scientifically based and aligned with the final Paris Agreement objective of 1.5°C and 2030/2050 EU decarbonization targets. This is a **key benefit of the EU Taxonomy and it should not be compromised**. In fact, while the

EU Taxonomy has limited value as a reporting tool, it can serve as a reference point in engagement with clients. For example, EU Taxonomy-aligned targets can guide target setting

for sustainability-linked financing. The use of the Taxonomy as a sustainable benchmark for transition finance was already explored in our joint report with UNEP FI issued in February 2022 (see chapter C)[13]. However, the EU Taxonomy does not provide the intermediate objectives and activities needed to reach that benchmark and it only covers a narrow number of economic activities.

A complementary approach which defines not only "what is green", but provides an additional, forward-looking dimension, should be considered in the EU Sustainable Finance Framework. **The transition of the economy should be at the forefront of the political agenda**. This transition is a steady process involving intermediate steps towards more sustainability. In order to promote this wider transition, it is necessary to move beyond the GAR and **focus on transitional activities and their financing.** The majority of financing in support of the transition towards a more sustainable economy and society will have to be directed towards activities and assets that are associated with carbon-intensive industries, businesses and sectors that highly contribute to climate change, including renovation of buildings with the worst energy performance, as these assets and activities will have the highest impact in terms of emission reduction but are unlikely to be reflected in the GAR (e.g., building renovation leading to improvement in the EPC level from F to E, D or C). These are the sectors and assets that are in **urgent need of financing** to decarbonize their activities. Banks' contribution to climate-related policies is to finance the greening of the economy, and not only the activities that are already green. Debt and lending products are indeed well suited to raise funds for activities and assets that are not yet EU Taxonomy aligned.

5. Conclusion

The GAR should not become to sustainability what CET1 is to capital. Bearing limited information, the GAR, when monitored by banks' supervisors, institutional investors, clients, NGOs and media can lead to misleading conclusions.

[12] Please refer to footnote 4
[13] https://www.ebf.eu/wp-content/uploads/2022/02/EU-Taxonomy-Report-2022-3.pdf

- **Investors and analysts** need an understanding of multiple metrics that reflect the transition progress of the companies or banks being assessed. The GAR will not enable to understand the progress.
- **For the financial undertakings themselves**, the GAR, as a snapshot of the current state of things, only has limited value as an internal steering tool for management, mainly due to its structure, the limited coverage of the EU Taxonomy, and **the missing aspects of transition finance.**
- **Supervisors** look into the risk profile of the banks they supervise, which comprises a set of risks that may change because of climate change, and they assess banks' internal processes to this end in their SREP (Supervisory Review and Evaluation Process). The GAR doesn't add value to this supervisory assessment and as acknowledged by the EBA, the EU Taxonomy framework cannot be considered a risk assessment tool.

In its current form, reported numbers of GAR are expected to be low, mainly due to structural imbalances as well strict requirements to document the alignment.

Above all, it is important that financial flows do not only target activities that can already be considered EU Taxonomy aligned, but also activities that are performing at different levels and which can accelerate companies' transition. Decisions cannot be made purely based on Taxonomy-related disclosures of companies. Not having Taxonomy-aligned activities does not in itself reveal the company's exact environmental performance. Instead, other disclosures, such as the company's disclosures under the CSRD will help inform markets about the company's environmental performance and the company's direction of travel (for companies in the scope of the CSRD). The GAR will be disclosed together with additional metrics that will help to better understand the portfolio composition of financial institutions. These **additional metrics that are disclosed need to be analyzed together with other relevant information on banks' efforts to finance the transition.**

Given the methodological limitations of the GAR and the practical usability issues we welcome the Commission's plans to review the GAR in 2024. The European Banking Federation **will be working with the European Commission, including in its capacity as member of the EU Platform on Sustainable Finance to assist its efforts to improve both** the Taxonomy's **usability, its usefulness and consistency with other ratios. We are also planning to issue a report on the usability of Sustainable Finance Framework with targeted recommendations to enhance its usability and usefulness for the financial sector.**

ANNEX

What is the Green Asset Ratio?

The EU Taxonomy Regulation[14] is one of the core legislative proposals on sustainable finance. To reorient capital flows towards sustainable activities, it was first necessary to reach a common understanding of what activities can be considered environmentally sustainable. The EU Taxonomy was therefore developed as a common classification system for sustainable activities.

It has since become one of the most significant components of the regulatory agenda on sustainable finance. Through the provisions of Article 8 of the EU Taxonomy Regulation, the EU Taxonomy is expected to deliver standardized reporting on the extent to which economic activities of companies under the scope of the Non-Financial Reporting Directive (NFRD) that will later be later replaced by the Corporate Sustainability Reporting Directive (CSRD), can be considered environmentally sustainable.

The Delegated Act on Article 8 of the Taxonomy Regulation[15] further specifies the disclosure requirements, which include Key Performance Indicators (KPIs) and reporting templates that companies as well as banks should use to disclose the sustainability of their activities.

As of January 2022, both banks and companies under the scope of the NFRD will have to report **the EU Taxonomy eligibility** of their activities in scope of Article 8. This means reporting the proportion of activities that are included in the Climate Delegated Act, which does not cover all economic activities. Eligibility reporting is nothing more than an indication that a company is undertaking or financing activities that can be assessed for alignment with the Taxonomy. **It does not tell us anything about the sustainability of the company or a bank**. Only a portion of these activities will be classified as **EU Taxonomy aligned** when companies and banks will have to report the alignment of their activities.

As of 2024, banks have to report the proportion of assets financing or invested in the activities aligned with the EU Taxonomy. The reason for the **one-year delay** is that banks need to assess the data of their clients first, to report their own alignment. Recognizing further the data availability issue, banks have to report only on activities of clients that themselves are subject to reporting obligations. Banks can therefore rely on clients' reporting under NFRD/CSRD to analyze their financing activities for their own reporting purposes under Article 8. Exception to this is the reporting of mortgages and car portfolios, where no data will be available via public reporting of clients and the use of proceeds financing, when the purpose of the loan is known (refurbishing of plants, purchase of energy efficient machinery, financing of green infrastructure projects etc.).

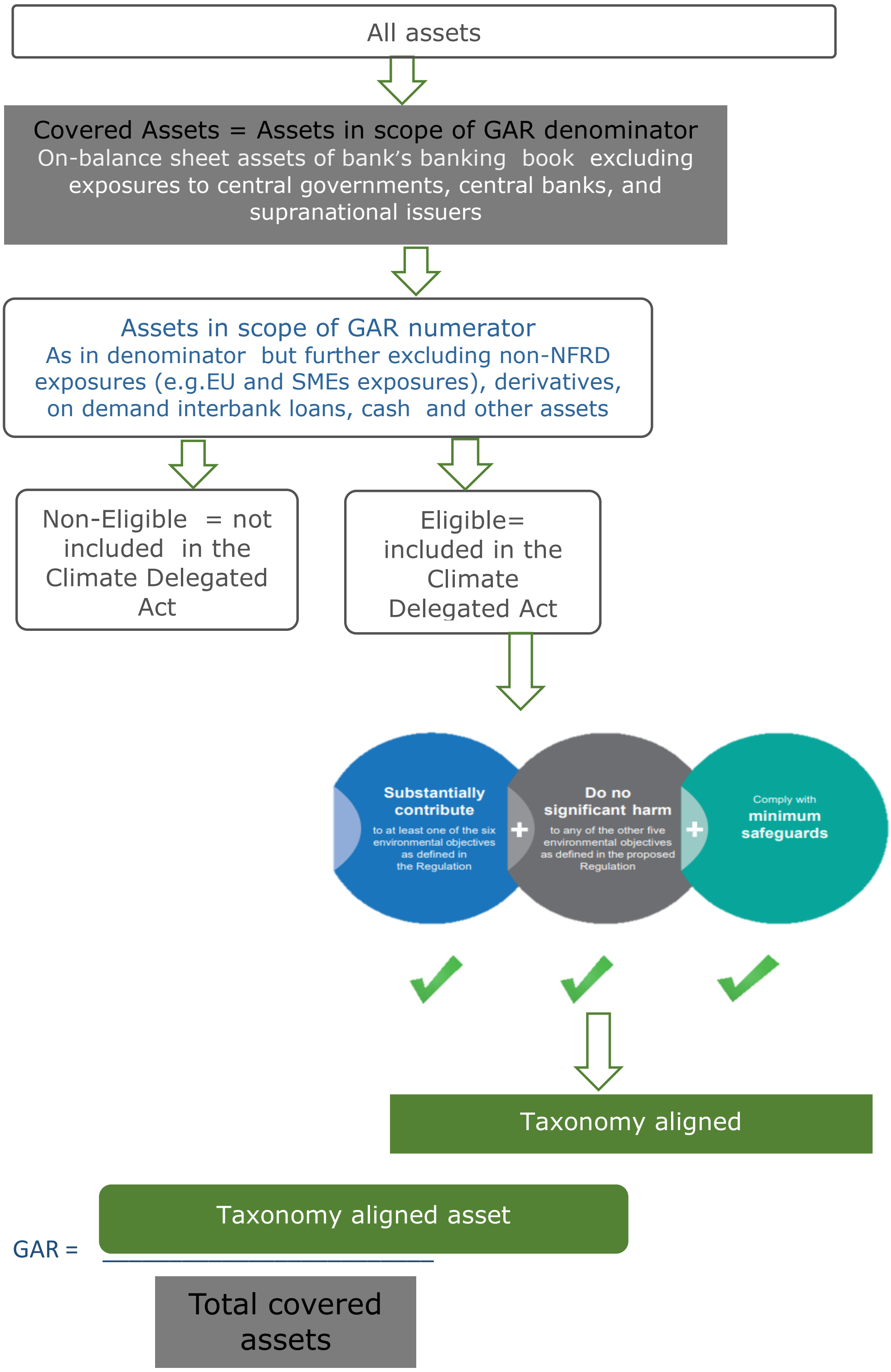
[14] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN
[15] Publications Office (europa.eu)

As of January 2024, banks have to disclose the aggregate GAR (on the stock of activities) for covered on-balance sheet assets as well as the breakdown by environmental objective and by type of counterparty. Additional KPIs such as on GAR (flow), financial guarantees, assets under management and as of 2026 fees and commission income from taxonomy aligned. Some banks[16] will also have to report KPIs on their trading book.

The denominator of the GAR represents a high proportion of the total assets regardless of whether they can or are allowed to be assessed for taxonomy eligibility. Only sovereign assets, central banks and supranational issuers are consistently removed from both numerator and the denominator, recognizing the current lack of an appropriate calculation methodology. While challenges with the assessment of the taxonomy alignment of SMEs' activities and activities of non-EU companies were also recognized, these exposures are only excluded from the numerators of GAR and not from the denominator as was done in case of sovereigns. The activities of SMEs and non-EU companies are therefore not allowed to be assessed for taxonomy alignment in the nominator of GAR but will automatically reduce the GAR given their inclusion in the denominator. This is the same as including them in the nominator with a 0% weight. The same is valid for economic activities for which no technical screening criteria are developed yet as these will also be included in the denominators of GAR. The European Commission is expected to reassess the composition of the GAR in June 2024.

[16] 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

GREEN ASSET RATIO



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