WE MEAN BUSINESS COALITION

EU GREEN TAXONOMY IN PRACTICE

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Disclaimer: The shown information in this white paper is only a summary of selected regulatory topics and dates. It is not binding and there is no claim to completeness.

EXECUTIVE SUMMARY

The EU Green Taxonomy is currently being rolled out, and it aims to define which of a company's activities are 'green', thereby making it easier for financial companies to funnel capital towards green companies/projects while minimizing their risks of greenwashing. The idea is a good one – but how is the implementation going in practice? We Mean Business Coalition has in this white paper sought greater insights into what the EU Green Taxonomy reporting practice is for both financial and non-financial companies. We have done so, because the legislation has been criticized for not being accurate, and at times not being relevant for those companies that are requested to report.

We have analyzed the 100 largest, listed EU companies' Taxonomy reporting, both to see how they apply the new legislation at its current stage – it is not fully implemented yet – but also to investigate if the legislation could be better and more precisely defined. We have also analyzed whether the Taxonomy activities are relevant for the companies being asked to report.

From our analysis we find both good practice and things that need attention. We have identified areas of improvement for both non-financial companies and financial companies. We also find legislation that could be more precise and that could often be drastically simplified. In short, our findings reveal:

- Financial and non-financial companies can do better in applying the regulations;
- Regulators can do better in defining key terms in the legislation to minimize very different interpretations, and via simplifying the reporting requirements – hence increasing comparable and useful reporting;
- Regulators can increase relevance by either developing significantly more taxonomy activities, or by narrowing the reporting burden to specific relevant sectors.

The good news is that all the companies' reports that we looked at refer to the Taxonomy, and they publish information in the right reports. They even, to a large extent, get voluntary assurance, just as many companies already work with/issue Taxonomy labelled bonds. Given that the EU Green Taxonomy is not fully implemented yet, this is a positive sign, and it gives great hope that investment can flow into businesses that are leading the way on climate action in Europe, at the speed and scale necessary for halving global emissions by 2030. With adjustments to some of the practices by companies and revisions to the legislation, reporting can be made truly useful.

INTRODUCTION – PURPOSE OF THE ANALYSES

This white paper seeks to investigate how the new EU Green Taxonomy reporting legislation is working in practice. Many companies affected by the new rules have commented that the EU Green Taxonomy is not always precise enough[1]. In the 100 reports analyzed for this white paper, 35 of them mention how the legislation is 'still up for interpretation' or something similar. Here is an example of a common comment:

> The EU Taxonomy Regulation and the Delegated Acts issued thereunder contain wording and terms that are still subject to considerable interpretation uncertainties and for which clarifications have not yet been published in every case. Therefore, management has disclosed their interpretation of the EU Taxonomy Regulation and the Delegated Acts adopted thereunder in section "Sustainable Finance: EU Taxonomy Disclosures" of the combined non-financial statement.' (Anonymized company)

The same is also relevant for the assurance statements given, as they are most often provided with some sort of disclaimer about the lack of regulation clarity. For instance:

> 'Due to the immanent risk that undefined legal terms may be interpreted differently, the legal conformity of their interpretation and, accordingly, our assurance engagement thereon are subject to uncertainties.' (Anonymized auditor)

This paper will investigate the reporting practice. We will focus on whether the reporting practice appears to be in line with the regulation or not – or if the regulation is so imprecise at its current stage, that the comparability and usability of the reports made by companies is jeopardized.

The analyses will also focus on, whether the activities included in the EU Green Taxonomy appear to be relevant and useful for the majority of large, listed companies, who currently are covered by the regulation. Are the right activities included in the EU Green Taxonomy for the companies that are required to report?

This paper aims to provide advice for both companies[2] and the European Commission about potential improvements, to deliver on our collective goals of reducing corporate emissions, and making it easier for investors to know which are the greenest companies/projects in Europe.

We will not refer to any specific company report in the paper, as there is a risk of diluting and derailing the dialogue about potential improvements from the generic to specific incidents, which is not the purpose.

1. See also Platform on Sustainable Finance (2022b) and Jagd (2022)

2. The reporting advice could potentially also be helpful for the companies' assurance providers and the national business authorities.

THE LEGISLATION – RECAP

The EU Green Taxonomy is the short name for this regulation: Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

PURPOSE OF THE EU GREEN TAXONOMY

The EU Green Taxonomy is a classification system that will define criteria for economic activities that are aligned with a net zero trajectory by 2050 and the broader environmental goals other than climate. The EU Green Taxonomy will explain for each sector, which economic activities are green, and which are not. This should make it clear to what degree the company, project or investment portfolio complies with the EU Green Taxonomy.

The intentions with the EU Green Taxonomy are[3]:

- To create a frame of reference for investors and companies;
- To support companies in their efforts to plan and finance their transition;
- To protect against greenwashing practices;
- To help accelerate financing of those projects that are already sustainable and those needed in the transition.

> 'Large financial and non-financial undertakings[4] can use the information disclosed to design credible green financial products such as green bonds or investment funds and, through the public disclosures under the Delegated Act, channel investor demand towards sustainable projects' (Supplementing Regulation (2021), p 3).

THE EU GREEN TAXONOMY'S CONNECTIONS TO OTHER EU REGULATIONS

In 2018, the EU announced a comprehensive package[5] called the EU Action Plan, proposing ten reforms in three areas, which should encourage investors to direct more capital into activities and sectors that make the economy more sustainable and can secure sustainable growth.

- Reorient capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth
  - Establishing an EU classification system for sustainability activities
  - Creating standards and labels for green financial products
  - Fostering investment in sustainable projects
  - Incorporating sustainability when providing investment advice
  - Developing sustainability benchmarks

3. EU Taxonomy Navigator (europa.eu)

4. Undertakings – a technical term used in the regulations to refer to companies or enterprises that are to undertake reporting. In this chapter about the legislation, we will therefore use this term – but in the more practice oriented analyses-chapter, we will use the more common word: companies.

5. https://finance.ec.europa.eu/publications/renewed-sustainable-finance-strategy-and-implementation-action-plan-financing-sustainable-growth_en

- Mainstreaming sustainability into risk management
  - Better integrating sustainability in ratings and research
  - Clarifying institutional investors and asset managers' duties
  - Incorporating sustainability in prudential requirements
- Foster transparency and long-termism in financial and economic activity
  - Strengthening sustainability disclosure and accounting rule-making
  - Fostering sustainable corporate governance and attenuating short-termism in capital markets

As can be seen, the EU Green Taxonomy is the first reform in this package, and is the cornerstone of a suite of new legislations and regulations, and it may be helpful to understand their connections:

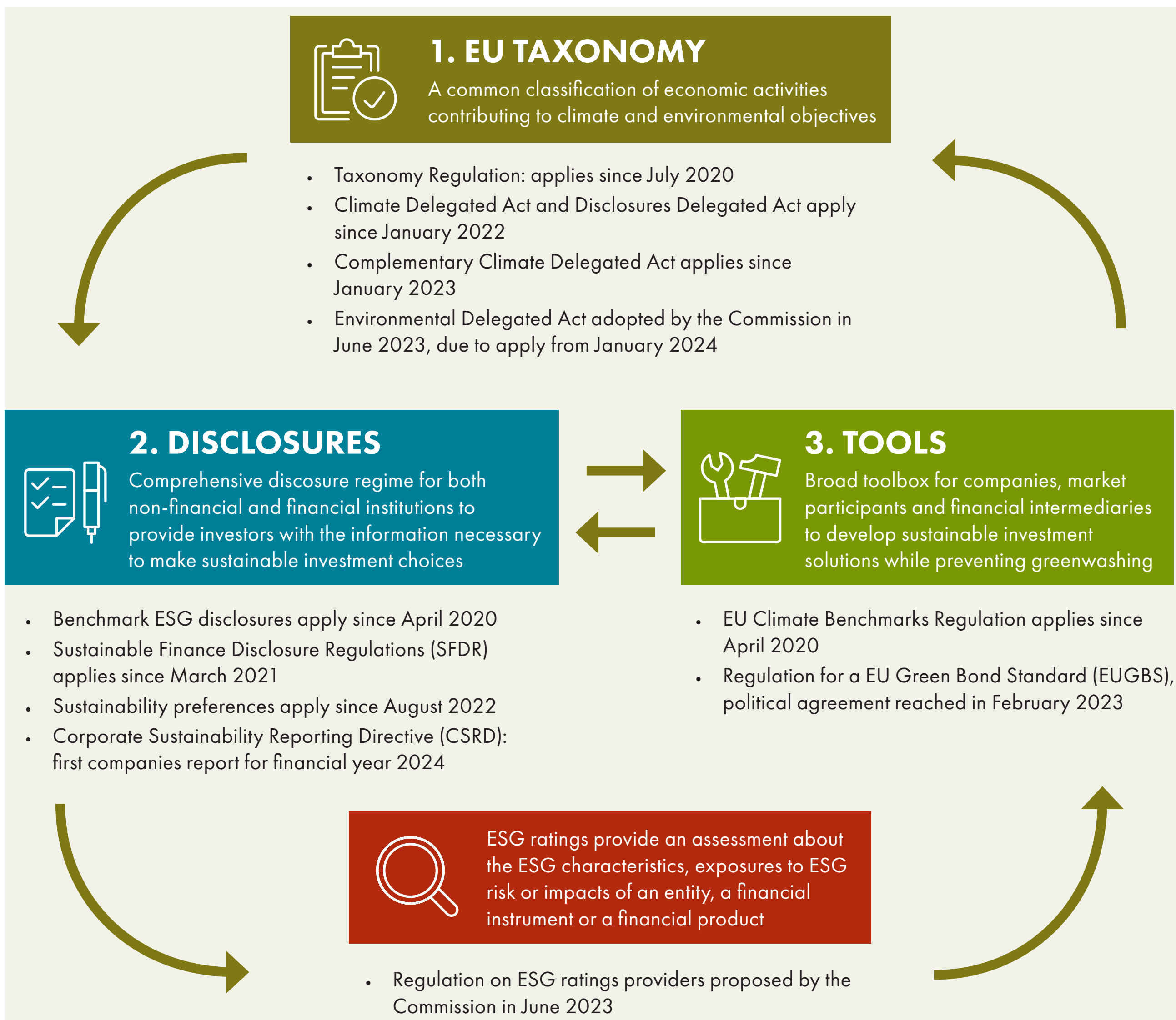

Figure 1: EU Green Taxonomy and all the new legislations and regulations, source: Commission Staff Working Document 317 (13.06.2023)

The EU Green Taxonomy is the driver of many other pieces of legislation, therefore it is essential that both the financial and non-financial undertakings understand the purpose and the use of the regulation and disclosure requirements.

DISCLOSURE REQUIREMENTS

The EU Green Taxonomy applies to undertakings subject to the obligation to publish non-financial statements in accordance with the Non-Financial Reporting Directive (NFRD)[6].

The disclosure requirements are differentiated between the non-financial and financial undertakings. Financial undertakings are those that offer financial products in the EU. Sometimes undertakings can fall into both categories (depending on their size and economic activities), but it is not common. The only common rule for both financial and non-financial undertakings is that the Taxonomy reporting must be part of the reporting of non-financial statements, or it shall provide cross-references to this.

Disclosure requirements for non-financial undertakings:

The EU Green Taxonomy covers six environmental objectives:

- climate change mitigation
- climate change adaptation
- the sustainable use and protection of water and marine resources
- the transition to a circular economy
- pollution prevention and control
- protection and restoration of biodiversity and ecosystems

For the reporting year 2022, it was only the two first objectives, climate change mitigation and adaptation, that were in force. They are defined as follows:

- Climate change mitigation activities should contribute substantially to the stabilization of greenhouse gas emissions by avoiding or reducing them or by enhancing greenhouse gas removals (EU Green Taxonomy, para 24).
- Climate change adaptation activities should contribute substantially to reducing or preventing the adverse impact of the current or expected future climate, or the risks of such adverse impact, whether on that activity itself or on people, nature or assets (EU Green Taxonomy, para 25).

For the reporting year 2022 climate change mitigation and adaptation covered a total of 101 economic activities spanning over 12 economic sectors[7].

The non-financial undertakings are to identify, if they contribute substantially to at least one of the two objectives (next year six objectives) – these activities are called **eligible activities.** These eligible activities are then to be assessed for, whether they are **aligned** with the EU Green Taxonomy. That is done by assessing whether the activity:

- Contributes significantly to one or more of the six environmental objectives
- Does no significant harm to any of the other five environmental objectives (also known as DNSH)
- Comply with minimum safeguards (meaning in line with OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights to not have a negative social impact)
- Comply with the technical screening criteria set out in the Taxonomy delegated acts[8].

6. From the reporting year 2023, all companies that fall under the Corporate Sustainable Reporting Directive (CSRD) will be required to report according to the EU Green Taxonomy. Since this will gradually be enlarged to cover more than 50,000 companies, the amount of taxonomy reporting will also increase substantially.

7. From the reporting year 2023, the four remaining objectives will be in force, and it is the expectation that new economic sectors and activities will continue to be added and existing ones refined and updated where needed. See more in the EU Green Taxonomy and the supplement adopted in June 2023. To see an overview of the current activity codes, see this: sustainable-finance-taxonomy-nace-alternate-classification-mapping_en.xlsx (live.com)

8. See more in the Climate Delegated Act (2021) and Complementary Climate Delegated Act (2021)

The non-financial undertaking shall[9] provide the Turnover, Operational Expenditures (OpEx), and Capital Expenditures (CapEx) data per:

- Eligible and aligned activity
- Eligible but non-aligned activity
- Non-eligible activities

All non-financial undertakings shall use the tabular form by using the templates set out in Annex II of the Disclosure Delegated Act (2021)[10] – even if they do not have any Taxonomy eligible activities.

The Disclosure Delegated Act (2021) defines the three financial elements this way:

- The **Turnover**[11] shall cover the revenue recognized pursuant to International Accounting Standard (IAS) 1, paragraph 82(a), as adopted by Commission Regulation (EC) No 1126/2008.
- **CapEx** shall cover additions to tangible and intangible assets during the financial year considered before depreciation, amortization, and any re-measurements, including those resulting from revaluations and impairments, for the relevant financial year and excluding fair value changes. It shall also cover additions to tangible and intangible assets resulting from business combinations. So, CapEx shall cover costs that are accounted based on:

  (a) IAS 16 Property, Plant and Equipment, paragraphs 73, (e), point (i) and point (iii);

  (b) IAS 38 Intangible Assets, paragraph 118, (e), point (i);

  (c) IAS 40 Investment Property, paragraphs 76, points (a) and (b) (for the fair value model);

  (d) IAS 40 Investment Property, paragraph 79(d), points (i) and (ii) (for the cost model);

  (e) IAS 41 Agriculture, paragraph 50, points (b) and (e);

  (f) IFRS 16 Leases, paragraph 53, point (h)

- **OpEx** shall cover direct non-capitalized costs that relate to research and development, building renovation measures, short-term lease, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of assets of property, plant and equipment by the undertaking or third party to whom activities are outsourced that are necessary to ensure the continued and effective functioning of such assets. Non-financial undertakings that apply national GAAP and are not capitalizing right-of-use assets shall include lease costs in the OpEx in addition to the costs listed in the first subparagraph of point 1.1.3.1 of Annex I of the Disclosure Delegated Act (2021).

The non-financial undertaking shall also provide accounting policies and methodologies used, provide information on assessment of compliance with the regulation, and how they avoid double-counting and make reconciliations towards the financial line items. There is currently no EU requirement for assurance of the Taxonomy reporting[12].

9. There is an exemption - possibility not to provide the OpEx activity split, if the OpEx is not material for the business model. But if this exemption is used, the total value of OpEx must still be disclosed in the tabular form and an explanation of the absence of activity-split must be given.

10. See Disclosure Delegated Act (2021) Article 2 (2)

11. Turnover is typically called Revenue in the financial reporting legislation.

12.Once the CSRD reporting apply, according to the phased solutions for this, limited assurance of the Taxonomy reporting will also apply, as for the rest of the CSRD reporting. See also FAQ number 4 of European Commission (2022)

Disclosure requirements for financial undertakings:

The disclosure requirements for financial undertakings are quite different from the requirements for the non-financial undertakings, as Turnover, CapEx and OpEx are irrelevant for assessing the financial activities, including lending, investment, and insurance. The special financial undertaking disclosure requirements can be found in the Supplementing Regulation (2021), which is based on Article 8 of the EU Green Taxonomy Regulation (2020).

The financial undertakings are not to use the same tabular form as the non-financials, but instead they have their own tabular forms, which are different dependent on the type of financial undertaking:

- Asset managers
- Credit institutions (incl. banks)
- Investment firms
- Insurers and reinsurers

Most reporting requirements for the financial undertakings kick in from reporting year 2023 or later, but the few requirements for reporting year 2022 will of course be investigated. They are:

(a) the proportion of their total assets exposed to Taxonomy non-eligible and Taxonomy-eligible economic activities;

(b) the proportion of their total assets of the exposures referred to in Article 7, paragraphs 1 and 2;

(c) the proportion of their total assets of the exposures referred to in Article 7(3);

(d) the qualitative information referred to in Annex XI;

(e) Credit institutions shall also disclose the proportion of their trading portfolio and on demand inter-bank loans in their total assets;

(f) Insurance and reinsurance undertakings shall also disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible non-life insurance economic activities.

THE EU GREEN TAXONOMY TIMELINE

The EU Green Taxonomy has been in force since 12th July 2020, and follows the below progression of disclosure obligations according to the Disclosures Delegated Act[13] supplementing Article 8 of the EU Green Taxonomy regulation.

As of January 2022	• Non-Financial entities report Taxonomy elegibility for the previous calendar year* • Financial entities report Taxonomy elegibility for the previous calendar year*
As of January 2023	• Non-Financial entities report elegibility and alignmentfor the previous calendar year • Financial entities report Taxonomy elegibility for the previous calendar year
As of January 2024	• Non-Financial entities report elegibility and alignment for the previous calendar year • Financial entities report Taxonomy elegibility 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 instutions include Taxonomy alignment of their traiding book and fees and commisions for non-banking activities

Figure 2: The reporting obligations and timelines as set out in the Disclosures Delegated Act, source: https://ec.europa.eu/sustainable-finance-taxonomy/

13. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32021R2178

METHOD AND OVERALL ANALYSES

This white paper investigates how the new EU Green Taxonomy reporting legislation is working in practice. We have analyzed the Taxonomy reporting for the 100 largest, listed companies in EU, which were subject to report from the reporting year 2022. We have identified the companies via Forbes' The Global 2000 list from 2023, which is based on 2022 reporting, where Forbes rank listed companies based their Sales, Profit, Assets, and Market value in USD. See the Annex to find a list of the companies included in the analyses. We have added the official GICS-codes (Global Industry Classification Standard) as well, whereby potential sector representations can also be found.

All 100 companies have been analyzed via manual reading and analyses of their sustainability/ integrated/ Universal Registration Document 2022 reports, as they were found on the companies' homepage with a deadline of 30th June 2023. We have developed and used a standard analyses template, which we based on a trial analyses of ten companies' reports. We have also gathered and consolidated the activity reporting from all the non-financial companies' reports per activity level, whereby we can see the total eligible & aligned, the eligible but non-aligned, and non-eligible Turnover, CapEx and OpEx from the non-financial companies (see Appendix II). Finally, we have also accumulated the mandatory financial company reporting as far as possible – see the chapter 'Issue on proportions' within the analyses of the financial company reporting.

The geographical split is reasonable with representation of 15 different countries out of the 27 EU Member States. However, Eastern Europe with only two companies is not well represented, due to the limited number of large, listed companies with headquarters in Eastern Europe. Given a search on the Forbes list, to see if we reasonably could add extra Eastern European companies to maximize representation, it became clear that the next ones on the list are significantly smaller, and we would then just add more noise rather than clarity given the different sizes of companies. Thus, we have chosen not to add additional Eastern European companies.

No 1: Geographical split of companies

	No of companies per country	Market value per country
		Bill. EUR
Austria	3	33
Belgium	2	148
Czech Republic	1	28
Denmark	5	460
Finland	4	116
France	29	2,324
Germany	25	1,339
Ireland	1	34
Italy	6	239
Luxembourg	1	20
Netherlands	5	385
Poland	1	17
Portugal	1	21
Spain	8	367
Sweden	8	252
Total	**100**	**5,783**

The GICS sector split is quite diverse with representatives from ten out of the eleven standard GICS, leaving only Real Estate as not represented. We therefore conclude these analyses are as good as fully sector-representative.

No 2: GICS split

	No of companies per GICS sector	Market value per GICS sector
		Bill. EUR
Communication Services	4	185
Consumer Discretionary	11	1,246
Consumer Staples	8	557
Energy	6	273
Financials	27	917
Health Care	6	706
Industrials	16	784
Information Technology	5	457
Materials	5	202
Real estate	0	0
Utilities	12	455
Total	**100**	**5,783**

GICS = Global Industry Classification Standard GICS - classification codes

According to the company overview there are 27 financial companies as defined by the GICS categories – but two of them are not offering any financial products to the market, so they are considered as non-financial companies in this paper, and they also report accordingly. Hence, there are 75 non-financial companies and 25 financial companies in this analysis.

14. 'The total population of companies within the scope of the NFRD in the EU27 was in 2020 1,956 (excluding exempted subsidiaries), made up of 1,604 listed companies (excluding listed banks and listed insurance companies), 278 banks and 74 insurance companies.' (European Commission, 2020, p 8). Testing 100 companies' reports gives us a confidence level of 95%, an error margin of +/-9.55%, assuming the population proportion is 50%. Even if we assume the population is 11,500 (excluding exempted subsidiaries), which would be the case if the companies that are added through national transposition of the Accounting Directive and NFRD are also considered – then the error margin only increases to 9.76%. Hence, we conclude a sample of 100 is satisfactory for our purpose. It can rightly be argued that the 100 largest, listed companies are not size-wise representative for the entire population. But the importance of these cannot be discussed.

15. Nine companies were taken out since they are listed outside of EU on non-EU regulated markets, and hence, currently not covered by the Taxonomy regulation. They were replaced with the next EU-headquartered companies in Forbes ranking.

ANALYSIS OF THE NON-FINANCIAL COMPANIES' REPORTS

All the 75 non-financial companies refer to the Taxonomy, which is positive. But seven of the companies report so poorly, that we must conclude they do not fulfil the basic formal requirements. Five of those seven companies do not provide any quantitative data and do not use the mandatory tabular forms. Two companies do provide some quantitative data, but either invent their own much smaller forms or simply provide the data in the text. It is not satisfactory that 9% of these large, listed companies do not fulfil even the most basic formal mandatory elements.

We also tested to see where the reporting is placed. The legislation is clear that the reporting must be placed alongside the non-financial reporting. All companies got that right. We see 17% report in sustainability reports, 50% report in integrated reports, and the rest in Universal Registration Documents –the latter especially is very much a French solution. One company unfortunately did not provide all elements in one report, so we had to piece the reporting together from both the sustainability and the integrated report – this is not a good user-friendly solution.

All companies that report quantitative data (70 of the 75 reports) also provide, in some shape or form, the mandatory accounting principles. But regarding the mandatory reconciliations and references to the financial reporting (see Disclosure Delegated Act (2021), Annex I, 1.2.1), these are still not often very well made (85% could do better – some a lot better). However, some French and German companies especially are good at making explicit reconciliations and references to their financial report. This is a simple and important improvement, which the companies should be able to do, also with the current legislation.

As indicated, it is still not EU mandated to get assurance of the Taxonomy reporting. Yet, we actually see 30 companies (40%) that have chosen voluntarily to get either limited or even reasonable assurance of the Taxonomy reporting. It is also interesting to see that of the 45 companies, who do not get any Taxonomy assurance, only two do not get any assurance of their sustainability reporting as such, while 43 do get some assurance, but which does not cover the Taxonomy reporting.

THE ISSUES OF THE COMPLICATED TABULAR FORMS

As we indicated at the beginning of this chapter, companies are experiencing issues with using the mandatory tabular forms. For the readers' convenience, we have included a copy of the first section-template of these forms in Appendix I, whereby it is possible to follow the headers and numbers of each column of the forms, when we go through the issues in this section. They can also be found in their entirety in the Disclosure Delegated Act (2021), Annex II.

Looking at all 75 non-financial companies' reports, 45 (60%) successfully make use of the forms without any obvious shortcomings – but 40% do have issues to some degree. That is a lot of issues.

Firstly, several companies fail to use the forms at all, as previously mentioned.

A less severe, but yet practical issue, arises around the use of activity codes in column 2. Most companies (56 or 75%) use the Delegated Act codes, as they should. We also see eight companies, which both provide Delegated Act codes and NACE codes[16], whereby they make things unnecessarily complicated for themselves. But we also see a few companies, who only provide NACE codes, which is not right, but not completely impossible to use, since an eager report user can via a mapping[17] table usually[18] find the right codes – but it is of course not user-friendly. The worst issue we see is that a few companies, who in the lack of activities they would have liked to be included in the Taxonomy, simply invent, and use homemade activities or do not provide any codes but just add numbers to the various categories of data. This is unacceptable.

Another issue arises from the use of the columns 5-10 on 'substantial contribution'. The intention with these columns is that the company should define, which of the two (next year six) environmental objectives the activity contributes substantially to. As can be seen, the unit is a percentage, and most companies do what they should, namely assign how much of the activity contributes to the individual objectives, which should add up to 100% per activity – to ensure the activity is not double counted. But a few companies 'copy-paste' the % from column 4, the proportion of Turnover, CapEx or OpEx – which is wrong. But fundamentally one could ask, why make the form so complicated? If the companies did make the reconciliations to the financial reporting line items, as they should (see previously), there would be no risk of double-counting – it would tally all the time – then columns 5-10 are redundant.

The last issue with the forms we would like to highlight, concerns columns 11-16, which are related to the DNSH assessment towards the other objectives. Not all activities have requirements for all 6 DNSH-elements (Complementary Climate Delegated Act (2021), Annex I) – but yet, we fairly often see companies fill in all fields in the DNSH columns with a 'Y', indicating 'yes', they are aligned on everything – and not a 'N/A', '-', or simply blank spaces, which they should have used where there are no DNSH requirements. It is obviously wrong, and perhaps it indicates the company did not read and assess the DNSH requirements, but just assumed they were aligned on everything. But another and perhaps simpler explanation could also be that the companies just thought, it looked 'better' to be 100% aligned on everything and did not leave anything open/blank/unanswered. But one fundamental question should be raised about these columns – what is the purpose of them? Who is going to use them – and for what? As given by the rules, if just one of the DNSH-requirements are not fulfilled, then the activity is not aligned – but only eligible. That means, it is given that all relevant DNSH requirements are fulfilled, if the activity is assigned to be aligned – it is an implicit conclusion – no further explanation is needed, and columns 11-16 are redundant.

Given all these practical problems and redundant information in the tabular forms, we wonder if it would be beneficial and provide much more useful reporting, if these forms were drastically simplified. We also wonder, who will use all these complicated elements, when evaluating the companies' taxonomy activities – and how?

In fact, we would suggest that columns 5-17 and 19-21 are removed. If the reason for having all these columns is related to the fact that the legislators do not trust the companies will report correctly (and as we can see from above, that assumption is sometimes not completely wrong), then await the mandatory limited assurance[19] - do not compensate by making the requirements overcomplicated. But when mandatory assurance kicks in, it will on the other side also require better and more precise regulation from the legislators. This will also ensure that the assurance providers do not have to make these broad disclaimers, as we are currently seeing.

16. The statistical classification of economic activities in the European Community, commonly referred to as NACE, which is an abbreviation for the French term 'Nomenclature statistique des Activités économiques dans la Communauté Européenne'.

17. See more here: [sustainable-finance-taxonomy-nace-alternate-classification-mapping_en.xlsx (live.com)]

18. Usually possible – but as the Platform rightly indicates, it is not always straightforward (Platform on Sustainable Finance (2022a), p 39), therefore this mapping tool has been created: [Platform on Sustainable Finance's report on environmental transition taxonomy (europa.eu)]

19. And may we suggest that the primary test direction for eligibility is completeness, while the primary test direction for alignment is validity. In that way the pool of activities that potentially could be green will be maximized, while the alignment reporting can easily be the base for green bonds.

A practical outcome of simplifying the forms would also be to allow them to fit into an ordinary reporting page, without having to turn them into landscape view or having to minimize the font into something unreadable. Presently, we see many creative attempts to make the forms fit into the reports, however they usually end up in the back of the reports, not the least because size-wise they do not fit anywhere.

THE ISSUE OF LACK OF ACTIVITY-DEFINITION

One of the most prominent issues with the current legislation is the lack of definition of an 'economic activity' (see also Platform of Sustainable Finance, 2022b). We do recognize that attempts have been made – especially in the FAQs . But often the information is vague and sometimes contradictory. See this example (European Commission (2022), no 2 – How is an 'economic activity' defined in the Disclosures Delegated Act?)

> 'An economic activity takes place when resources such as capital, goods, labour, manufacturing techniques or intermediary products are combined to produce specific goods or services. It is characterised by an input of resources, a production process and an output of products (goods or services).'

But in the same FAQ – in the reply to question number 3 What is a Taxonomy-eligible economic activity? it is stated that:

> 'In principle, if an undertaking generates turnover or invests in capital expenditure (CapEx) or operating expenditure (OpEx) corresponding to an economic activity that is described in the Climate Delegated Act, it would count as eligible for Taxonomy-eligibility disclosure.'
>
> 'Finally, the Taxonomy Regulation, the Climate Delegated Act and the Disclosures Delegated Act do not differentiate between core and non-core economic or business activities. Therefore, undertakings should report all of their economic activities in line with the definition of eligibility under Article 1(5) of the Disclosures Delegated Act, as explained above.'

The latter reply indicates that an activity does NOT have to generate turnover – it can simply be a capital[21] or operational expenditure – but the first reply indicates an activity will require some sort of production process given a classic input-output model. These are VERY different replies, and the outcome is that we see VERY different interpretation of what an activity is, whereby the reports often become incomparable.

For instance, in the sample we can see a Nordic utility provider and its French peer report quite differently – despite being almost the same size and, from a financial point of view, have more or less the same profile. The Nordic company reports solely according to their segment reporting[22] – which means they report on three activities. The French company reports according to the assets' nature, and hence reports on 21 activities.

We do not know, which solution is the right one. But we can see that it is almost as if the different interpretations are agreed upon in the geographical areas. So, in the Nordics and in Germany we primarily see segment-reporting – while the rest of EU are more inclined to report according to the assets' nature, though still also prefer segment reporting for OpEx. See this overview of the OpEx reporting on the next page.

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20. FAQs = Frequently Asked Questions. The European Commission has issued a plethora of FAQ-letters – see also the EU Taxonomy Navigator to get an overview of the FAQs issued. The legal status of these is not completely clarified, but we must assume they are not legally binding – but guiding.

21. It could be CapEx for installing solar power on the rooftop of the headquarters. It will most likely not generate Turnover, it will not be part of the production process – but it will reduce the fossil fuel consumption at the headquarters, and it could be the base for a green bond issuance.

22. IFRS 8, Operating Segments

No 3: OpEx reporting

	All companies	Nordic & German companies	Other EU
No OpEx-data, or difficult to tell given the accounting principles	13	4	9
Segment driven	41	21	20
Assets' nature driven	21	6	15
Total	**75**	**31**	**44**

From a practical point of view, we do understand why the segment reporting might seem most appealing for companies, as they can re-use the data-split they have already in their bookkeeping/ERP and consolidation systems. But to be able to use the Taxonomy reporting to support issuance of green bonds or other green financial instrument solutions – also sometimes for non-core activities like fossil-free electricity for the headquarters or similar projects, the 'assets' nature' reporting might actually be more useful for both the companies and the investors.

Looking at the CapEx reporting, the habits of each geographical split become even clearer. We have looked at, whether the CapEx only was provided driven by the segment reporting, or whether the company for instance also added transport and/or real estate activities, as one must assume that most companies, regardless of their line of business, will own/lease buildings[23] and will have some sort of transportation needs of either goods and/or services (human beings)[24] – if these activities were not part of the 'core activities'. The outcome looks like this:

No 4 CapEx activity method

	All companies	Nordic & German companies	Other EU
No CapEx-data	5	2	3
Segment driven	26	15	11
One additional activity applied	16	6	10
Two additional activities applied	28	8	20
Total	**75**	**31**	**44**

As noted, based on the current legislation we cannot indicate which practice is the right one – but we can say, that it is applied very differently across the EU. It is not useful for companies, their assurance providers, or the national business authorities – and eventually neither for the investors, that the legislation is unclear, and the reporting is not comparable. So, a clarification of the term 'activity' is needed to produce more efficient and useful reporting.

23. Real estate activities could for instance be 7.2 Renovation of existing buildings.

24. Transport activities could for instance be 6.5 Transport by motorbikes, passenger cars and light commercial vehicles.

THE ISSUE OF FINANCIAL MATERIALITY

A third issue we will raise for the non-financial reporting is related to financial materiality. Financial materiality is not to be confused with 'contribute substantially', where the entire Complementary Climate Delegated Act (2021) and other subsequent guidelines and FAQs make an effort to define how the activity can be determined if it 'contributes substantially'. Some of these definitions do actually have some quantitative thresholds – but they are all defined non-financially, because the aim is that the activity should 'contribute substantively' to the climate mitigation or adaptation to be aligned – not necessarily financially.

According to European Commission (2022) FAQ number 13 'Is there any minimum turnover, CapEx and OpEx threshold below which undertakings are not obliged to report Taxonomy-eligibility or alignment of their economic activities ('materiality thresholds')?' The reply is:

> 'According to Article 8(2) of the Taxonomy Regulation, undertakings subject to the NFRD/ CSRD) are under the obligation to report the proportion of their turnover, CapEx and OpEx associated with Taxonomy-aligned economic activities. The Disclosures Delegated Act specifies further the content and presentation of the relevant information to be reported. No exemption is foreseen from the obligation to report.
>
> Section 1.1.3.2. of Annex I provides for a certain degree of flexibility in the reporting of the OpEx...' (and the rest of the reply is solely on the OpEx exemptions).

So, the reply is still unclear, as the Disclosure Delegated Act does not indicate, whether a financial materiality threshold is allowed for Turnover or CapEx – it is only defined specifically for OpEx. But given the more generic reply in this FAQ that: 'No exemption is foreseen from the obligation to report', it could be interpretated that it is not allowed to make any materiality thresholds for Turnover or CapEx – but we are not certain.

In our analyses of non-financial companies, we can see 40% of the companies openly state they start by making some sort of materiality assessment of the financials. Most often are the financial thresholds uprightly and openly defined and reported – but sometimes not. From what we can see, the threshold definitions vary quite significantly, as it can be anything from 1% to 5% or a specific monetized amount of the Turnover, CapEx or OpEx. One can also argue, that if the company solely uses the segment reporting as driver for the activity reporting, that will also bring some substantial financial materiality thresholds, as many companies use a 'rule of thumb-threshold' of 5-10% to make their IFRS segment split.

At the same time, we can also see some companies, who surely have not assigned any financial materiality thresholds and have included even the smallest amounts to be eligible and perhaps even aligned – so small, that the %s of Turnover, OpEx or CapEx are less than 0.0% - and then one could ask: is that really material? Though it is not certain that financial materiality equals climate impact, one could perhaps question: do activities of that magnitude 'contribute substantially', and are they important for the financial companies' evaluation of the non-financial companies' activities?

As for the activity definition, we cannot be fully certain, which reporting practice is right. But we do understand why so many companies choose to use 'homemade' financial thresholds. The Taxonomy reporting process in most of the non-financial companies is initially very much driven by the financial data – and hence, when the companies are to evaluate what to include and what not to include in the Taxonomy reporting, they start by looking at the financial significance of the postings, not the least because the subsequent work related to the technical screenings criteria, DNSH assessments, and Minimum Safeguards can be very time and resource consuming. So, it is useful for the companies to be able to segregate up front between what to spend time and resources on – and what not to.

We therefore recommend that the European Commission allow for companies to make initial financial materiality thresholds, but of course require that these are defined and reported. Ensuring that these are used uniformly in the entire EU, which will maximize comparability and usefulness, one could also consider defining them up front – for instance: all activities > 1% of the Turnover, CapEx or OpEx are to be included as eligible and then tested for alignment. In that way it will also be much easier for the companies and their assurance providers to ensure reporting is complete.

THE ISSUE OF RELEVANCE

The final issue to investigate, is whether the Taxonomy is relevant for the large, listed non-financial companies, who are covered by the legislation and hence are required to report? Are the Taxonomy activities part of the activities which most large, listed companies work with, whereby the Taxonomy also could work as a guide for how the companies can make their business green, or is it only a few companies within a few sectors who will be able to work actively with the Taxonomy? We have investigated it in two ways:

- How many companies report on any Taxonomy eligible activity?
- What are the accumulated values of eligible & aligned, eligible but non-aligned, and non-eligible activities per the Turnover, CapEx and OpEx per company reporting in mill. EUR – see Appendix II.

Looking only at the eligibility frequency, we can see 14 companies, who do not have any eligible Turnover. 25 companies have less than 5% eligibility, if we add up the eligible Turnover, CapEx and OpEx and compare to the total. If we add the five companies, who do not report any data, where four out of five specifically indicate it is due to lack of being covered by the Taxonomy activities, we conclude that 30 companies are, not at all, or only marginally covered by the Taxonomy activities – that represents 40% of the companies caught up in the regulations. A lot of large, listed companies, are now required to spend time and resources on reporting on the Taxonomy – but for whom it is not relevant, because the EU Green Taxonomy activities are not their activities.

As can be seen from Appendix II, of the 101 activities, 15 are not used at all, and another 24 activities are hardly used[25], which means 39 of 101 are never or rarely used[26]. It indicates that a lot of the activities are not even remotely aligned with the large, listed companies' core activities. Remember, we focus on the large, listed companies because they are the companies who are required to report – it is not the small entrepreneurs.

We are sure that the activities chosen to be included in the initial Taxonomy-activities were selected due to their green potential[27] – and that is a fine principle. But it is also clear that these activities are not necessarily the activities which the large, listed companies primarily work with as their core business, since in fact, 63% of their Total Turnover is non-eligible. This poses questions about the relevance of the Taxonomy.

In contrast, we can only see six activities which are heavily[28] used:

- 3.3 Manufacture of low carbon technologies for transport
- 3.9 Manufacture of iron and steel
- 4.9 Transmission and distribution of electricity
- 4.29 Electricity generation from fossil gaseous fuels
- 6.5 Transport by motorbikes, passenger cars and light commercial vehicles[29]
- 6.10 Sea and coastal freight water transport, vessels for port operations and auxiliary activities

25. The aligned and non-aligned but eligible value is less than 100 mEUR per Turnover, CapEx and OpEx

26. Remember though, that these analyses cover 10 out of 11 GICS sectors.

27. As indicated in Commission Staff Working Document 152 (2021) and in European Commission (2022), no 2.

28. The aligned and non-aligned but eligible value is larger than 50,000 mEUR per Turnover.

29. If the 'activity' definition is clarified, and assets' nature driven activity reporting is selected as the right solution, in contrast to the simpler segment driven reporting, we foresee that perhaps '6.5 Transport by motorbikes, passenger cars and light commercial vehicles' but especially '7.2 Renovation of existing buildings' would be reported far more frequently, whereby many more green alignment-potentials can be identified.

Ideally statistical analyses would have been made prior to issuing the regulation, whereby the green potential (eligible activities) could have been maximized for the large, listed companies covered by the reporting burden – perhaps topped up with the activities with the best green potentials, as inspiration.

Alternatively, the reporting requirement could have been made narrower and more directed towards the companies in the sectors, who appear to be covered by the Taxonomy activities. In this table we have made an overview of the companies per GICS sector, compared to how many that report who are only marginally covered (eligible) by the EU Green Taxonomy activities:

No 5 Eligible activity reporting – sector split

	No of companies per GICS sector	Marginally covered companies by Taxonomy activities
Communication Services	4	2
Consumer Discretionary	11	3
Consumer Staples	8	8
Energy	6	0
Financials	2	1
Health Care	6	6
Industrials	16	6
Information Technology	5	4
Materials	5	0
Real estate	0	0
Utilities	12	0
Total	**75**	**30**

The Taxonomy activities do not appear to cover the major companies within Consumer Staples, Health Care, and Information Technology, whereas companies within Energy, Materials, Utilities, and the car manufacturers (part of Consumer Discretionary) are fully covered.

We hope the inclusion of the last four environmental objectives in 2023, and an enlargement of activities for the climate adaptation and mitigation objectives, also will enlarge the realistic pool of potential eligible activities, whereby the ability to identify potentially green activities (i.e., aligned), grows significantly. This will increase the relevance for the non-financial companies to report, and it will enhance the financial companies' ability to identify more green activities to funnel capital towards.

BONDS

We have also investigated the use of issuing corporate bonds – and whether these are 'green', 'sustainability' or perhaps even Taxonomy labelled. Firstly, it is interesting to notice that 73 of the 75 non-financial companies actually issue corporate bonds. 53% of these have only issued 'ordinary' bonds – meaning, they are not 'green' or 'sustainability' labelled – or even Taxonomy labelled. But that also means that 47% of the companies actually do issue bonds to raise 'green' capital. That means, there is a significant opportunity for the Taxonomy to play an even larger role in the future– and we are already seeing 20% of the companies also issuing 'taxonomy' labelled bonds[30].

30. Despite the fact that the European green bond standard (europa.eu) is not live yet. Usually, the companies also refer to ICMA = International Capital Market Association – see more here: Green Bond Principles » ICMA (icmagroup.org)

No.6 Non-financial companies and bonds

	# of companies
No bonds issued	2
Bonds issued, but no green bonds	39
Green bonds issued, but not Taxonomy related	27
Taxonomy related bonds issued	7

That is a quite remarkable development in a reasonably short timeframe, which indicates the market for 'green finance' is developing fast in recent years and the prospects for Taxonomy-use could be there as well.

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