Banking for Future

EU Taxonomy Disclosures: A Practical Analysis

White Paper

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A Practical Analysis

Background

From 2022 large companies subject to NFRD reporting are required to disclose information on their Taxonomy-related activities (Regulation Delegated Act). The main purpose is to increase market transparency and thus to enable financial markets to facilitate the transition towards sustainable economy.

The regulatory requirements provide for a two-phase approach:

1. **Phase: Eligibility reporting from 2022**
   In the first phase financial institutions must report their exposure structure and Taxonomy-eligible activities in respect to the environmental goals (for the year 2021 only for climate change mitigation and adaptation).
2. **Phase: Alignment reporting from 2024**
   In the second phase full disclosure on the Taxonomy-aligned activities and Green Asset Ratio (GAR) is required.

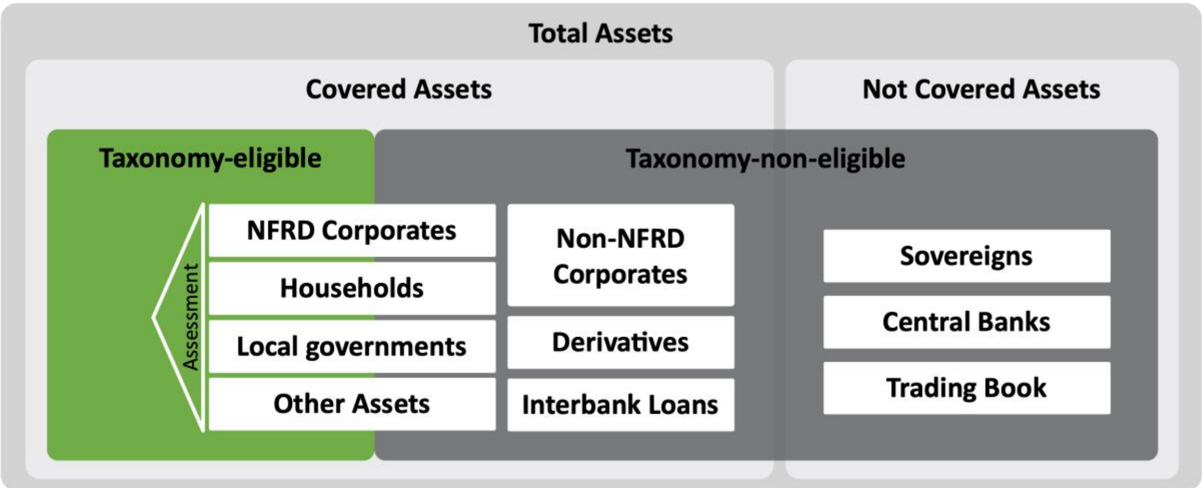
> The Taxonomy Regulation establishes an EU-wide classification system, by which investors and companies can assess whether certain economic activities are environmentally sustainable.
>
> Article 8 of the Regulation requires companies subject to the NFRD to disclose quantitative and qualitative information on their activities related to the Taxonomy.

The rationale behind this gradual approach is to use the eligibility-reporting as a stepping stone for the Taxonomy-alignment disclosure and also due to high dependency of external data provided by non-financial corporates in their own Taxonomy-related disclosures.

Comparability and coherence between the two phases and across companies can be assured by using the provided templates for the eligibility-reporting on a voluntarily basis. The minimum disclosure should be based on actual data. If the information is not available yet, financial institutions may use own estimations only as part of their voluntary reporting.

Eligibility-reporting requirement

Although the disclosure format is not determined, financial institutions are encouraged to align it with the provided templates in Annex VI of the Delegated Act. A specific template provided by the Platform on Sustainable Finance for the eligibility-reporting only can be used on voluntarily basis.



The structure of the provided templates gives guidance on how to segregate the total assets or to calculate the structural KPIs for eligibility reporting. First of all, a basic distinction should be made, if an exposure is included in or excluded from the GAR calculations.

Covered assets, which are considered in both the numerator and the denominator of the ratio, undergo first an eligibility assessment. These assets comprise exposures to financial corporations, large non-financial corporations subject to NFRD, households and local governments.

Covered assets, which are not part of the numerator, are per definition not eligible and are added only to the denominator. These assets comprise exposures to non-financial corporates not subject to NFRD-reporting, derivatives and on demand interbank loans.

Not covered or excluded assets are exposures to central governments, central banks and trading exposures. The inclusion of the first two will be part of regulatory review in 2024 (Art. 9). The Taxonomy-alignment of the Trading book assets has to be disclosed from 2026 onwards.

The quantitative and the qualitative disclosure in the eligibility-reporting covers 7 KPIs as ratios to the total bank assets, including their explanation in terms of calculation, data sources and limitation, as well as information on compliance with the Taxonomy-Regulation.

Quantitative Information	
KPI	Proportion in total assets of exposure in:
#1	Taxonomy-eligible activities
#2	Taxonomy non-eligible activities
#3	Central governments, central banks and supranational issuers
#4	Derivatives
#5	Corporates not subject to NFRD disclosure
#6	Trading assets
#7	Interbank loans
Qualitative Information	
Contextual information on quantitative indicators	
Compliance with the Taxonomy-regulation: business strategy, product design and clients	
Information on alignment of trading portfolio with the Taxonomy Regulation	

Analysis of the disclosed information

An analysis of the non-financial reports of several European-based banks gives first insights into the methodologies, data and difficulties related to the Taxonomy Regulation disclosure. The sample covers 9 institutions of very large to small sizes with different business models and product lines. The analysis refers only to the specific disclosure under Art. 8 and Art. 10 of the Delegated Act.

By definition the first two KPIs should be mutually exclusive and should cover the total of bank assets, since an activity can be either taxonomy-eligible or non-eligible[1].

However, some banks have introduced additional category of “Taxonomy-relevant economic activities”, which cover assets subject to eligibility assessment. They are then split into Taxonomy-eligible and non-eligible exposures, on the grounds that some exposures are per definition excluded from the Taxonomy. The ratios are then calculated differently among institutions. This adds a complexity in comparability of the ratios among institutions. No double counting is allowed, which means that all the assets are reported only once and in sum comprise the total assets. For consistency, financial institutions should use a scope of covered assets for their eligibility reporting disclosures close to the scope of covered assets for their alignment reporting.

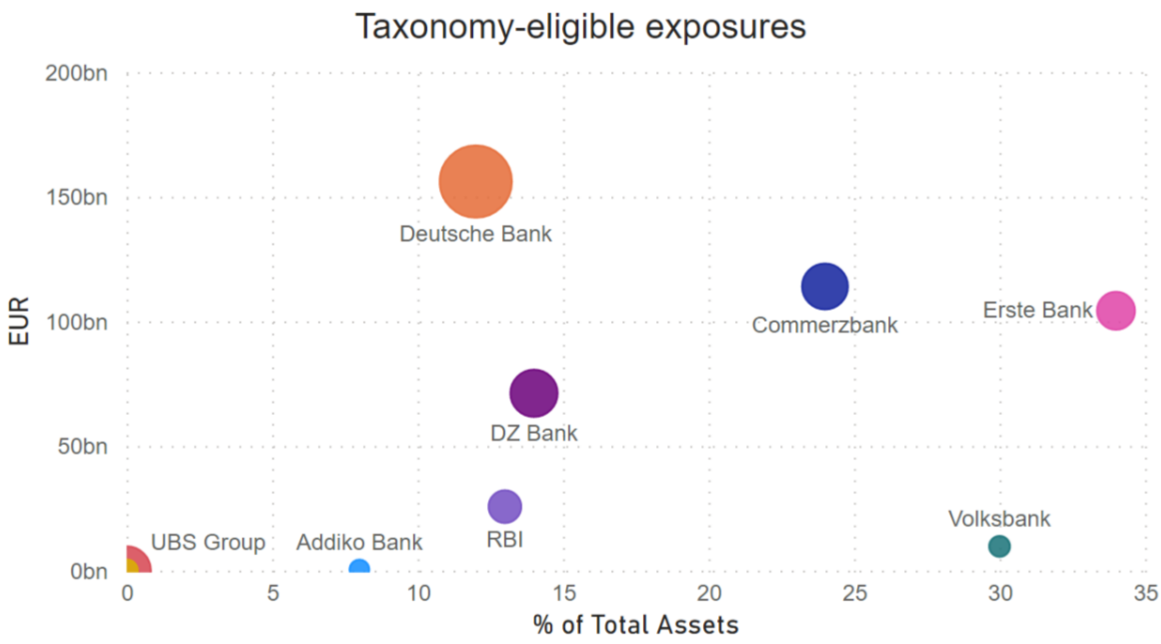
The eligibility assessment identifies exposures with clear connection to taxonomy-related activities. Retail exposures like housing loans, house renovation loans and car loans are categorized as taxonomy eligible, when the purpose of the proceeds is known. Most of the analysed banks have adopted a conservative approach with identifying the lowest boundary of the proportion of the Taxonomy-eligible activities. This means that KPI 1 will grow in the future due to better data availability and methodological sophistication.

Since the disclosures under the NFRD are (or were) not available yet some banks have categorized all corporate exposures as non-eligible. None of the banks has reported to have obtained NFRD information on bilateral basis from their counterparties and/or made estimates based on such data. Some banks have

[1] a holistic assumption that all bank assets relate to economic activities

used the categorization of the NACE codes according to the Taxonomy Compass by the European Commission.

A comparison of the reported values for KPI #1 can be observed on the following chart. The positionings of the analysed banks are not straightforward and clear. Structural differences between them have to be taken into account.



Disclaimer. The data presented in this graph is obtained from disclosed information in the official reports of the financial institutions on a best-effort basis. The accuracy or reliability of the data is not guaranteed or warranted in any way. For the purpose of comparability some data is manipulated and normalised.

The quantitative reporting of the sample banks can be directly analysed in the following interactive dashboard.

The other five KPIs show the general structure of the business model respective important categories for the future alignment-reporting. Banks have commonly applied definitions in compliance with FINREP.

Some banks have reported KPI #3 and #4 as one measure, since it is not clear from the regulatory text, if derivatives should be disclosed separately. However, since those two categories of financial exposures are very different in nature and a breakdown of the KPIs in exposures to investments in derivatives (Art. 7 Delegated Act) is pursued, for the purposes of comparability and transparency exposures should be disclosed separately. In alignment with the provided templates, derivatives and exposures to governments and central banks are considered as separate asset categories.

KPI #5 is of special importance since many banks have not identified the scope of their exposures to corporates subject to NFRD. Banks have made their own estimations based on existing internal data on turnover, total assets, number of employees etc. to make a general categorisation. Banking groups with significant exposure outside the EU have to exclude these exposures from the eligibility-assessment as well.

It is important to note that large part of the European Bank's corporate portfolios are exposures to SMEs, which are not subject to NFRD reporting. The inclusion of the SME exposures will be reviewed based on an impact assessment in the coming years (Art. 9 Delegated Act).

The non-NFRD exposure is derived after deduction of the NFRD exposure.

The disclosure of KPI #6 is more relevant for credit institutions with significant trading book portfolios, which has structural impact on some of the analysed institutions. Although these assets are excluded from the GAR covered assets, their Taxonomy-alignment will be disclosed separately from 2026.

KPI #7 is relevant for institutions with significant Treasury and money market exposures. The structural effects on such business models are reflected in the Taxonomy-eligibility ratio as well. For the retail banks it is not material.

Regarding the qualitative information provided a direct comparison between the banks is difficult. Some banks have provided clear reference to the Disclosure Regulation and their compliance with it. Some have been rather comprehensive, while others have not even explained the approach and data used in the calculation of the KPIs.

Conclusion

The analysis of the eligibility-reporting of the sample banks has shown that every bank has adopted different approach in its calculations based on different interpretations of the regulatory requirements. This leads directly to lower comparability and coherence, and thus lack of transparency for the market. The results indicate that the reporting requirements for financial institutions are still not clearly defined and/or communicated by the regulatory authorities. However, these limitations could be resolved with the introduction of standardised and digitalised disclosure data under the upcoming CSRD (Corporate Sustainability Reporting Directive). Even with completely identical approaches and coherent underlying data structural differences between the business models should be still considered when making comparisons between sustainability KPIs of different financial institutions.

Do you need help for ESG reporting in your institution?

Together with RFC Professionals, a partner consulting company, I am working on solutions for financial institutions on how to design and implement comprehensive and tailored-made ESG reporting framework.

Our offering includes:

- **Business Analysis:** Business model analysis, determining the regulatory requirements, stakeholder analysis
- **Gap Analysis:** Determining existing gaps against regulatory requirements or targets
- **Reporting Concept:** Materiality assessment, determining lead indicators and their relation to sustainability goals
- **Implementation:** Support with drafting or review of internal reporting or external disclosures, business requirements, data preparation, development of Dashboards
- **Roadmap:** Action plan for compliance with future disclosure requirements

We can tailor our offering to your needs, where necessary, leveraging subject-matter experts from our network.

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