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COMMISSION STAFF WORKING DOCUMENT

Enhancing the usability of the EU Taxonomy and the overall EU sustainable finance framework

Accompanying the document

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions

A sustainable finance framework that works on the ground

{COM(2023) 317 final}

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Introduction

Over the past 5 years, the EU has gradually established a comprehensive regulatory framework for sustainable finance through several milestones. The *2018 Action Plan on Financing Sustainable Growth*[1] and the *2021 Strategy for financing the transition to a sustainable economy*[2] have put forward an ambitious set of goals in support of the European Green Deal.

Enhancing the usability of the EU Taxonomy and the wider sustainable framework is a key priority and will remain a core element of the Commission's future work. With the founding pillars now in place, the EU Taxonomy and sustainable finance tools are being progressively onboarded by market players. The quality and availability of sustainability information are also expected to improve with the implementation of the European sustainability reporting standards (ESRS) and the European Single Access Point (ESAP). However, several concerns over usability and consistency have come to light that need to be urgently addressed.

The Commission has already taken significant steps in addressing implementation challenges reported by stakeholders. A series of targeted measures and several legislative initiatives were recently developed to clarify key concepts of the framework. These also aimed at supporting the implementation of complex and interconnected requirements.

The Commission remains committed to continuously improving the regulatory framework to ensure the rules are clear, consistent and as easy to implement as possible. This includes clarifying and simplifying the interplay between the key concepts, removing unnecessary administrative burdens and costs, and identifying any gaps that might prevent stakeholders from complying with their obligations.

This staff working document provides an overview of the key pillars of the regulatory framework and takes stock of the recent actions taken to enhance the usability of the EU Taxonomy and of the wider sustainable finance framework.

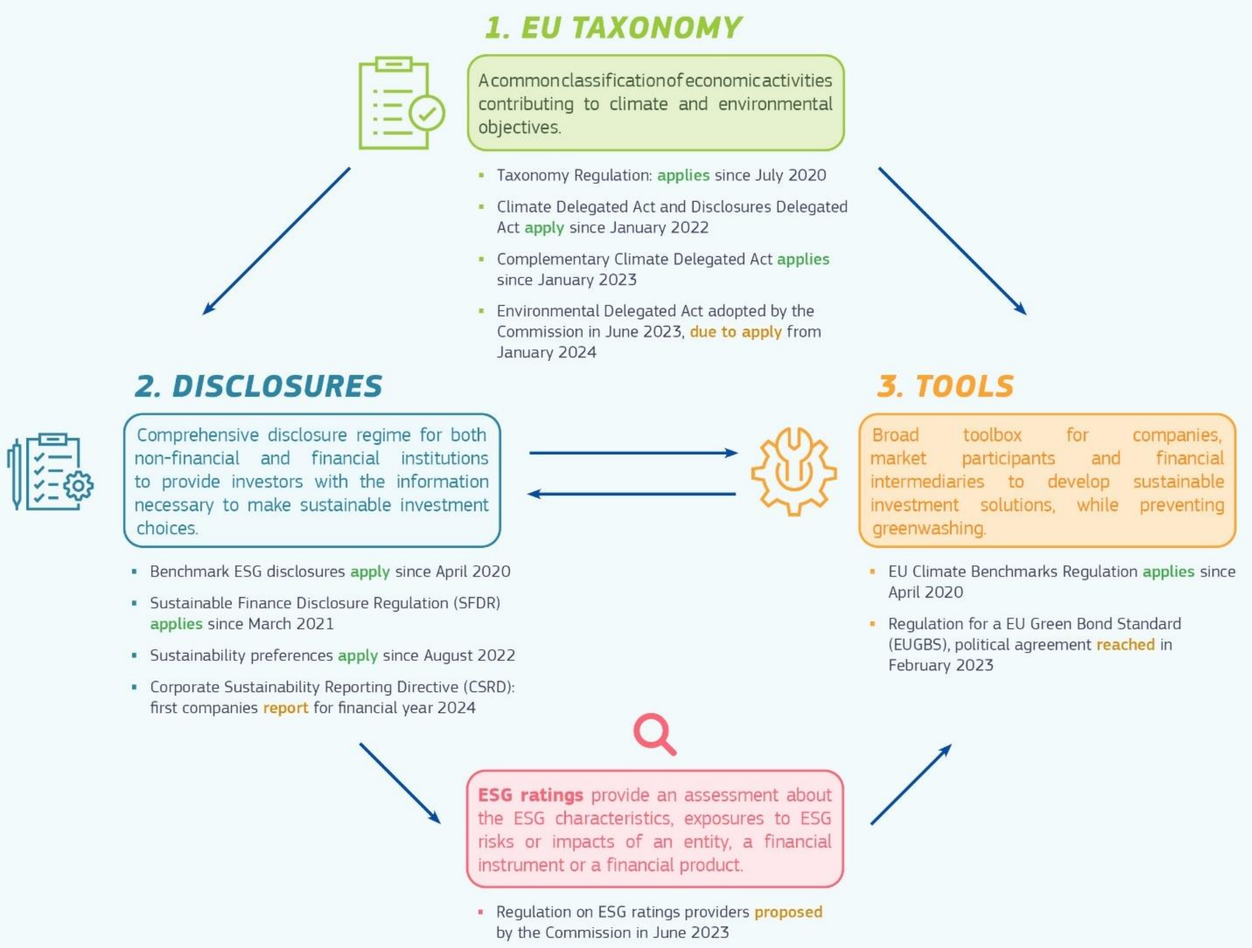
[1] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions on Action Plan: Financing Sustainable Growth, COM (2018) 97 final.
[2] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions on Strategy for Financing the Transition to a Sustainable Economy, COM (2021) 390 final.

1. The foundations of the EU sustainable finance framework

The EU sustainable finance agenda relies on three pillars: (1) the **EU Taxonomy**[3]; (2) several **disclosure frameworks** for non-financial and financial undertakings[4]; and (3) a set of **investment tools** to develop sustainable solutions[5]. Five years after the launch of the first action plan for sustainable finance, the three pillars are in place and are providing for a regulatory environment conducive to supporting sustainable investments.

This section provides an overview of these policy foundations and recent developments.

Figure 1: The pillars of the EU sustainable finance framework



[3] 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.

[4] These include Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, and Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[5] These include Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, and Proposal for a regulation of the European Parliament and of the Council on European green bonds, COM/2021/391 final.

1.1. The EU Taxonomy sets a common language for the agenda

The EU Taxonomy established a **robust and science-based classification system** which provides a set of criteria to identify economic activities substantially contributing to the EU's six environmental objectives. This common set of criteria enables investors to share a common understanding of the environmental sustainability impacts of their investments while providing safeguards against greenwashing. The EU Taxonomy also acts as an efficient **measuring tool** to monitor the degree to which investments or economic activities of undertakings are sustainable[6].

The Taxonomy Climate Delegated Act (for climate mitigation and climate adaptation objectives) is already up and running and covers a total of 107 economic activities spanning over 13 economic sectors. The recent adoption of the **Taxonomy Environmental Delegated Act**[7] and of **the targeted amendments to the Taxonomy Climate Delegated Act**[8] has significantly enhanced the taxonomy framework and expanded the potential of sustainable investments. New economic sectors and activities will continue to be added and existing ones refined and updated where needed[9].

Since January 2023, large non-financial undertakings have started to assess and report their alignment with the Climate objectives under the **Taxonomy Disclosures Delegated Act**[10].

Box 1: Observations from recent Taxonomy corporate disclosures (financial year 2022)

The first indications of early corporate reporting from this year show encouraging signs that the EU Taxonomy is increasingly being used by undertakings to signal their sustainability performance and efforts. As of 17 May 2023, 63% of the STOXX Europe 600[11] undertakings have already disclosed their taxonomy eligibility and alignment. Among these undertakings, 30% (178 companies) reported non-zero values for capital expenditure (CapEx) alignment, 23% (139 companies) for revenue alignment and 21% (127 companies) for operating expenditure (OpEx) alignment. **On average, the taxonomy alignment of these companies is around 17% for revenue, 23% for CapEx and 24% for OpEx**[12].

Reporting figures also suggest that nearly two in three companies that disclosed CapEx eligibility reported a non-zero alignment figure and one in two companies that disclosed revenue eligibility reported a non-zero degree of aligned revenue.

Another notable observation from recent reporting figures is that the existing taxonomy can effectively serve as a powerful signal for companies in transition. A significant number of companies are reporting taxonomy-aligned CapEx figures that are materially higher than their aligned revenue, especially in high-emitting sectors. Looking at average sector alignment, the sectors with the highest average CapEx and revenue alignment numbers are the utilities (70% aligned CapEx, 40%

[6] The mere fact that a company does not have taxonomy-aligned activities does not mean that conclusions can be drawn regarding the company's environmental performance or its ability to access finance.

[7] The Environmental Delegated Act covers the remaining four environmental objectives, i.e. water and marine resources, circular economy, pollution prevention and control and biodiversity.

[8] The amendments expand on economic activities not included in the climate taxonomy so far and make targeted changes and clerical corrections to selected existing climate criteria.

[9] The recently proposed Delegated Acts add more than 35 activities spanning over 8 sectors.

[10] Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation.

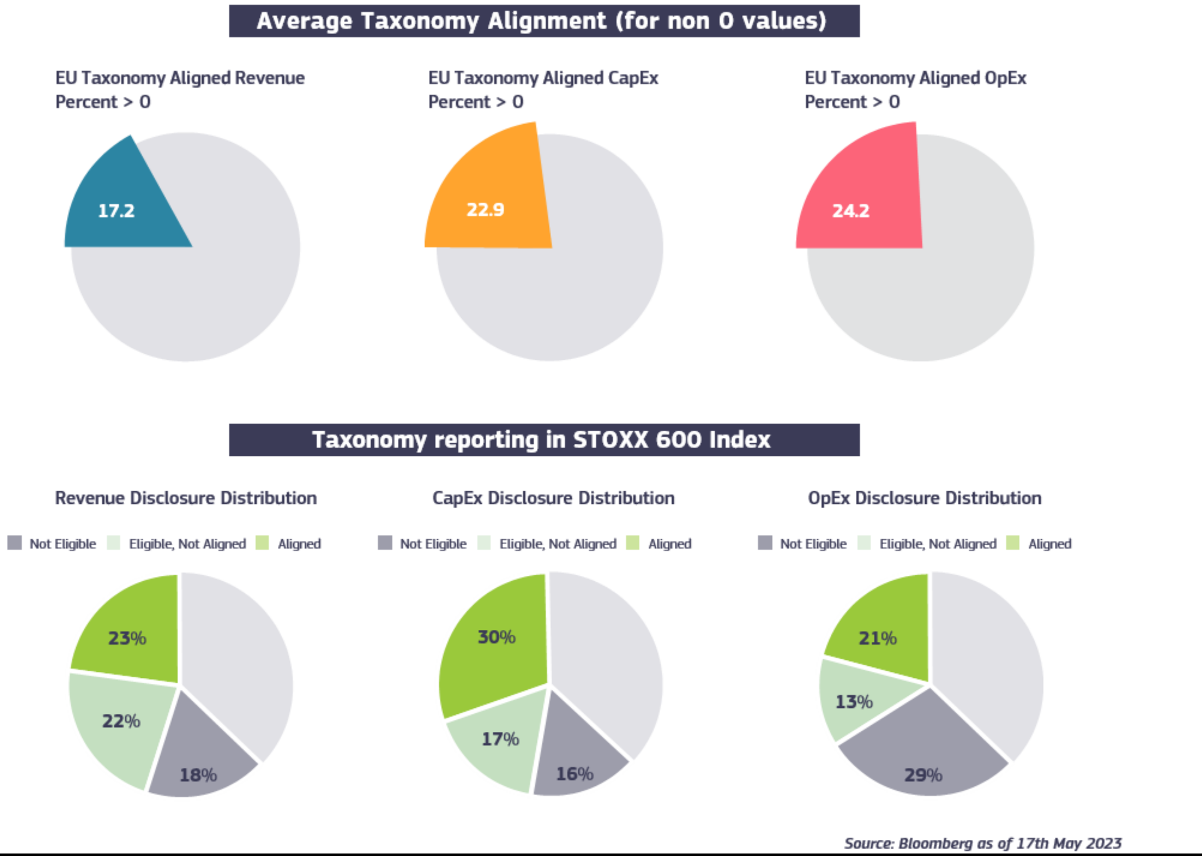
[11] The STOXX Europe 600 index is composed of 600 components representing large, mid and small capitalisation companies among 17 European countries, covering approximately 90% of the free-float market capitalisation of the stock market in Europe.

[12] Data based on FY 2022 disclosures up to 17 May 2023; source: Bloomberg.

aligned revenue) and real estate (25% aligned CapEx, 25% aligned revenue) sectors, followed closely by the energy sector with average CapEx alignment of 23%, more than three times the average aligned revenue for the sector[13]. This highlights the opportunity for forward-looking signals that the taxonomy can provide for companies in sectors that need to decarbonise the most.

Finally, data shows that undertakings high taxonomy alignment (based on disclosed and estimated figures) are significantly overweight in funds with sustainability-related characteristics (Article 8 SFDR) and objectives (Article 9 SFDR), with substantially larger weights for those undertakings in funds with sustainability-related objectives compared to funds with sustainability characteristics[14]. **This confirms the potential of the taxonomy as a critical tool to identify undertakings and sectors in transition, and for these undertakings to signal their transition finance needs and to access finance more broadly.**

Figure 2: Recent taxonomy-alignment data – STOXX 600 undertakings disclosures



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[13] Data based on taxonomy-alignment reporting of 455 companies up to 16 May 2023; source: GS SUSTAIN Goldman Sachs Global Investment Research.

[14] E.g. as of December 2022, MSCI ACWI companies with taxonomy aligned revenue of 21-40% were 169% overweight in art. 9 SFDR funds and 8% overweight in art. 8 SFDR funds; companies with taxonomy aligned revenue of 41-60% were 376% overweight in art. 9 funds compared to 50% in art 8 funds; Companies with taxonomy aligned revenue of 81-100% were 451% overweight in art. 9 funds compared to 101% in art 8 funds; source: GS SUSTAIN Goldman Sachs Global Investment Research .

In parallel, the Commission continues to engage in international forums (G20, the International Platform on Sustainable Finance (IPSF)) to help increase the uptake of taxonomy-based approaches and support their interoperability. The IPSF has played a key role in this regard by conducting an in-depth comparison exercise that identifies areas of common ground between certain features of the EU and Chinese taxonomies. The IPSF will pursue these efforts by enriching the Common Ground Taxonomy with new economic sectors and activities, covering additional environmental objectives and incorporating other jurisdictions' taxonomies.

1.2. A comprehensive disclosure regime for non-financial and financial undertakings providing investors with necessary information to make sustainable investment choices

The EU has put in place a comprehensive disclosure regime impacting the whole financial sector to increase transparency about environmental, social and governance (ESG) impacts, risks and opportunities. The key pillars are the **Sustainable Finance Disclosure Regulation (SFDR)[15];** which lays out sustainability disclosures for financial market participants, financial advisers and certain financial products; and the **Corporate Sustainability Reporting Directive (CSRD)[16]** which defines the sustainability reporting rules for large companies and listed SMEs. The frameworks also ensure the proportionality of sustainability reporting requirements, especially regarding SMEs.

The disclosure rules integrate the taxonomy disclosures and adopt a double materiality approach. This involves the systematic integration of both financially material sustainability risks (outside-in) and sustainability impacts (inside-out) in financial decision-making processes.

- **The CSRD** revised and strengthened the sustainability reporting rules for companies introduced by the Non-Financial Reporting Directive (NFRD) and widened the scope of companies that will need to report.[17] It establishes the requirement for companies to report standardised sustainability information according to European sustainability reporting standards (ESRS). The ESRS will also provide crucial information about the degree of sustainability of investees' activities to investors that need to report under the SFDR, the Benchmark Regulation (BMR) and the Capital Requirements Regulation/Directive (CRR/D).

- **The SFDR** requires financial market participants (FMPs) and financial advisers to disclose the sustainability risks and impacts of their investment products, activities and processes to end-investors since March 2021. It introduced a series of sustainability-related disclosure obligations at the level of both financial market participants and financial products. This includes an obligation for financial products with sustainability-related characteristics (Article 8 SFDR) and objectives (Article 9 SFDR) to regularly assess and report their degree of alignment with the taxonomy. The SFDR Delegated Act[18], which applies since January 2023,

[15] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

[16] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[17] The NFRD covered approximately 11,700 companies and groups across the EU. The CSRD increased the number of firms subject to EU sustainability reporting requirements to more than 49,000.

[18] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022 supplementing Regulation (EU) 2019/2088 of the European Parliament and of the Council with regard to regulatory technical standards specifying the details of the content and presentation of the information in relation to the principle of 'do no significant harm', specifying the content, methodologies and presentation of information in relation to sustainability indicators and adverse sustainability impacts, and the content and presentation of the information in relation to the promotion of environmental or social characteristics and sustainable investment objectives in pre-contractual documents, on websites and in periodic reports.

increased the quality and comparability of information provided by FMPs on the sustainability risks, characteristics and impacts of financial products in the EU. In Q1 2023, net assets in funds promoting environmental characteristics or having sustainable investment as their objective reached EUR 4.8 trillion, up from EUR 3.8 trillion in mid-2020[19]. Data also shows that these funds continue to attract significant flows, with equity funds promoting environmental characteristics or having sustainable investment as their objective receiving nearly four times the cumulative inflows versus non-ESG funds between 2019 and 2022.[20]

- The **Benchmark Regulation** (BMR) introduced disclosure requirements[21] for all EU benchmarks with ESG factors[22], mandating administrators to disclose whether they integrate ESG in their benchmark design, and if so how. BMR also requires benchmark administrators of EU Climate Benchmarks to regularly report, as part of their benchmark statements, on the performance of their benchmarks against a set of sustainability-related Key Performance Indicators (KPIs).

- **The sustainability amendments to the Markets in Financial Instruments Directive (MiFID)[23] and Insurance Distribution Directive (IDD)[24]** introduced retail investors' sustainability preferences as part of the suitability test in investment and insurance advice. The new rules, applicable since August 2022, have given retail investors the opportunity to set minimum sustainability requirements for their investments, which can be expressed in relation to the taxonomy-alignment of products. Distributors will rely on products' sustainability-related information made available under the SFDR to match retail investors' sustainability preferences.

- The recently proposed **European Single Access Point (ESAP)** Regulation[25] complements the disclosure initiatives by creating an EU-wide mechanism offering easily accessible and digitally usable information based on companies' public reporting requirements. This proposal, on which provisional agreement was reached between the European Parliament and the Council in May 2023, will improve access to ESG information, especially information to be reported under CSRD, including taxonomy-related information within such reporting.

- The recently proposed **Regulation on transparency and integrity of ESG rating activities** aims at increasing clarity on the operations of ESG rating providers, in particular regarding the methodologies, objectives, characteristics and data sources. This proposal will also foster accessibility and promote innovation in the market, as well prevent and mitigate potential risks associated with conflicts of interest.

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[19] Source: European Commission based on Morningstar.

[20] Source: GS SUSTAIN Goldman Sachs Global Investment Research.

[21] Commission Delegated Regulation (EU) 2020/1816 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published.

[22] Except for interest rate and currency-related benchmarks.

[23] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

[24] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast).

[25] Proposal for a Regulation of the European Parliament and the Council establishing a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability, COM/2021/723 final.

1.3. Tools for companies, market participants and financial intermediaries to develop sustainable investment solutions

The third building block is a set of investment tools which includes benchmarks and standards. These aim to support financial market participants in their efforts to align their investment strategies with the EU's climate and environmental goals.

- **The EU climate benchmarks**[26], i.e., the EU Paris-aligned Benchmark (PAB) and the EU Climate Transition Benchmark (CTB), were introduced under the EU Benchmark Regulation[27]. Their methodologies rely on minimum technical requirements focused on decarbonisation trajectory and activity exclusions. Exclusions encompass companies that significantly harm one or more environmental objectives set out in the Taxonomy Regulation. PABs and CTBs are designed to reorient investment towards ESG opportunities rather than focusing on simple risk reduction, in line with the objectives of a transition to a climate-resilient economy. Since their introduction, assets under management of financial products referencing a PAB or CTB benchmark have already reached an estimated EUR 116 billion in 2023[28]. PABs and CTBs have also been recognised by major investment institutions, including public institutions and non-EU institutions[29], as solid tools to help investors tailor their portfolios to follow a decarbonisation pathway.

- The **European green bonds standards initiative** is a voluntary standard to help scale up and raise the environmental ambitions of the green bond market[30]. It sets a gold standard for how companies and public authorities can use green bonds to raise funds on capital markets to finance ambitious large-scale green investments, while meeting high sustainability requirements and protecting investors. It will also help investors to easily assess, compare and verify that their investments are sustainable and ensure that funds are allocated to taxonomy-aligned economic activities, thereby reducing greenwashing risks.[31]

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[26] Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.

[27] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks.

[28] Source: Financial Times, "Why carbon emissions reports need handling with care", 30 May 2023.

[29] For example, the Danish central bank, New Zealand's Superannuation Fund, Taiwan's largest public pension fund and the pension funds of the German states of Baden-Württemberg, Brandenburg, Hesse and North Rhine-Westphalia.

[30] Proposal for a regulation of the European Parliament and of the Council on European green bonds, COM/2021/391 final. Political agreement reached by co-legislators on 28 February 2023.

[31] According to data from the LGX DataHub, 120 sustainable bonds currently refer to the Taxonomy in post-issuance documentation, of which about 40% claim to be fully taxonomy-aligned, while about 60% claim some partial taxonomy alignment.

2. Usability of the EU sustainable finance framework as a priority

Enhancing the usability of the Sustainable Finance framework is of key importance to ensure proper adherence of stakeholders. The first year of reporting under the Taxonomy Disclosures Delegated Act[32] has shown that some undertakings are facing difficulties with demonstrating and reporting taxonomy alignment. These implementation challenges are mainly due to a lack of resources to integrate these new aspects in reporting systems, but there are also several usability issues linked to the criteria and test requirements that are urgent to address.

Beyond the EU Taxonomy, stakeholders are also reporting implementation challenges regarding key concepts and reporting obligations under the wider sustainable finance framework such as the SFDR, the BMR and the MiFID/IDD sustainability preferences rules. While these issues have not prevented the general mainstreaming of the EU Taxonomy and sustainable finance tools, they could hinder market actors' adherence to the sustainable finance rules and lower the framework's potential.

The Commission is committed to addressing these concerns and taking the necessary actions to ensure the framework works on the ground. This involves providing market actors with regular clarifications and guidance, ensuring that the tools are easy to use, that the key sustainability concepts are clear and well connected and that any reporting duplication is removed. This work continues to be supported by the European supervisory authorities (the ESAs, i.e. the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)) and the Platform on Sustainable Finance (PSF). Information on the key areas for further improvement is included in the last Section of this document ('Going forward').

As a first step, the Commission has already started to address key implementation issues raised by stakeholders and taken important steps to enhance the usability of the framework. These are summarised in Section 3 and 4.

3. Measures enhancing the usability of the EU Taxonomy criteria and disclosures

The EU Taxonomy being a novel and complex instrument, it is understandable that undertakings have been facing difficulties in understanding and applying the criteria in this early phase of implementation. In addition, the new KPIs under the Taxonomy Disclosures Delegated Act are the first of their kind in the non-financial disclosure framework, requiring additional expertise and resources from in-scope entities.

To support stakeholders in their implementation efforts, the Commission has been providing **regular guidance on the interpretation and application of certain criteria and disclosures**. In addition, the Commission has recently launched **a series of online tools and guides to help users navigate the criteria and fill their reporting templates.** These should save stakeholders time and resources when assessing and reporting their taxonomy alignment.

These documents and tools are gathered on the new **EU Taxonomy Navigator website[33].** They should help address some of the difficulties encountered by stakeholders when trying to cope with the test requirements and obligations.

[32] Non-financial undertakings falling under the scope of the CSRD were required to start reporting on taxonomy eligibility (i.e. whether their activities are covered in the EU Taxonomy) since January 2022 and on taxonomy alignment (i.e. whether the taxonomy eligible activities comply with the technical screening criteria defined in the taxonomy delegated acts) since January 2023.

[33] https://ec.europa.eu/sustainable-finance-taxonomy/

<u>Overview of the Commission's recent measures to support the implementation of the taxonomy criteria and disclosures</u>

- **Commission notices (frequently asked questions) providing legal guidance and technical clarifications to undertakings**

The first set of frequently asked questions (FAQs) published in April and July 2021 focused on the taxonomy and its reporting framework in general. Since then, the FAQs have become more and more specific in response to questions from stakeholders and Member States to the Commission.

As of January 2022, non-financial undertakings were required to start reporting on taxonomy eligibility (i.e., whether their activities are covered in the EU Taxonomy). In response to this, the Commission published a dedicated guidance document and notice to clarify the provisions of the Taxonomy Disclosures Delegated Act. The aim was to answer technical questions that market participants had submitted to the Commission concerning eligibility assessments.

As of 1 January 2023, non-financial undertakings are required to report on taxonomy alignment (i.e., whether the taxonomy eligible activities comply with the technical screening criteria defined in the Taxonomy Delegated Acts). To prepare for these reporting obligations, the market identified a set of technical questions centered on the interpretation of the technical screening criteria in the Taxonomy Climate Delegated Act. In addition, the Commission published further a draft legal interpretative guidance for non-financial undertakings on taxonomy alignment reporting in accordance with the Taxonomy Disclosures Delegated Act. To alleviate undue reporting burdens, the Commission will clarify in the final version of this guidance how activities that are not material for the business of reporting undertakings should be reported in their KPIs[34].

The Commission plans to adopt another guidance document by the end of this year. The new document will focus on taxonomy alignment reporting obligations for financial undertakings, which will be required to report their green assets ratio (GAR) and other KPIs as of 1 January 2024.

The box below provides an overview of all the FAQs documents that the Commission has already published.

[34] The objective is to clarify that, while not being exempted from their reporting requirements under the Taxonomy Disclosures Delegated Act, undertakings are not obliged to perform a Taxonomy-assessment of economic activities that are not material for their business and for which they lack evidence or data to prove compliance with the EU Taxonomy. This applies only to these specific economic activities. In the absence of such an assessment, undertakings should not, however, report those activities as Taxonomy-aligned.

Box 2: Taxonomy FAQ documents

April 2021

- What is the EU taxonomy and how will it work in practice?[35]

July 2021

- What is the EU taxonomy Article 8 Delegated Act and how will it work in practice?[36]

December 2021

- How should financial and non-financial undertakings report taxonomy-eligible economic activities and assets in accordance with the Taxonomy Regulation Article 8 Disclosures Delegated Act?[37]

February 2022

- Commission Notice on the interpretation of certain legal provisions of the Taxonomy Regulation Article 8 Disclosures Delegated Act on the reporting of eligible economic activities and assets[38]
- FAQ on the Taxonomy Complementary Climate Delegated Act[39]

December 2022:

- Draft Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Climate Delegated Act establishing technical screening criteria for economic activities that contribute substantially to climate change mitigation or climate change adaptation and do no significant harm to other environmental objective[40]
- Draft Commission Notice on the interpretation and implementation of certain legal provisions of the Disclosures Delegated Act under Article 8 of EU Taxonomy Regulation on the reporting of Taxonomy-eligible and Taxonomy-aligned economic activities and assets[41]

May 2023:

- Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and its link to the Sustainable Finance Disclosure Regulation (SFDR)[42]

An FAQs repository is available on the **EU Taxonomy Navigator website**. Users can search for specific questions that are of interest to them and filter the questions by organisation type and FAQ document. In the future, the Commission aims to further improve the repository's filtering features to include options such as filtering by delegated act or by sector of activities.

- **EU Taxonomy Compass**

[35] https://finance.ec.europa.eu/system/files/2021-04/sustainable-finance-taxonomy-faq_en.pdf
[36] https://finance.ec.europa.eu/system/files/2021-07/sustainable-finance-taxonomy-article-8-faq_en.pdf
[37] https://finance.ec.europa.eu/system/files/2022-01/sustainable-finance-taxonomy-article-8-report-eligible-activities-assets-faq_en.pdf .
[38] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022XC1006(01) .
[39] https://ec.europa.eu/commission/presscorner/detail/en/qanda_22_712 .
[40] https://ec.europa.eu/finance/docs/law/221219-draft-commission-notice-eu-taxonomy-climate.pdf .
[41] https://ec.europa.eu/finance/docs/law/221219-draft-commission-notice-disclosures-delegated-act-article-8.pdf
[42] https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en#faqs.

The EU Taxonomy Compass[43] is an online tool that enables users to search for economic activities covered in the Climate Delegated Act and directly access their respective technical screening criteria. The format of the Taxonomy Compass aims to make the criteria easier to use by enabling users to check: (i) which activities are included in the EU Taxonomy (i.e. which are taxonomy eligible); (ii) which objectives they substantially contribute to; and (iii) what criteria have to be met for activities to be considered taxonomy aligned. For instance, the tool includes a filtering option that users can adjust to only see enabling and/or transitional activities. In addition, the text of the technical screening criteria includes hyperlinks to EU regulations and directives that are mentioned, enabling users to consult the relevant pieces of EU legislation while familiarising themselves with the taxonomy criteria.

The EU Taxonomy Compass is used in the market as a basis for undertakings' reporting. The Taxonomy Compass's content can be downloaded in Excel and JSON format, enabling users to embed the compass in their internal systems.

In the future, the Commission plans to extend the EU Taxonomy Compass to also cover the activities under the other environmental objectives (following the adoption of the Taxonomy Environmental Delegated Act), as well as amendments to the Taxonomy Climate Delegated Act.

- **EU Taxonomy Calculator**

The EU Taxonomy Calculator[44] is an interactive tool to show non-financial undertakings in a step-by-step guide how to determine their taxonomy eligibility and alignment ratios. The tool guides users through seven main steps[45] to calculate their turnover, CapEx and OpEx KPIs and automatically fills in the respective reporting templates included in Annex II to the Taxonomy Disclosures Delegated Act.

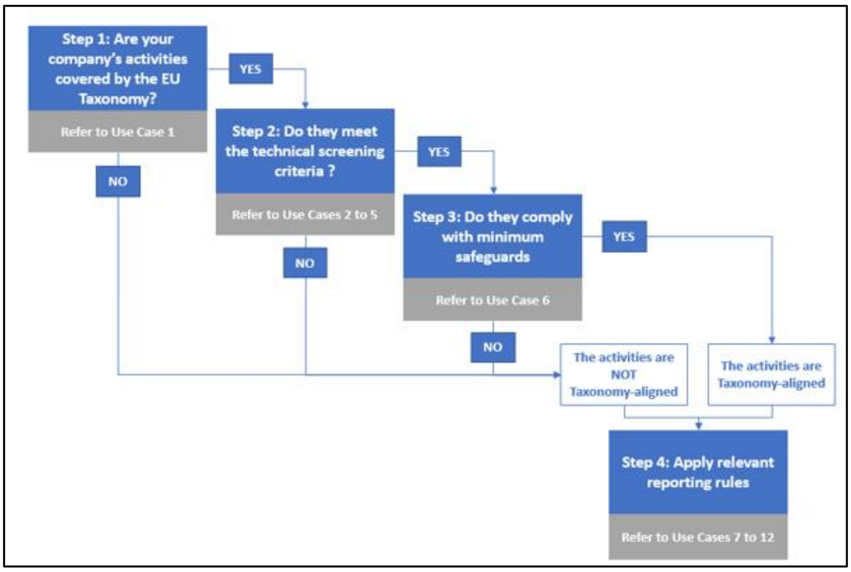
The Taxonomy Calculator is focused for now on the objective of climate change mitigation. However, the Commission plans to extend the tool to cover the other remaining environmental objectives of the EU Taxonomy.

- **EU Taxonomy User Guide**

The EU Taxonomy User Guide[46] aims to bring the EU Taxonomy closer to stakeholders who may not be experts in sustainable finance. The user guide offers a step-by step guide to help non-financial and financial undertakings assess their taxonomy eligibility and alignment. It further exemplifies these steps through 12 use cases that range from 'which of the activities performed by my company are covered by the EU Taxonomy?' to 'how can the EU Taxonomy help my company to define and disclose a new credible low carbon and/or adaptation strategy?'.

Figure 3: Overview of the coverage of use cases

[43] https://ec.europa.eu/sustainable-finance-taxonomy/taxonomy-compass/the-compass .
[44] https://ec.europa.eu/sustainable-finance-taxonomy/wizard .
[45] From identifying the sectors/activities the undertaking operates in to determining the percentage of substantial contribution alignment.
[46] https://ec.europa.eu/sustainable-finance-taxonomy/home .



4. Measures enhancing the usability of the wider sustainable finance framework

Beyond the EU Taxonomy, the implementation of the different sets of disclosures and tools has helped increase the transparency and comparability of sustainable financial products in recent years. However, stakeholders have also reported several difficulties when applying key concepts, definitions and disclosure requirements under the wider sustainable finance framework due to usability and sequencing issues within the framework. These can be explained by the pace at which the framework was developed in order to ensure the timely implementation of the European Green Deal's objectives, which resulted in some misalignments between the different legislative pieces. These usability issues have slowed down implementation progress and are therefore urgent to address.

The Commission has recently taken important steps to address implementation challenges reported by stakeholders.

First, the Commission provided **clarifications regarding the implementation and interplay between the sustainability concepts under the EU Taxonomy, the SFDR and the Benchmark Regulation**. More specifically, recent guidance interpreted the rules to provide a 'safe harbour' for taxonomy-investment to be automatically qualified as 'sustainable investment' under the SFDR, as well as a 'safe harbour' for passive funds tracking an EU climate benchmark to be automatically qualified as a 'product with sustainable investment as its objective'[47]. The Commission also announced that it is currently conducting a comprehensive assessment of the SFDR disclosure regime to address key interpretive and usability issues reported by stakeholders and ensure it plays its part in tackling greenwashing. More details on these measures are provided in Section 4.1 below.

Second, **the Commission addressed two important ESG data gaps** in the framework. The Commission clarified the cases in which FMPs can rely on estimates for their taxonomy-related

[47] i.e., financial products falling under Article 9 of the SFDR.

disclosures under the SFDR, and committed to developing sustainability disclosure requirements for securities not currently covered under the SFDR[48].

4.1. Measures to support the implementation of the sustainability concepts under the EU Taxonomy, the SFDR and the Benchmark Regulation

The EU Taxonomy, the SFDR and the EU climate benchmarks under the BMR are closely interlinked and are intended to complement each other to form a coherent set of disclosures, criteria and investment tools. It is therefore important that the frameworks work well together to ensure that the labels and criteria provide comfort and legal certainty to users. Consistency is also necessary to ensure that investors can properly compare and understand the sustainability features of financial products in the EU.

Box 3: the interlinkages between the SFDR, EU Taxonomy and EU Climate Benchmarks

The EU Taxonomy Regulation, the SFDR and the BMR have introduced three different approaches to defining sustainability that have become central concepts of the EU sustainable finance framework. The taxonomy details what can be considered as **environmentally sustainable economic** activities, while the SFDR defines **sustainable investment** and the BMR sets sustainability criteria for its two **Climate Benchmarks**, i.e., the EU Climate Transition Benchmark (CTB) and the EU Paris-aligned Benchmark (PAB).

In addition to introducing a definition of sustainability, the SFDR is a transparency regime for financial market participants and advisors in which the taxonomy disclosures and EU Climate Benchmarks feed into to ensure the sustainability-related disclosures for financial products rely on science-based criteria:

- **SFDR – Taxonomy interactions:** All financial products promoting environmental characteristics[49] or having sustainable investment as their objective[50] are required to regularly disclose their alignment with the EU Taxonomy. This provides FMPs, financial advisers and end-investors with a useful tool to determine and monitor the degree of sustainability of an investment.
- **SFDR – EU climate benchmarks interactions:** Under SFDR Article 9(3), EU climate benchmarks are referred to as a robust investment strategy for funds having as their objective a reduction in carbon emissions. The PAB and CTB are therefore useful and reliable labels for investment products pursuing such an objective.

The EU Taxonomy and EU climate benchmarks therefore complement the SFDR by increasing the comparability between financial products, providing tools to develop and monitor environmental-focused investment strategies, and fighting greenwashing. However, stakeholders pointed to several operational difficulties when applying these frameworks simultaneously due to legal uncertainties regarding the status of investments in taxonomy aligned economic activities and of products tracking EU climate benchmarks under the SFDR. Financial advisers and investors also flagged some concerns regarding the comparability of the disclosures and concepts between the three frameworks.

[48] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises.
[49] Financial products falling under Article 8 SFDR.
[50] Financial products falling under Article 9 SFDR.

<u>Overview of the Commission's recent measures to address these key usability issues:</u>

Measure 1*: Clarification that investments in 'environmentally sustainable economic activities' within the meaning of the EU Taxonomy can be qualified as a 'sustainable investment' within the meaning of the SFDR.*

Due to the absence of a clear legal link between what constitutes an *environmentally sustainable economic activity* under the EU Taxonomy and what constitutes *sustainable investment* under the SFDR, FMPs were uncertain of whether an investment in a taxonomy aligned economic activity could be automatically deemed as *sustainable investment* under the SFDR. This lack of clarity hindered the objective of the EU Taxonomy, i.e. setting a common language to define sustainability throughout the whole regulatory framework.

This has resulted in unintended and unnecessary burdens for FMPs that are including taxonomy aligned investments in products falling under Article 8 or Article 9 SFDR. These investments were subject to a double assessment under both the EU Taxonomy and the SFDR which could discourage FMPs from using the taxonomy framework for portfolio construction. Distributors have also pointed out that retail investors struggled to understand and compare the concepts of *sustainable investment* and *taxonomy aligned* due to the complexity of these terms and the lack of clear correlation between them.

To remedy this, the Commission has provided guidance clarifying that there is a safe harbour for taxonomy aligned investments under the SFDR in its latest taxonomy FAQ document published on 12 June 2023[51]. The FAQ document clarifies that investments in taxonomy aligned 'environmentally sustainable' economic activities can be automatically qualified as 'sustainable investment' under the SFDR. However, if an FMP invests in an undertaking with some degree of taxonomy-alignment through a funding instrument that does not specify the use of proceeds, such as a general equity or debt, the FMP would still need to check additional elements under the SFDR if she/he wants to consider the whole investment in that undertaking as sustainable investment.

This clarification intends to simplify and encourage the use of the taxonomy framework as a base for a common understanding of what environmental sustainability means in EU financial products and use of proceeds instruments. It also aims to address the implementation challenges mentioned above by increasing the comparability of sustainability-related disclosures for retail investors and bringing consistency between two key legislative acts of the EU sustainable finance framework.

Measure 2: *Clarification that passive funds tracking an EU Climate Benchmark fall under the scope of Article 9 and are deemed to have sustainable investment as an objective.*

Despite the legal link between the SFDR and the EU climate benchmarks under SFDR Article 9(3), there are a few technical differences between the requirements for PAB and CTBs and the definition of 'sustainable investment' under the SFDR which have caused confusion among market participants regarding the status of passive financial products tracking a PAB/CTB under the SFDR[52].

This unintended misalignment between the two frameworks has hindered the objectives of the EU climate benchmarks within financial markets, i.e. to provide comfort and certainty to their users. In

[51]Commission Notice on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and its link to the Sustainable Finance Disclosure Regulation (SFDR): https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en#faqs

[52] This refers to the few misalignments between the principal adverse impacts under the SFDR (as defined in the Annex 1 of the Delegated Regulation (EU) 2022/1288) and the exclusions under the EU Climate Benchmarks (as defined under the Article 12 of the Delegated Regulation (EU) 2020/1818).

fact, the lack of legal clarity has caused serious uncertainty over the ability of PAB/CTB index-tracking funds to fall under Article 9 SFDR and led many of these funds to declassify to Article 8 SFDR in the last quarter of 2022[53]. The PABs/CTBs remain for now the only currently available sustainability label in the area of financial services at EU level.

The Commission has therefore provided guidance so that a **safe harbour is provided for passive funds tracking an EU Climate Benchmark to automatically be considered as making sustainable investments under the SFDR** in its SFDR Q&A published in April 2023[54].

In this guidance, the Commission considered that the limited discrepancies between the ESG criteria for sustainable investment under the SFDR and the exclusions under the PAB/CTB do not translate in differences in environmental, social or governance ambitions and performance and therefore do not imply that the PAB/CTB methodology is incompatible with the SFDR concept of sustainable investment.

***Measure 3**: Commission's future comprehensive assessment of the SFDR.*

In addition to the few misalignments between the SFDR, the EU Taxonomy and the EU climate benchmarks, market actors have expressed concerns about the applicability and usability of specific obligations and definitions under the SFDR framework itself. While the SFDR was meant as a disclosure regime, the market has been using it in a different way, namely as a labelling scheme. Since the existing definitions are not fit for that purpose, the misuse of the Regulation has created issues, including concerns of greenwashing risks and legal uncertainty as to how some fundamental concepts should be understood and applied.

The Commission has therefore announced a comprehensive assessment of the implementation of the SFDR framework[55]. The exercise will mainly focus on assessing the shortcomings of the SFDR to improve legal certainty, and to enhance its usability and role in mitigating greenwashing. The assessment will also consider the interactions with other related sustainable finance legislations, like the Taxonomy Regulation, the Benchmark Regulation, the MiFID/IDD sustainability amendments and the CSRD. The assessment will look at improving the coherence within the framework and ensuring the data flows effectively throughout the value chain.

The Commission is currently preparing the ground to launch an open public consultation in autumn 2023 to seek feedback from the financial industry and other stakeholders. In parallel, workshops with the industry and other stakeholder groups will be organised.

The issues addressed by the two safe harbours (measures 1 and 2) are without prejudice to the future SFDR assessment. In parallel, the ESAs are consulting on the revision of the SFDR Regulatory Technical Standards[56] (RTS) until early July 2023 and will provide the Commission with proposed changes to the disclosure regime in the autumn.

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[53] Source: Morningstar.
[54] Commission's answers to questions on the interpretation of Regulation (EU) 2019/2088, submitted by the European Supervisory Authorities on 9 September 2022, link here. The ESAs have also consolidated all past Q&A documents related to the SFDR, link here.
[55] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on Long-term competitiveness of the EU: looking beyond 2030, COM(2023) 168 final.
[56] https://www.esma.europa.eu/press-news/consultations/joint-consultation-review-sfdr-delegated-regulation .

4.2. Measures to support financial undertakings with their sustainability disclosure obligations and to address current ESG data gaps

Financial undertakings are faced with different sets of disclosure obligations under the Taxonomy Disclosures Delegated Act, the SFDR, the Climate Benchmark Delegated Regulation, the CSRD and the Capital Requirements Regulation and Directive (CRR/D). The ability of financial undertakings to cope with these requirements hinges on the consistency and quality of information made available by financial and non-financial undertakings under the EU sustainable finance framework.

Some sequencing issues between ESG disclosure obligations for non-financial and for financial undertakings have made it difficult for the latter to satisfy their own reporting obligations. The bulk of these misalignments is now being gradually resolved with time and through the elaboration of the ESRS. This will enhance access to sustainability-related information from entities within the scope of the EU regulatory framework.

However, some data gaps will remain even after the implementation of the ESRS, especially for accessing sustainability-related information from entities or financial products out of the scope of the EU regulatory framework. **To help address these ESG data availabilities issues, the Commission has recently adopted two measures:**

***Measure 4**: Clarification on the use of estimates to assess the taxonomy alignment of companies out of the scope or not yet reporting under the Taxonomy Regulation for disclosures under the SFDR.*

Under the SFDR Delegated Act[57], financial undertakings have been required to regularly report the taxonomy alignment of their financial products with environmental characteristics or objectives since January 2022. Collecting the necessary information has been particularly challenging for FMPs given that non-financial companies have only started disclosing their taxonomy ratios from 2023 under the Taxonomy Disclosures Delegated Act. This is turn has been affecting the ability of financial advisors to properly consider investors' sustainability preferences under MiFID and IDD.

Now that companies are gradually starting to publish their taxonomy figures, this data gap is expected to close for investments in EU entities in scope. However, stakeholders reported that there was still a lack of clarity on how FMPs can cope with their taxonomy-related disclosure obligations under the SFDR Delegated Act in cases where companies are either not yet reporting under the Taxonomy Disclosures Delegated Act or are out of its scope.

To address this, the Commission has clarified that the use of complementary (i.e. additional) assessments and estimates for companies not in scope or not yet reporting under the CSRD/Taxonomy Regulation is permitted. The use of estimates is only permitted in cases where FMPs cannot reasonably access information about economic activities carried out by undertakings that are not reporting (or not reporting yet) under the Taxonomy Disclosures Delegated Act, such as unlisted SMEs. This clarification was provided in the SFDR Q&A[58] published in April 2023. The aim is to simplify the disclosure obligations and alleviate burdens on both companies and FMPs when facing difficulties in accessing sustainability data.

[57] Commission Delegated Regulation (EU) 2022/1288 of 6 April 2022.

[58] Annex to Commission Decision of 13 May 2022 on the adoption of the answers to be provided to questions submitted by the European Supervisory Authorities under Article 16b(5) of Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010 and Regulation (EU) No 1095/2010 of the European Parliament and of the Council, link here. The ESAs have also consolidated all past Q&A documents related to the SFDR, link here .

The use of estimates can help market participants in using taxonomy-alignment metrics during the initial years of phased-in application of the Taxonomy Disclosures Delegated Act when such information is not available[59]. In addition, the Commission will assess the feasibility of issuing guidance to stakeholders on how to construct robust and reliable taxonomy estimates.

***Measure 5**: Development of sustainability disclosure requirements for securities not captured under the SFDR.*

Unlike financial products (funds, insurance-based investment products, portfolio management), there are no cross-cutting disclosure requirements for securities claiming to be sustainable as they are not captured under the SFDR (bonds, covered bonds, structured notes, derivatives, equity, etc).

This situation creates challenges for product manufacturers lacking sustainability-related information when assembling their investment products, and for financial advisers whose advice can cover a broad range of financial instruments. Indeed, financial advisers are required to assess whether the investment choices they advise match the sustainability preferences of their clients under the sustainability amendments under MiFID and IDD, which proves difficult in the absence of such information for some securities. Ultimately, this might expose end-investors to greater risks of greenwashing.

To remedy this situation, the Commission proposed to develop targeted additional information covering non-equity ESG securities under the proposals for the Listing Act[60]. To avoid unnecessary burdens, this set of disclosures for issuers will not capture securities whose sustainability profile can be assessed by leveraging already existing disclosures, namely CSRD disclosures (equity securities, non-earmarked bonds).

These upcoming cross-cutting ESG disclosures will also facilitate the implementation of the sustainability preferences under the MiFID/IDD framework by providing financial advisers and portfolio managers with relevant sustainability-related information to satisfy investors' preferences.

Going forward

The actions presented in Sections 3 and 4 are expected to ease the implementation of key concepts of the framework and address several important challenges reported by stakeholders in the past year. Beyond these targeted measures, **enhancing the usability of the taxonomy criteria and disclosures and improving the consistency of the overall sustainable finance framework will remain a core element of the Commission's future work.**

The EU will continue to improve the framework over time and address key usability concerns in upcoming policy developments. Based on stakeholders' feedback, the framework will be strengthened and reviewed to ensure the rules work as intended and enable market players to play a role in the transition to a more sustainable economy. This work will continue to be supported by the ESAs which play a significant part in developing and improving the usability of the rules and in providing the Commission with insights from market supervisors' expertise. The PSF also plays an important role in

[59] Given the large exposures of EU financial products to non-NFRD companies or companies that are not yet disclosing against the Taxonomy.

[60] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2017/1129, (EU) No 596/2014 and (EU) No 600/2014 to make public capital markets in the Union more attractive for companies and to facilitate access to capital for small and medium-sized enterprises, COM/2022/762 final.

identifying the key implementation challenges faced by external stakeholders and in advising the Commission on how to address them[61].

The **future work to enhance the usability of the Taxonomy** will include regular updates of the Climate and Environmental Delegated Acts to address usability issues, market developments and technological progress. The Commission will also continue to support market actors with further guidance and plans to adopt an FAQ document focussing on taxonomy alignment reporting obligations for financial undertakings by the end of 2023. In addition, as part of the upcoming review of the Disclosures Delegated Act, the Commission will assess whether and how to include entities outside the scope of taxonomy reporting in the key performance indicators of financial institutions, including SMEs.

In the meantime, the Commission continues to work closely with the PSF and the ESAs to monitor reporting under Article 8 of the Taxonomy Regulation, and to assess where changes may be warranted in the context of the upcoming review. The PSF has been tasked to deliver recommendations to the Commission (i) to ensure the taxonomy criteria and disclosures are usable on the ground for all actors in scope; and (ii) to enhance the usability of the taxonomy for non-EU players or economic activities conducted outside the EU. The PSF will also work on developing market practices to better understand how stakeholders are currently using the framework and identifying relevant opportunities and challenges.

Finally, any policy developments under the wider framework will aim at **enhancing the consistency of different regulatory pieces** and simplifying their implementation, among other objectives. This work will also be supported by the expertise of the PSF which will advise the Commission on the coherence and effectiveness of the wider sustainable finance framework.

[61] PSF mandate can be found here: https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance-old/platform-sustainable-finance_en#organised