

MEMO# 33939

December 6, 2021

EU ESG: Final Delegated Act Supplementing Article 8 of the Taxonomy Regulation

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TO: ICI Members

ICI Global Members

ESG Task Force

EU ESG Disclosure Regulation Working Group SUBJECTS: ESG

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In November 2021, the European Parliament and Council approved the delegated act^[1] (DA) supplementing Article 8 of the EU Taxonomy Regulation.^[2] This DA covers corporate issuer disclosure of Taxonomy alignment, which provides information to asset managers enabling them to meet the sustainability disclosure requirements for Article 8 and Article 9 products^[3] under the EU Sustainable Finance Disclosure Regulation (SFDR).^[4]

In addition to being consumers of the disclosures mandated by Article 8 of the Taxonomy Regulation, some asset managers are also subject to its disclosure requirements. The DA specifies the content, methodology and presentation of information to be disclosed by financial undertakings (including asset managers)^[5] and non-financial undertakings that are subject to the Non-Financial Reporting Directive (NFRD).^[6] It is important to note that the scope of the NFRD will be expanded by the Corporate Sustainability Reporting Directive (CSRD).^[7] The NFRD scope covers large undertakings that are public-interest entities exceeding on their balance sheet dates the average number of 500 employees. The CSRD proposes to expand the scope to all to all large undertakings^[8] and all EU-listed corporates, with the exception of listed micro-undertakings.

Importantly, the Commission pushed back the detailed Taxonomy-alignment disclosures for financial undertakings (including asset managers in scope of NFRD) to 1 January 2024, while non-financial undertakings will be expected to report on detailed Taxonomy-alignment disclosures from 1 January 2023.

This memorandum gives an overview of the DA, with a focus on the disclosure requirements for non-financial undertakings and asset managers.

1. Disclosures by non-financial undertakings

Taking on board recommendations from the industry for a shorter historical comparison period, non-financial undertakings are now required to include the KPIs from the previous annual reporting period only, instead of five reporting periods, with the first period covering the year 2023.

The KPIs should cover only the Taxonomy environmental objectives of climate change mitigation and climate change adaption until 12 months after the date of application of the delegated regulations that contact the technical screening criteria for the other Taxonomy environmental objectives.

As required by Article 8(2) of the Taxonomy Regulation, non-financial undertakings should report Taxonomy-alignment with key performance indicators (KPIs) in relation to turnover, capital expenditure (CapEx), and operational expenditure (OpEx). The DA provides details on the calculation for the three KPIs.

A. Specification of turnover, CapEx, OpEx KPIs

Turnover KPI. This KPI should be calculated as net turnover^[9] derived from products or services, including intangibles, associated with Taxonomy-aligned economic activities,^[10] divided by the total net turnover. The numerator shall exclude the part of the net turnover derived from products and services associated with climate adaptation activities,^[11] unless such activities are qualified as enabling activities^[12] or are themselves Taxonomy-aligned.

CapEx KPI. The denominator of the CapEx KPI should cover (i) tangible and intangible assets before depreciation, amortization and any re-measurements during the financial year, and (ii) additions to tangible and intangible assets resulting from business combinations. The numerator includes costs related to assets and processes which meet or plan to meet the criterion of Taxonomy-aligned economic activities, or plan to expand Taxonomy-aligned economic activities. Such plans should seek to complete within five years. Taking into consideration the industry feedbacks for more flexibility for the CapEx plans, the Commission extended the maximum period for aligning activities with the Taxonomy under a CapEx plan to 10 years (up from seven years), where justified. The adopted DA clarifies that the CapEx plans should be disclosed at an economic-activity-aggregate level. Further, where the relevant technical screening criteria are amended before the completion of the CapEx plan, non-financial undertakings should either update the CapEx plan within two years to ensure its alignment with the updated criteria or restate the numerator of the CapEx KPI. Such updating of the CapEx plan resets the plan's time period to align activities with the Taxonomy. Costs related to purchasing of output from Taxonomy-aligned economic activities, as well as Taxonomy-eligible economic activities,^[13] may also be included in the numerator provided that such measures are implemented and operational within 18 months.

OpEx KPI. The denominator includes 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 property, plant and equipment. Similar to that of the CapEx KPI, the numerator includes: (i) costs related assets and processes that meet or plan to meet the criterion of Taxonomy-aligned economic activities; (ii) plan to expand Taxonomy-aligned economic activities; or (iii) costs related to purchase of output from Taxonomy-aligned economic activities, as well as Taxonomy-eligible activities, that are implemented and operational within 18 months. The

requirements for an OpEx plan are similar to those for a CapEx plan, but with additional flexibility. Where the OpEx is not material for the business model of non-financial undertakings, these undertakings could be exempted from the calculation of the numerator of the OpEx KPI and disclose the numerator as being equal to zero. They should however disclose the total value of the denominator of OpEx KPI and an explanation of the absence of materiality of OpEx in their business model.

B. Qualitative disclosure accompanying KPIs

Non-financial undertakings are required to disclose additional information accompanying the KPIs, including the accounting policy used, assessment of Taxonomy-alignment for their economic activities, a quantitative breakdown of the numerator of each KPI, and a qualitative explanation of key elements of change in each KPI during the reporting period. The qualitative disclosures should be made in the same parts of the non-financial statements that contains the KPIs. Otherwise, non-financial undertakings should provide cross-references to the parts of the non-financial statements that contains the KPIs.

C. Presentation of KPIs

The reporting templates^[14] consist of three standardized tables for reporting each of the KPIs. Non-financial undertakings should disclose the total KPIs for all economic activities and all environmental objectives respectively at the level of the undertaking or group. In addition, they should provide a breakdown of the KPIs based on the economic activity pursued, including transitional and enabling activities, and the environmental objective reached. They should also identify the proportion of Taxonomy-aligned economic activities and Taxonomy-eligible activities that do not meet technical screening criteria.

2. Disclosures by asset managers

In-scope asset managers are required to disclose the green investment ratio, which is the proportion of Taxonomy-aligned investments managed by them in the value of all covered assets under management from both their collective and individual portfolio management activities.

A. Turnover-based and CapEx-based KPIs

Asset managers should disclose two KPIs - one based on turnover KPIs of the investee companies and another one based on the CapEx KPI of investee companies.

While the denominator would be the value of all assets under management resulting from both collective and individual portfolio management activities of asset managers, the numerator would consist of the weighted average of the value of investments in Taxonomy-aligned economic activities of investee companies, calculated by the applicable turnover and CapEx KPIs for each investee company. Where the investee companies are financial undertakings, relevant KPIs pursuant to the DA should be used as a proxy for the share of turnover and CapEx used for non-financial investee companies.^[15]

Netting is allowed for the purposes of reporting the share of Taxonomy-aligned investments by applying the methodology used to calculate net short positions in the Short-Selling Regulation.^[16]

B. Disclosure standards for asset managers

Like non-financial undertakings, asset managers are required to include the KPIs from the previous annual reporting period (as discussed in Section 1C, above). They should also provide a breakdown of exposures and investments in the numerator, where applicable, and denominator, including exposures to non-financial undertakings, financial undertakings, non-NFRD undertakings established in the EU, and non-NFRD undertakings established in non-EU countries. The DA further sets out the treatment of certain assets and investments in the KPIs.

Sovereign and central bank exposures. The Commission will assess at a later stage whether and how to develop a methodology for assessing the environmental performance of sovereign exposures. In the absence of a robust methodology for assessing the share of Taxonomy-alignment of sovereign and central bank exposures, the DA does not include them in the numerator and denominator of the KPIs of asset managers.

Derivatives. Derivatives are excluded from the numerator of KPIs of asset managers in view of their use to mitigate counterparty risk rather than for financing or investment.

Environmentally sustainable debt securities. Environmentally sustainable bonds or debt securities should be included in the numerator of the KPIs up to the full value of Taxonomy-aligned economic activities that the proceeds of these bonds and debt finance. The DA further clarifies that exposures to bonds and debt securities whose purpose is not to finance specific activities should be included in the numerator as weighted by turnover KPI and CapEx KPI of the issuer. Where the technical screening criteria are updated, and the activities that the environmentally sustainable bonds or debt securities finance no longer meet the updated Taxonomy-alignment criteria, such exposures could be reported as Taxonomy-aligned until five years after the application date of the updated technical screening criteria.

Non-NFRD undertakings. Asset managers should not take into account the exposures to non-NFRD undertakings (financial or non-financial) in the calculation of the numerator of KPIs. Nevertheless, for non-NFRD companies established outside the EU, asset managers, if demonstrate compliance with the substantial contribution criteria,[\[17\]](#) may use estimates to assess the Taxonomy-alignment of these companies. Asset managers should formalize, documents and make public the methodology upon which such estimations are based, including the approach and research methodology, the main assumptions and precautionary principles used. They should also disclose the proportion of Taxonomy-aligned exposures based on estimates separately from the KPIs.

C. Qualitative disclosures by asset managers

Similar to non-financial undertakings, asset managers are required to accompany the KPI with qualitative information. Asset managers should include the qualitative information in the same parts of the non-financial statement that contains the KPIs, or provide cross-references to the parts of the non-financial statements that contain the KPIs. This information should include but not be limited to the scope of assets and activities covered by the KPI, information on data sources and limitations, and explanations of the nature and objectives of Taxonomy-aligned activities and how these activities evolve over time. Asset managers should describe compliance with the Taxonomy Regulation in the business strategy, as well as product design processes and engagement with clients and counterparties.

D. Methodology for reporting KPIs

Asset managers should report the KPIs in a standard table that follows the template^[18] set out in the DA. They should provide the KPIs in relation to each environmental objective and aggregated Taxonomy-aligned economic activities, with a subset of transitional and enabling activities identified. Further, asset managers should disclose the KPIs on aggregated Taxonomy-eligible activities, as well as the shares of investment in Taxonomy non-eligible economic activities. The share of exposures to non-NFRD undertakings has to be disclosed within the denominator only. Along with the KPIs, asset managers should provide a breakdown in the numerator and denominator per type of investment, e.g., derivatives.

3. Implementation Timeline

As adopted, the application of the DA is limited to certain elements in the first year of application. The staged application timeline is as follow:

- As of 1 January 2022 for the reporting period 2021, non-financial undertakings are only required to disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible economic activities, along with the qualitative disclosures set forth in the DA. On the other hand, asset managers are only required to disclose the proportion of their total assets of exposures to (i) Taxonomy non-eligible and Taxonomy-eligible economic activities, (ii) derivatives, central governments, central banks and supranational issuers, and (iii) non-NFRD undertakings. These disclosures should be accompanied by qualitative disclosures pursuant to the DA.
- As of 1 January 2023 for the reporting period 2022, the DA will apply fully to non-financial undertakings. Non-financial undertakings should disclose all the KPIs and accompanying qualitative information pursuant to the DA.
- As of 1 January 2024 for the reporting period 2023, all financial undertakings, including asset managers, should fully apply the DA and disclose the KPIs and accompanying qualitative information as required in the DA.

4. Review of the DA

A review of the application of the DA will be conducted by 30 June 2024. During the review, the Commission will assess the need for including exposures to sovereign debts and non-NFRD undertakings in the calculation of KPIs of financial undertakings. Subject to the review, financial undertakings may include the information voluntarily submitted by non-NFRD undertakings in the numerators of the KPIs starting from 1 January 2025. In parallel, the Commission will work on the development of specific guidelines for simplified voluntary provision of Taxonomy-related data by non-NFRD and certain non-EU country companies as part of a broader project relating to non-financial voluntary reporting by companies that do not fall under the scope of the NFRD.

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endnotes

[1] See Text of the draft EU Taxonomy Article 8 Delegated Act, *available at* https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12440-Sustainable-finance-obligation-for-certain-companies-to-publish-non-financial-information_en.

[2] See 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, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32020R0852&from=EN#d1e40-13-1>. The European Commission adopted the Taxonomy Regulation in July 2021.

[3] On 12 May 2021, ICI Global submitted a response to a consultation by the three European Supervisory Authorities (EBA, EIOPA and ESMA - ESAs) on proposed regulatory technical standards (RTS) under the Sustainable Finance Disclosure Regulation (SFDR) for taxonomy-related disclosures for SFDR Article 8 and 9 products that contribute to environmental objectives. See ICI Memorandum No. 33535, dated 13 May 2021, *available at* <https://www.ici.org/memo33535>.

[4] See 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, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088>.

[5] Only asset managers in the scope of NFRD will be required to disclosure in accordance with Taxonomy Article 8. The following "financial undertakings" that are subject to the NFRD (to be replaced by the CSRD), are covered by the DA: asset managers, credit institutions as defined in Article 4(1), point (1) of Regulation (EU) No 575/2013, investment firms as defined in Article 4(1), point (2) of Regulation (EU) No 575/2013, insurance undertakings as defined in Article 13, point (1) of Directive 2009/138/EC, or reinsurance undertakings as defined in Article 13, point (4) of Directive 2009/138/EC.

[6] DIRECTIVE 2014/95/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095>.

[7] Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting COM/2021/189 final, *available at* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0189>. The CSRD is expected to be finalized by mid-2022.

[8] See id. Large undertakings are defined as those that surpass at least two of the following three criteria: (i) balance sheet total of 20 million EUR; (ii) net turnover of 40 million EUR; and (iii) 250 employees.

[9] "Net turnover" refers to the amounts derived from the sale of products and the provision of services after deducting sales rebates and value-added tax and other taxes directly linked to turnover. See DIRECTIVE 2013/34/EU OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives

78/660/EEC and 83/349/EEC at Article 2(5), *available at*
<https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32013L0034>.

[10] Taxonomy-aligned economic activities are economic activities that comply with the requirements laid down in Article 3 of the Taxonomy Regulation.

[11] See Taxonomy Regulation, *supra* note 2, at Article 11(1a), and the respective technical screening criteria for climate change adaptation activities at Annex II of the EU Taxonomy Climate Delegated Act, *available at*
[https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=PI_COM:C\(2021\)2800](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=PI_COM:C(2021)2800).

[12] See Taxonomy Regulation, *supra* note 2, at Article 11(1b).

[13] Taxonomy-eligible economic activities refer to activities that are described in the delegated acts adopted pursuant to Article 10(3), Article 11(3), Article 12(2), Article 13(2), Article 14(2) and Article 15(2) of the Taxonomy regulation, irrespective of whether such activities meet all of the technical screening criteria laid down in those delegated acts. See draft DA, *supra* note 1, Article 2(5).

[14] See DA, *supra* note 1, at Annex II.

[15] See DA, *supra* note 1, at Annex III, paragraph 1.1, point (b), (c), (d) and (e).

[16] REGULATION (EU) No 236/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 March 2012 on short selling and certain aspects of credit default swaps, *available at*
<https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32012R0236&rid=3>

[17] See Taxonomy Regulation, *supra* note 2, Article 3a, 3c and 3d.

[18] See draft DA, at Annex IV, p.27-29.