



European Sustainable Finance Survey | 2020



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The photo shows the headquarter of the European Central Bank in Frankfurt am Main, Germany.

Contents

Sustainable equity and the EU Taxonomy	1
Assessment of EURO STOXX 50, CAC 40 and DAX	1
Challenges reported by companies	4
Recommendations proposed by companies	7
Sustainable lending and the EU Taxonomy	9
Assessment of banks' lending activities	9
Challenges reported by banks	10
Recommendations proposed by banks	13
About the survey	16

Sustainable equity and the EU Taxonomy

Assessment of EURO STOXX 50, CAC 40 and DAX

Findings 1 to 8 are based on an assessment of ISS ESG data and publicly available information on 75 European companies listed on three main European indices: EURO STOXX 50, DAX and CAC 40.¹

From an investor perspective, European capital markets offer limited investment options that comply with the EU Taxonomy² criteria.

1. Because of the low level of taxonomy compliance (alignment) among companies, investment opportunities in taxonomy-aligned activities are limited. In the three indices under consideration, less than third of the revenues stem from economic activities that are defined as taxonomy-relevant activities in the final report³ by the Technical Expert Group on Sustainable Finance (TEG): 27% for DAX, 22% for CAC 40, and 20% for EURO STOXX 50 (see Figure 1). A small share of total revenue is estimated to be fully taxonomy-aligned: 2% for EURO STOXX 50, slightly less than 2% for CAC 40, and 1% for DAX (see Figure 1). Overall, 77% of analysed companies have an alignment level equal to or lower than 1%, while 13% of analysed companies have an alignment level equal to or above 5%. The low share of taxonomy-aligned revenue is mainly due to a high-carbon economy, the currently proposed set of activities in the TEG report, and reporting practices (for more information on challenges see Findings 8 to 24).

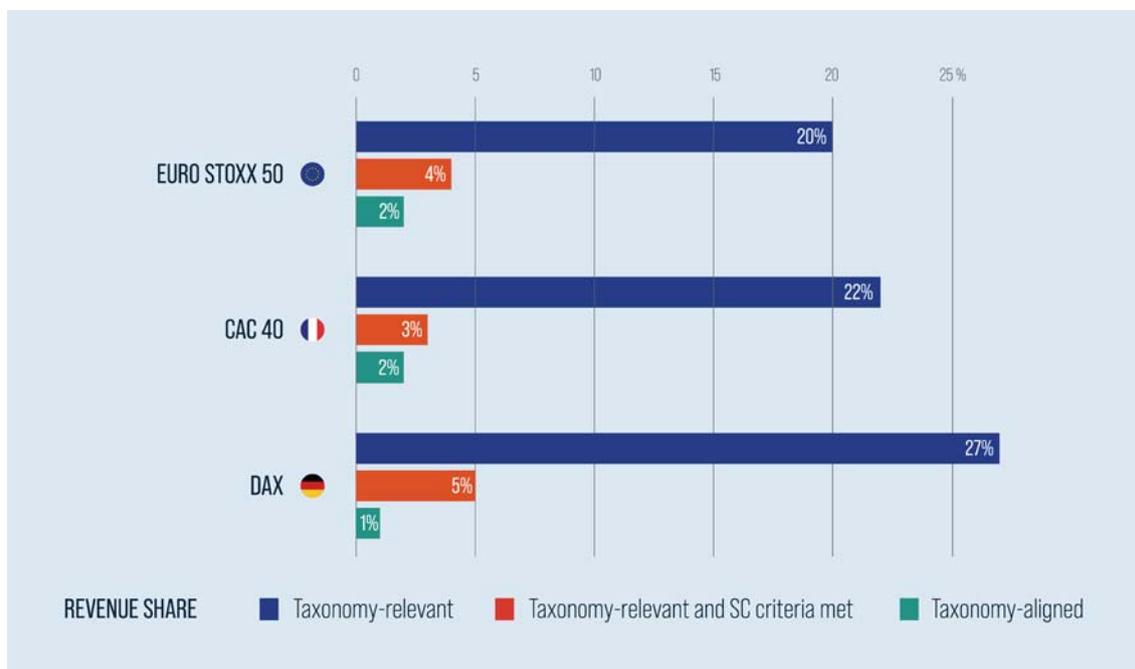


Figure 1: Comparison of taxonomy-relevant and taxonomy-aligned revenues

¹ While a majority of companies listed on the three indices have been analysed, none of the indices has been analysed in its entirety. In particular, companies that do not operate in taxonomy-relevant sectors as well as banks have not been included. Averages were calculated over relative revenue shares and do not account for the size of revenue streams among different companies. All numbers were rounded to the nearest integer (for more information on methods see 'About the survey').

² In this report, 'EU Taxonomy' or 'taxonomy' refer to the EU taxonomy for sustainable activities.

³ In this report, 'TEG report' refers to the 2020 final report of the Technical Expert Group on Sustainable Finance (TEG 2020) (see 'References'). In case another TEG report is mentioned in the text, it will be specified.

2. Companies in the DAX show a large discrepancy between taxonomy-relevant and taxonomy-aligned revenue shares. While the DAX has the highest share of taxonomy-relevant revenues among the three indices under consideration, it has the lowest level of alignment (see Figure 1). The level of taxonomy-aligned revenue relative to taxonomy-relevant revenue is higher for CAC 40 than for DAX. The low level of alignment for DAX could be explained in part by reporting practices (see Finding 18) and the prominence of manufacturing and automotive companies in this index. Automotive companies' activities are generally considered taxonomy-relevant but often do not fulfil substantial contribution (SC) criteria (see Finding 6).

3. Only a limited number of companies conduct taxonomy-relevant activities. The number of taxonomy-relevant activities per company varies between zero and 13. The group of 75 analysed companies conduct on average two taxonomy-relevant activities, with a median of one activity per company. Companies in the energy generation, waste management, electricity and construction sectors are more likely to conduct a higher number of taxonomy-relevant activities. In contrast, several companies analysed in the study do not generate any revenue from taxonomy-relevant activities (see Finding 9). These companies operate mostly in the information and communications technology (ICT) or manufacturing sectors – sectors and/or activities that are not (fully) included in the TEG report.

From a company perspective, achieving full compliance with the taxonomy appears very challenging.

4. A small share of revenues substantially contribute to climate change mitigation and/or adaptation. Around a fifth of the revenues stemming from taxonomy-relevant activities meet the SC criteria: 23% for EURO STOXX 50, 16% for CAC 40, and 19% for DAX. Reasons include 'ambitious' and/or non-verifiable taxonomy criteria. For 'transition' activities (most manufacturing activities) in particular, the taxonomy defines quantitative emission intensity thresholds that are more ambitious than common market standards. Only a fraction of the 'transition' activities meet or exceed the criteria. In addition, limited data availability inhibits the verification of whether quantitative thresholds are met, leading to some activities being counted as not aligned.

5. The majority of revenues that substantially contribute to one of the taxonomy's environmental objectives have a negative impact on another environmental objective. Over a half of revenues that substantially contribute to climate change mitigation and/or adaptation do not fulfil the taxonomy's criteria for other environmental objectives. About 56% of revenues that meet the SC criteria fail to meet all do no significant harm (DNSH) criteria. Reasons include limited data availability and 'ambitious' DNSH criteria. Some elements of the DNSH criteria are not implemented across most companies and/or are not as prevalent in company reporting (e.g. whether or not stakeholders were consulted in the context of setting up water conservation plans). Some activities have no SC criteria or SC criteria that are relatively easy to achieve. Examples include the production of electricity from wind or solar that have no SC criteria and the production of certain goods falling under 'low-carbon technologies' that do not have to meet any further thresholds (TEG 2020). These activities have yet to comply with DNSH criteria⁴ to be considered taxonomy-aligned. The percentage of activities that meet the SC criteria but do not

⁴ According to the principle of proportionality in the TEG report, the nature and extent of due diligence can vary depending on factors such as the size of the company, the context of its operations, and the severity of its potential adverse impact. This variance suggests that it is possible to omit certain DNSH criteria from the compliance check if deemed disproportionate. Since there is a lack of clear guidance as to when this principle should be invoked, this assessment generally deemed all DNSH criteria to be relevant for all companies, regardless of their size and location, and only omitted those DNSH criteria that were clearly irrelevant for the specific activity under consideration (e.g. prevention of the spread of invasive plants was deemed irrelevant for electric vehicle charging stations).

meet DNSH criteria is small compared to the share of taxonomy-relevant activities that do not meet the SC criteria (see Finding 4).

6. The share of taxonomy-aligned revenues varies considerably between sectors. In the utilities sector, a substantial proportion of revenues that stem from taxonomy-relevant activities is taxonomy-aligned. In stark contrast, less than 1% of automotive revenues across the three indices stem from activities that are taxonomy-aligned, despite 69% of the revenue of automotive companies being considered taxonomy-relevant (see Figure 2). For the automotive sector the most substantial reduction in revenue shares towards alignment occurs when assessing compliance with the SC criteria. This is because SC criteria specify emission thresholds per vehicle category, which are (almost) exclusively met by electric vehicles.

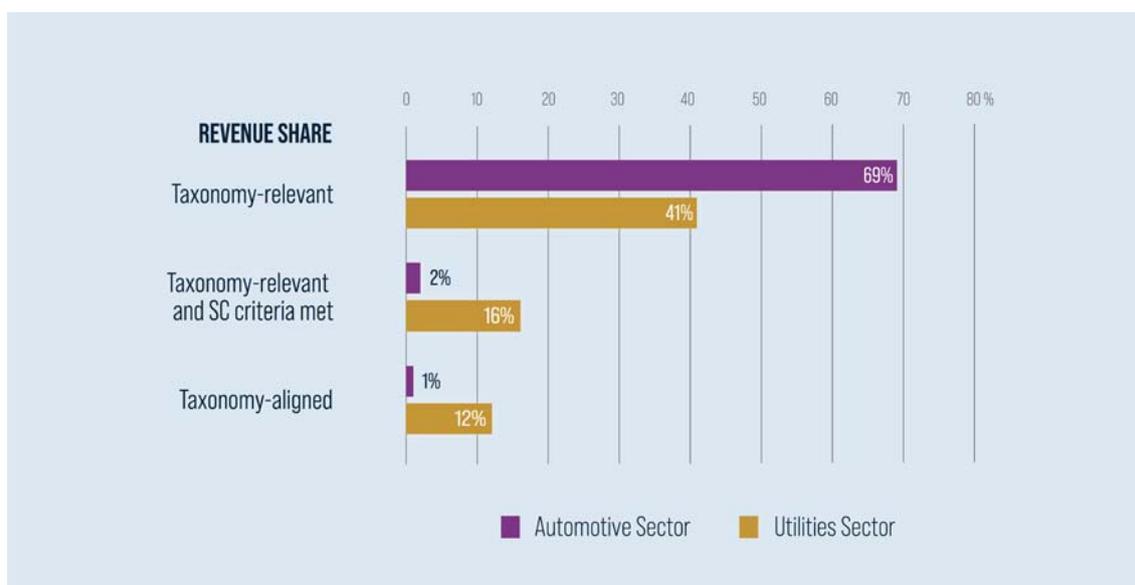


Figure 2: Comparison of taxonomy-relevant and taxonomy-aligned revenues for the automotive and utilities sectors⁵

7. Most companies invest resources to foster climate change mitigation. 95% of companies analysed were found to already invest in climate change mitigation, whether through capital expenditure (CapEx) and/or operational expenditure (OpEx). Due to limited availability of information, an in-depth assessment on whether or not expenditures into relevant activities met all screening criteria was not possible (see Finding 16).

⁵ This figure does not show revenue shares that are taxonomy-relevant and meet the substantial contribution (SC) criteria, as well as the do no significant harm (DNSH) criteria. This is because there is no relevant difference between those revenue shares and the revenue shares that are taxonomy-aligned.

Challenges reported by companies

Findings 8 to 30 are primarily based on i) written responses from 84 companies to an online questionnaire and ii) in-depth interviews conducted with a subgroup of 25 companies.⁶

Incomplete definitions undermine the taxonomy's impact.

8. The taxonomy excludes many potentially relevant activities. At present, the TEG report (and this report) covers only two of the six environmental objectives (i.e. climate change mitigation and adaptation). However, many companies also carry out activities that could contribute to the taxonomy's four other environmental objectives. Furthermore, the current list of relevant activities defined in the TEG report is not yet final, and excludes some relevant economic activities that contribute to climate change mitigation and adaptation. Companies are thus concerned that the taxonomy could paint an inaccurate 'brown or green' picture by leaving out sustainable activities that are currently ineligible. The TEG has already suggested additional activities for inclusion in the taxonomy (e.g. telecommunication networks, and aviation and maritime transport) (TEG 2020).

9. The focus on revenue excludes relevant mitigation and adaptation activities. Around 60% of companies report undertaking activities that contribute to climate change mitigation or adaptation, but do not generate revenue. For example, companies from the ICT sector frequently do not generate revenue from data processing and hosting services that are taxonomy-relevant. Other companies combine the sale of products with an offer of services that may contribute to climate change mitigation, but only charge for the products. Examples include offering best practice advisory services or co-designing products with customers to optimise transport logistics and reduce carbon emissions. Separating the revenue streams for services from those of products, which may not meet the taxonomy criteria or which the company itself may not produce, will require considerable time and resources.

10. The taxonomy insufficiently reflects life cycle and supply chain issues. Companies report that the taxonomy does not include life cycle considerations and emission reductions along the supply chain, despite their considerable positive effects on the environment. While several companies have established procedures for calculating scope 3 emissions from their activities, the current criteria do not in general include these impacts from supply chains. Additionally, the proposed criteria do not consider the life cycle perspective of products. The taxonomy encourages the production of electric cars, but the criteria do not evaluate whether electric cars are more sustainable than conventional cars over their entire life cycle.

The taxonomy is perceived to exclude novel technologies.

11. The taxonomy does not sufficiently take into account incremental contributions towards climate change mitigation and/or adaptation. Companies report that enabling activities can have a positive effect towards climate change mitigation, even when the end product does not fulfil the taxonomy criteria and their expenditures are not "part of an implementation plan to meet the activity threshold over a defined time period" (TEG 2020: 15). Designing a more efficient logistics process or making a car lighter can contribute to climate change mitigation, even if it does not comply with the taxonomy criteria. Furthermore, only a few cases exist in which activities that

⁶ Given the diversity of the participants and the relatively small target group, the survey's findings cannot be used to infer information about all large companies in Europe or about different subgroups of participants in the questionnaire or the interviews.

substantially contribute to climate change adaptation count towards taxonomy-aligned revenue shares. The taxonomy generally considers only two activities as enabling climate change adaptation. All other activities are adapted activities and their revenues are not considered taxonomy-aligned (only the relevant expenditures are deemed taxonomy-aligned). By not rewarding incremental progress, the taxonomy discourages companies from taking measures that can have an immediate positive impact on climate change, even if they do not meet all taxonomy criteria.

12. The taxonomy does not reflect investment in Research & Development (R&D). R&D in new technology can move activities towards alignment and reduce carbon emissions quickly. To reduce carbon emissions in the electricity sector within the necessarily short timeframe, investment is crucial not only in renewable energy sources, but also in R&D for new technology. R&D in decarbonising gas or decreasing the DNSH impacts of biofuels can also move activities towards alignment. However, companies stress that the taxonomy does not acknowledge these R&D activities. The taxonomy may thus encourage investment only in activities that are already sustainable and fail to generate the necessary capital for aligning more problematic activities, which will inhibit a more complete transition.

Companies note a lack of clarity and resources available for applying the taxonomy.

13. Most companies do not perceive a clear match between their economic activities and taxonomy-relevant activities. Nearly all companies have questions about classifying their activities according to the taxonomy. Even in sectors included in the TEG report, companies find it difficult to determine where some activities fit. Some company activities fall under more than one activity defined in the taxonomy (e.g. steel products which significantly contribute to greenhouse gas emission reductions during their use phase are included under both 'manufacture of iron and steel' and 'manufacture of low carbon technologies').

14. Taxonomy criteria are unclear to companies. Two thirds of companies request more information on all areas relating to the SC and DNSH criteria for each activity. Doubts include how to meet the SC and DNSH criteria and how to determine whether an activity is 'enabling' climate change mitigation and/or adaptation. Additionally, several companies indicate that the length and complexity of the TEG report is an obstacle.

15. The taxonomy includes many vague definitions, which leaves room for interpretation and creates uncertainty. The TEG report makes recurring use of vague terms, such as 'technologies', 'components', 'key components', and 'equipment and machinery that is essential for eligible technologies' (TEG 2020). Whether or not a certain activity falls under the taxonomy sometimes depends on the definition of these terms. As a result, the share of revenues that companies, investors, rating agencies, and others deem taxonomy-aligned may vary depending on their interpretation.

16. The taxonomy provides insufficient guidance on how to assess CapEx and OpEx regarding taxonomy alignment. The TEG report suggests that when assessing the taxonomy alignment of companies, in addition to aligned revenue shares, potentially aligned CapEx and OpEx should also be considered. However, companies do not currently report expenditures in a way that allows for an assessment of their taxonomy alignment, while the TEG provides little guidance on how to integrate these elements into the assessment.

17. Many companies consider the implementation timeframe to be too short. Several companies mention that promoting the taxonomy before they have had a chance to adapt to the criteria might result in negative impacts, including diverting investment away from activities that were transitioning to alignment.

The taxonomy's disclosure requirement will be challenging for companies to fulfil.

18. Most companies do not collate and retain data on taxonomy alignment. More than one third of companies report that data is not available either because the taxonomy does not include their activities or the taxonomy is considered 'not applicable' to their activities. For companies that report that data is not available, most do not collect the data (29% for turnover and 39% for CapEx and OpEx) or do not aggregate data according to taxonomy definitions (4% – 7%). Many companies are waiting for the final version of the taxonomy before beginning the process of alignment.

19. The taxonomy does not reflect the complexity of business practices. This makes it harder to determine where activities fit in and how they should be categorised. One corporation from the manufacturing sector points out that, with the complex interactions between daughter companies, it can be difficult to distinguish between a product sold and a product produced by the corporation. Additionally, separating the revenue streams for different activities can be highly challenging if the taxonomy-relevant activities do not correspond to the company's internal processes for calculating revenues.

20. The taxonomy requires a substantial adjustment to internal processes for the more granular criteria of the taxonomy to be incorporated. Companies report that their sustainability Key Performance Indicators (KPIs) currently focus more on global frameworks (e.g. the Sustainable Development Goals (SDGs) and CDP) and internationally applicable tools (e.g. MSCI or Sustainalytics) that do not match the information requirements of the taxonomy. Moreover, companies may collect data in formats other than those stipulated by the taxonomy (e.g. CO₂ emissions per ton of produced product). Such differences make a comparison with taxonomy criteria and thresholds challenging, and the resulting adjustments will require additional time and resources. The adjustments are particularly concerning for companies with a significant presence outside of the Europe, which will also continue to report using global KPIs and international standards. Additionally, several companies indicate that such adjustments should happen simultaneously, once the final version of the taxonomy has been adopted and the criteria for all six environmental objectives have been defined.

21. Disclosure requirements, auditing and liability are unclear. Many companies are unsure about the level of due diligence expected to meet DNSH and Minimal Social Safeguards (MSS) criteria, as well as what information investors will request and whether audits will be expected. Uncertainty also exists about the correct application of the criteria and what information companies would need to disclose for their activities to be considered aligned. Several companies request more information on how to interpret the criteria relative to one another. Specifically, companies ask whether there was a grey area between '100% aligned' and '0% aligned' especially when only one DNSH criteria has not yet been met.

22. Most companies fear high costs because of taxonomy-related disclosure requirements. Companies state that the taxonomy would increase operational costs either substantially (21% of survey respondents) or slightly (60% of survey respondents). The additional costs would primarily stem from adjusting data collection and sustainability disclosure processes to meet taxonomy criteria. The main reasons include difficulties in separating revenue streams according to the taxonomy criteria and fitting complex operational and production processes into the taxonomy structure. The complexity of the taxonomy paired with the still-unclear definitions for many

activities will require companies to hire external consultants and/or auditors to achieve alignment and fulfil disclosure processes. Companies in the energy and manufacturing sectors express particular concern about costs. Companies with relatively little revenue from taxonomy-relevant activities may not make the effort to evaluate or achieve taxonomy alignment.

Companies expect the taxonomy to have limited impact.

23. The taxonomy's scope limits its benefit for the real economy and the environment. Several companies mention that the impact of the taxonomy may be limited by the relatively small number of activities covered by the taxonomy in its current form, low interest rates available in the market at present and the taxonomy's European focus. These factors could contribute to doubts about the taxonomy's effectiveness and result in an unwillingness among companies to apply it. Finally, the taxonomy's effectiveness depends on the continuing and increasing demand from investors for green finance products.

24. Only a few companies expect to benefit from taxonomy-based disclosure. About 25% of respondents to the questionnaire think that the taxonomy will increase revenue, ease access to green funding facilities, or lower strategic or compliance risks, while fewer expect easier access to capital (16%), lower cost of capital (13%) or lower operational risks (13%). 13% of respondents expect no additional benefits from the taxonomy at all. This is because the taxonomy includes only a small percentage of activities in companies' revenue streams and companies have already implemented their own sustainability-related activities that serve to reduce these risks.

Recommendations proposed by companies

Further clarification would help companies to better understand and apply the taxonomy.

25. Companies request additional resources for understanding the taxonomy and its implications. Suggestions include stakeholder forums with industry participants and the creation of a help desk to clarify the definition and application of criteria. Reports and guidelines on the taxonomy should be concise and show a clear connection to current reporting and sustainability standards. Guidance should focus more on specific stakeholders and target groups, as financial departments, smaller companies and consumers all lack knowledge of the taxonomy. Information adjusted to different target audiences would further help to integrate sustainable finance into companies' overall strategies. Companies stress the need for additional clarification on the distribution of responsibility between themselves and their investors.

26. Companies want more clarification on the disclosure requirements. The extent of the disclosure requirements remains unclear, including the level of due diligence expected for meeting DNSH criteria and MSS. Companies seek greater clarification on which specific information investors will request and whether the investors would perform negative screenings or expect audits.

Disclosing against the taxonomy should be practice-oriented and flexible.

27. Companies stress the importance of practicality. To make the taxonomy and its application as practicable as possible, many companies propose a so-called phased-in approach. Such an approach would allow companies to focus on more readily available data and general KPIs while collating more detailed data.

28. Many companies suggest adding a limited number of taxonomy-based KPIs to the Non-Financial Reporting Directive (NFRD). Companies point out potential difficulties in combining the taxonomy with individual companies' materiality processes under the NFRD. As proposed in the TEG report, the taxonomy would be difficult to combine with individual companies' materiality processes under the NFRD, because not all companies are required to report on all KPIs. Companies suggest making generic KPIs from the taxonomy mandatory under the NFRD, while not applying all the taxonomy's detailed criteria.

29. Companies need further clarification on the inclusion of sustainability efforts beyond those included in the taxonomy. While an expansion of the number of activities and sectors covered under the taxonomy would help, the taxonomy will never be all-encompassing. Companies therefore request further clarification on how to demonstrate the sustainability of efforts beyond the scope of activities defined in the taxonomy.

30. Companies think that combining different approaches towards corporate sustainability would help trigger capital flows. The required capital flows for a transformation of the European economy could be facilitated by combining the current project finance/use of proceeds finance approach with more global, corporate finance-linked KPIs. These global KPIs could correlate directly to the EU carbon neutrality target and be based on the SDGs or common environmental, social, and governance (ESG) criteria, which most companies already use in their reporting.

Sustainable lending and the EU Taxonomy

Findings 31 to 57 are based on i) the assessment of publicly available bank information and ii) in-depth interviews with six European banks: Banco Santander S.A., BNP Paribas S.A., Commerzbank AG, Deutsche Bank AG, HSBC Holdings plc and Raiffeisen Bank International AG (for more information on methods see 'About the survey').⁷

Assessment of banks' lending activities

Banks are inclined to apply the taxonomy to project finance and the proceeds of green financial products.

31. Some banks are taking the taxonomy into account when reviewing their sustainable finance classification and tagging systems. Several banks are in the process of reviewing and/or adjusting their internal (green) loan classification and tagging systems to improve the identification of green assets. Two banks state that they are, to some extent, considering the taxonomy in these revisions. Deutsche Bank recently published its group-wide sustainable finance framework, which links to the taxonomy on a best effort basis. This framework stipulates sector-specific eligibility, and environmental and social due diligence criteria for sustainable finance.

32. Two banks refer to the taxonomy for the use of their green bond proceeds. In 2020, Santander Consumer Bank Nordic Group launched the issuance of a green bond with exclusive use of proceeds for retail loan and lease contracts for electric passenger vehicles. The eligibility criteria of the respective green bond framework are stated to be in line with the recommendations of the TEG's 2019 report. Furthermore, in June 2020 Deutsche Bank issued a green bond that is based on the International Capital Market Association's (ICMA) Green Bond Principles and Social Bond Principles, and considers the taxonomy's criteria for the use of proceeds on a best effort basis. The current green asset pool under the green bond framework mainly consists of wind and solar power assets.

33. Common mitigation activities are likely candidates for taxonomy-aligned lending. Investors in renewable energy production or energy efficiency in buildings regularly use sustainability related data, standards, and schemes (e.g. green building certifications). The availability of such data, standards and schemes is perceived to increase the likelihood of establishing the taxonomy alignment of respective debt financing, while also reducing assessment costs for banks. Moreover, most banks are experienced with lending for mitigation-related investments, particularly through lending lines offered to promote energy efficiency and project finance for renewable energy operations. Banks' familiarity with these mitigation activities and the availability of data, standards, and schemes is accompanied by the absence of SC thresholds for some mitigation activities (e.g. electric passenger vehicles, wind power, and the installation of smart meters for gas and electricity). Taxonomy-aligned lending is therefore especially likely for common mitigation activities.

⁷ The following statements focus on banks' lending activities exclusively; they do not take into account other business lines of the bank such as asset management or investment banking. At the time of writing, lending activities are exempt from applying or disclosing in line with the taxonomy.

34. Project finance is perceived as particularly suited for taxonomy-aligned lending. Project finance is clearly attributable to an economic activity financed. This makes it comparatively easy to match the financing purpose with the list of economic activities defined by the taxonomy. Moreover, project finance operations are subject to thorough due diligence processes, often underpinned by international standards such as the IFC Performance Standards or Equator Principles. Thus, the project finance due diligence process may already produce a significant share of the data necessary to assess taxonomy alignment. Establishing the taxonomy alignment of future project finance operations will likely also be enhanced when the fourth iteration of the Equator Principles comes into effect (i.e. in October 2020). The updated Equator Principles demand that project finance operations are subject to a climate change risk assessment – a prerequisite of the taxonomy’s DNSH criterion for adaptation.

Challenges reported by banks

Applying the taxonomy is currently neither feasible nor scalable for all lending activities.

35. The activity-centred approach of the taxonomy is not applicable to all lending activities. Applying the taxonomy to a loan requires that the use of the loan is linked to a specific economic activity. This implies that the taxonomy can only be applied to lending which has a well-defined purpose (e.g. earmarked loans for energy efficiency improvements or project finance for renewable energy operations). For common lending activities (e.g. general purpose loans or revolving credit facilities) which constitute a large proportion of banks’ loan portfolios, and even for special green products (e.g. sustainability-linked loans), the specific use of the loan is generally not well-defined, which will inhibit the application of the taxonomy to such lending activities. Some banks therefore caution that if banks were to apply the taxonomy to the overall balance-sheet (and disclose accordingly), the taxonomy-aligned ratio would by definition be rather low. Such a low ratio would send the wrong message to the market and may result in reputational losses for a bank.

36. Bank IT systems are currently not geared up to record taxonomy alignment. Bank IT systems for tracking and documenting financing are generally built for reporting on the consolidated group level – detailed information on the activity level is not or insufficiently recorded and tags often lack the nuance to differentiate between anything more than ‘green’ and ‘not green’ lending. Banking IT infrastructure therefore does not permit tracing the use of a loan down to the activity level or to the level of granularity required by the taxonomy. Adjusting banks’ internal IT systems will require significant administrative time and investment, and must go hand-in-hand with an adjusted document query.

37. The application scope of the taxonomy is limited to the list of taxonomy-aligned activities defined by the TEG. In its report (TEG 2020), the TEG states that the Platform on Sustainable Finance will need to extend the current list of taxonomy-relevant activities for the environmental objectives mitigation and adaptation. Meanwhile, economic activities and criteria for the remaining four environmental objectives must still be defined (see Finding 8). The taxonomy can only be considered for financed economic activities that the TEG has already defined, thereby limiting banks’ taxonomy-aligned portfolio share to these defined activities. Some banks therefore caution against reporting on taxonomy-alignment before the Platform concludes its work. Examples of activities that are already financed by banks, but are not yet included in the TEG’s list of taxonomy-relevant activities include activities relating to the circular economy and to maritime transport.

38. The taxonomy does not sufficiently take into account incremental progress. Most banks underline the importance of intermediate steps to achieving taxonomy alignment and reaching the EU's energy and climate targets. The TEG acknowledges such 'improvement measures' (TEG 2020). However, the measures are only eligible for taxonomy alignment if they are either part of a time-limited implementation plan to meet the taxonomy criteria or if they can be subsumed under the current list of eligible measures defined by the TEG (mainly under 'low-carbon technologies' or 'building renovation' measures) (see Findings 11 and 12). Banks perceive this set of eligible improvement measures as too narrow to adequately account for a client's activities or for projects that represent intermediate steps to taxonomy alignment. In this context, several banks highlight that many green activities and projects they currently finance may not be compliant with the taxonomy at present, despite contributing to carbon neutrality. Such activities represent a notable share of their green lending portfolios.

39. The taxonomy may only be applicable to new loans. Information about the client and the financed activity are generally gained during the due diligence and structuring processes of providing a loan. Banks report that obtaining information to assess taxonomy alignment after the closure of a deal will be difficult. Therefore, some potentially taxonomy-aligned assets in a bank's loan portfolio will not be captured.

40. Banks see a potential demand side shortage for taxonomy-aligned lending. Several banks highlight that the taxonomy's level of ambition limits the share of economic activities that are fully taxonomy-aligned. Moreover, some banks warn that, without financial incentives for the borrower (e.g. grants or advantageous financing terms), demand for taxonomy-aligned loans will remain small, limiting the taxonomy's impact on the quantity and quality of sustainable activities. In this context, a few banks highlight that offering better financing terms for taxonomy-aligned economic activities will require more than a bank's willingness to develop the sustainable finance segment. Rather, favourable terms must be based on the economics of such loans (i.e. risk expectations and/or regulatory incentives for banks). One bank further emphasises that such incentives are especially relevant when taxonomy criteria require to go beyond national legislation.

41. Building bank capacities to identify and assess taxonomy-relevant activities will require time. Bank sales staff has an important role to play in identifying taxonomy-relevant client financing requests and offering targeted lending solutions in response. Some banks state that they have started to inform and educate their sales staff about the taxonomy (e.g. through targeted webinars). Enabling sales staff to take on this role, however, is a process that will require multiple rounds of training, significant time, and must coincide with similar progress on the clients' side.

A strict and uniform application of the taxonomy criteria across lending activities may significantly restrict the use of the taxonomy.

42. The taxonomy does not account for the large variety in banks' lending portfolios in terms of client types and financing volumes. The taxonomy does not distinguish between economic activities of different sizes or between different types of entities that implement an activity. For example, when applying the taxonomy to lending activities, banks would have to treat small loans provided to small- and medium-sized enterprises (SMEs) in the same manner as multi-million euro corporate finance operations, assuming both lending activities fall under the same taxonomy-relevant economic activity. Banks may find such an undifferentiated application of the taxonomy criteria to be unreasonable and may refrain from applying the taxonomy to significant shares of their lending portfolios.

43. A rigorous application of all taxonomy criteria in some cases seems unreasonable.

Compliance with the DNSH criterion for adaptation, which applies equally to all taxonomy-relevant mitigation activities, requires that all material physical climate risks associated with an activity are identified through a climate risk assessment and are reduced to the greatest extent possible. Interpreting this criterion in a strict manner would imply, for example, that evidence on a conducted climate risk assessment must be collected not only for a large-scale solar PV project finance operation, but also for a loan provided to an individual household for the financing of rooftop solar PV. For such small-scale projects, however, it is questionable whether the costs of a climate risk assessment are justified. In this context, banks express uncertainty about how to treat projects and activities that narrowly fail to comply with individual taxonomy criteria. This could be the case for criteria that are particularly challenging to assess (e.g. supply chain related criteria) or when market realities challenge compliance with all taxonomy criteria.

44. The taxonomy criteria do not account for the variety of sub-activities in some cases.

Some of the taxonomy's economic activities comprise a large variety of sub-activities. For example, infrastructure for low-carbon land transport is an umbrella activity that covers the construction of railways and infrastructure and equipment for active mobility (TEG 2020). Following the taxonomy's logic, lending provided in relation to charging stations for electric vehicles or e-bikes would have to be assessed regarding the same potential harms that rail infrastructure may cause (e.g. ecosystem deterioration and biodiversity loss) and would be subject to the same requirements (e.g. Environmental Impact Assessment).

Banks find it difficult to interpret and assess the taxonomy criteria.

45. Criteria for adaptation activities lack clarity or are difficult to assess. Some banks raise concerns regarding the vague framing and qualitative nature of the screening criteria for adaptation-related activities. Banks also highlight the lack of guidance on how compliance with these criteria could be examined in practice. For example, banks mention the lack of common baselines and standards for climate risk assessments – a requirement of the DNSH criterion adaptation. These concerns and challenges are among the reasons why climate change adaptation activities have so far received little attention when examining the potential for taxonomy-aligned lending.

46. The linkage between taxonomy criteria and commonly used sustainability standards and schemes is not clear.

Most banks highlight that it is unclear to what extent widely adopted financing standards (e.g. the Equator Principles) or sustainability-related certification schemes (e.g. green building certification such as LEED or BREEAM) allow inferences on taxonomy alignment. This issue is particularly relevant when banks attempt to assess the taxonomy alignment of past transactions that are still on the balance sheet. For such transactions banks have already concluded document queries, and must assess taxonomy alignment based on previously applied standards and schemes. Similarly, several banks pointed out that it is unclear whether and to what extent existing company-level ESG ratings and related data could yield insights on the taxonomy alignment of an activity.

47. Data necessary for assessing taxonomy alignment is often unavailable, especially for SME activities.

All banks highlight the current lack of data that would be required to assess the taxonomy alignment of companies' activities. This data gap is particularly wide for smaller companies that are not subject to disclosure requirements. Some banks point out that the differences in the availability of data between larger and smaller companies could result in a bias towards taxonomy-aligned lending for larger companies. Furthermore, banks perceive the general lack of indications as to where and how relevant data and information can be obtained as

a major obstacle. They caution that this lack of information may limit the application of the taxonomy to activities for which pertinent information is easily accessible or inferable.

48. Banks' ability to assess the compliance of clients' activities with the taxonomy is limited.

Banks might not have the resources or may face other limitations when examining the compliance of economic activities with the taxonomy. For example, some banks emphasise the need to involve external technical experts to confirm taxonomy compliance, especially for highly technical criteria or when activities fall under sectors in which the bank has not yet gained sufficient experience and in-house expertise. One bank notes that accruing adequate technical expertise in-house will be difficult given the broad range of sectors to which most banks provide financing. This limitation applies particularly to smaller banks. A further limitation concerns the assessment of criteria that apply to clients' supply chains. Here, banks would need to rely on or assume compliance based on the clients' statements. One bank underlines that, given these limitations, financial institutions can only make estimations of taxonomy-alignment on a best effort basis. Both the missing guidance on how to conduct such estimations and the room for interpretation often left by qualitative and DNSH criteria can present significant obstacles for banks. Thus, some banks voice doubts as to whether they should be responsible for carrying out thorough assessments for taxonomy alignment and raise liability concerns should they report on the taxonomy alignment of their lending.

49. Assessing and establishing taxonomy alignment is particularly challenging for financed activities located outside the EU.

One challenge concerns differences in non-financial reporting standards across countries and regions, and the resulting variation in the availability of required data from companies. Another difficulty relates to differences in industry standards and legal requirements for sustainability across countries, which may challenge inferences regarding the taxonomy alignment of financed activities. In particular, this may apply to taxonomy criteria that refer to EU regulation or 'comparable standards' (TEG 2020). The comparable standards requirement could be difficult for banks to interpret and assess, and might discriminate against companies located in jurisdictions where legal standards lag significantly behind EU standards.

Recommendations proposed by banks

The use case of the taxonomy for lending should be confined.

50. The application of the taxonomy for lending purposes should be restricted to specific assets and financial products. All banks question the feasibility and the value of applying the taxonomy to the whole lending portfolio. Rather, the application scope of the taxonomy for lending should be limited to those lending activities where the use of a loan is known. Examples mentioned by banks include but are not limited to project finance operations, mortgages, and corporate loans as long as the use of proceeds is clearly allocated to specific capital expenditures and/or operating and maintenance expenses. The restricted application scope has then to be taken into account when calculating the taxonomy-aligned portfolio share. Moreover, banks should only consider the taxonomy for new loans. Future delegated acts should take these points into account when defining the scope and purpose of the application of the taxonomy for bank's lending business. In this context, one bank further cautions against a mandatory use of the taxonomy for risk management purposes, deeming it unsuitable.

The market for taxonomy-aligned lending should be promoted.

51. Incentives for banks and companies, as well as EU-level investment projects would boost the market for taxonomy-aligned lending. Some banks point to incentive schemes for companies (e.g. grants and export credit insurances) and EU-level investment initiatives (e.g. refinancing programmes) as levers for the development of taxonomy-aligned activities, and hence as important factors for accelerating the market for taxonomy-aligned lending. Some banks also point to the impact regulatory incentives (e.g. a favourable leverage ratio and lower capital requirements for taxonomy-aligned loans) may have in this context.

52. The list of eligible activities, especially of ‘enabling activities’ and ‘improvement measures’, needs to be expanded. Banks highlight that the taxonomy should not only focus on frontrunners, but should also consider economic activities that are moving towards the EU’s sustainability goals. One way to do so is to define further ‘improvement measures’ and ‘enabling activities’ across all sectors – e.g. in the manufacturing sector to account for all components of a sustainable project.

The practicability of the taxonomy for banks needs to be enhanced.

53. Banks need greater clarity and more practical guidance on how to interpret and apply the taxonomy criteria. One bank highlights the need for a help desk that market participants could consult for specific taxonomy-related advice. Help desk queries could concern technical matters, the interpretation of taxonomy criteria, or requests for advice on how to assess the taxonomy alignment of specific projects. In this context, another bank underlines that guidance is especially needed on how to conduct taxonomy alignment estimations. A practice group would be useful for facilitating the exchange of best practices and approaches. Such a help desk or practice group would also reduce the likelihood that different market players interpret criteria differently, thus encouraging a harmonised application of the taxonomy.

54. Banks need to know where to find relevant information for alignment checks and references to standards and schemes they already apply. Banks raise the need to clarify to what extent widely applied principles and standards would allow banks to infer taxonomy-alignment. Being able to draw on established loan appraisal processes (e.g. processes that involve green building certification schemes or widely adopted financing principles, such as the Green Loan Principles or the Equator Principles) is especially relevant in the context of activities performed outside the EU. A comparison between the criteria of the taxonomy and those of sustainability-related standards and schemes used by banks (e.g. in the form of an equivalence table) should be provided, as well as advice on how banks can address apparent differences and gaps. One bank highlights that references to standard documents (e.g. vehicle registration documents) would also be helpful. Moreover, when criteria entail a national component (e.g. requirements on nearly zero-energy buildings as defined in national regulation), banks would appreciate information on the metric or threshold that applies in different countries. Such country-specific indications are important because many banks operate across jurisdictions.

55. Simplified assessments and pragmatic approaches would foster a more comprehensive application of the taxonomy. Several banks advocate the introduction of flexibility rules (e.g. thresholds or proportionality rules for criteria application) to foster the application of the taxonomy to larger shares of lending portfolios (e.g. by covering more client segments, particularly SMEs). Flexibility rules may also help to overcome challenges that arise when applying the taxonomy to previous transactions, in particular information and documentation gaps that cannot be filled ex-post.

56. Relevant data on companies and their activities should be collected and made easily available. Databases that collect relevant information on companies' economic activities and projects would make the assessment of taxonomy alignment easier. Such databases should be designed in a manner that is user-friendly for companies of all sizes (i.e. for entities that share the data) and for financial agents (i.e. for entities that retrieve the data). In this context, one bank mentions that adjusting and mainstreaming accountancy regulation in accordance with taxonomy requirements (e.g. embedding the taxonomy into the International Financial Reporting Standards) would help to obtain missing financial data.

57. Third party validation of the taxonomy alignment of an economic activity would reduce banks' burden of evidence. For reporting on taxonomy-aligned lending activities, banks require guidance on the type and granularity of evidence that clients and banks should provide. In this context, several banks raise the need for external audits and validation processes to confirm an economic activity's taxonomy compliance. External verification would not only address the limited technical capacities of banks and mitigate their liability concerns, but would foster the standardisation and mainstreaming of assessments for taxonomy alignment.

About the survey

Methodology

The German Federal Ministry for the Environment commissioned adelphi and ISS ESG to assess the sustainability – defined as alignment with the EU Taxonomy – of Europe’s financial system. The objectives are:

1. Measure the extent of taxonomy alignment
2. Identify challenges to and solutions for measuring taxonomy alignment
3. Raise awareness and build capacity regarding the taxonomy

In 2020, the survey focused on the first two environmental objectives of the taxonomy and drew from three sources of evidence: i) ISS ESG data and publicly available information, ii) responses to an online questionnaire, and iii) in-depth interviews. In detail:

Findings 1 to 30 on sustainable equity and the EU Taxonomy primarily draw on:

- **ISS ESG data** as well as publicly available information on 75 companies included in the following indices (ordered by market cap): EURO STOXX 50, CAC 40 and DAX. Out of the total of 75 analysed companies 40 were listed in EURO STOXX 50, 35 in CAC 40 and 28 in DAX.⁸
- **Responses to an online questionnaire** sent to 421 companies. The invited companies are included in the following indices (ordered by market cap): EURO STOXX 50 (Eurozone), FTSE 100 (United Kingdom), CAC 40 (France), DAX (Germany), AEX (Netherlands), OMX Stockholm 30 (Sweden), IBEX 35 (Spain), FTSE MIB (Italy), OMX Copenhagen 20 (Denmark), OMX Helsinki (Finland), BEL 20 (Belgium), ISEQ Overall (Ireland), ATX (Austria) and WIG20 (Poland). Out of 421 invited companies, 84 submitted responses. **Table 1** and **2** show the distribution of the participating companies across industry sectors and the countries they are located in.
- **Interviews with 25 companies** that responded to the questionnaire. The selection of companies was as evenly distributed across countries and taxonomy-relevant sectors as possible, but skewed by the willingness of companies to participate. **Table 1** and **2** provide an overview of interviewed companies’ respective locations and industry sectors.

⁸ Some companies are listed in more than one stock market index, i.e. both in EURO STOXX 50 and CAC 40 or DAX. Therefore, the number of analysed companies (75 companies) is lower than the sum of the analysed companies in the three indices (40 in EURO STOXX 50, 35 in CAC 40 and 28 in DAX).

Sector	Questionnaire (number of companies) ⁹	Interviews (number of companies)
Agriculture, forestry and fishing	7	1
Manufacturing	26	10
Electricity, gas, steam & air conditioning supply	12	7
Water supply; sewerage & waste management	2	0
Construction	4	0
Transport and storage	9	1
Information and communication	6	2
Real estate activities	3	1
Financial services and insurance	17	3
Professional, scientific and technical activities	3	0
None	16	0

Table 1: Distribution of participating companies across sectors

Country	Questionnaire (number of companies)	Interviews (number of companies)
Austria	4	1
Belgium	3	0
Denmark	4	1
Finland	10	2
France	3	2
Germany	16	8
Ireland	8	2
Italy	4	2
Netherlands	4	2
Poland	5	1
Spain	4	2
Sweden	8	1
UK	11	1

Table 2: Distribution of participating companies across the different countries under consideration

Findings 31 to 57 on sustainable lending and the EU Taxonomy primarily draw on:

- Publicly available information (e.g. annual reports and lending policies) of the following banks: Banco Santander S.A., BNP Paribas S.A., Commerzbank AG, Deutsche Bank AG, HSBC Holdings plc and Raiffeisen Bank International AG. Results of the analysis, which included a section on identified gaps and challenges regarding the application of the taxonomy to lending, were shared with banks in advance and/or during the interviews.
- In-depth interviews with the aforementioned banks.

The survey will be repeated in 2021 and 2022. For information on the applied methodology, please refer to www.sustainablefinancesurvey.de/survey.

⁹ Some companies operate in more than one sector. The number of participating companies (84 companies) is therefore lower than the total sum of participating companies in all industry sectors.

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