European Sustainable Finance Survey

Snapshot: Asset managers, asset owners and the EU Taxonomy

2022

adelphi

Supported by:

Federal Ministry
for the Environment, Nature Conservation,
Nuclear Safety and Consumer Protection

based on a decision of
the German Bundestag

adelphi

adelphi is the leading independent think-and-do tank in Europe for climate, environment and development. We are some 300 strategists, thought leaders and practitioners working at the local and global levels to find solutions to the most urgent political, economic and social challenges of our time. As a policy consultancy, we support a just transition towards carbon neutrality and sustainable, liveable societies. Our work is grounded in transdisciplinary research, evidence-based consulting and stakeholder dialogues. With these tools we shape policy agendas, facilitate political communication, inform policy processes and support decision makers.

For more information please contact sustainable.finance.survey@adelphi.de or go to www.sustainablefinancesurvey.de.

Imprint

Authors: Annica Cochu, Christian Metzler, Lea Mohnen, Bianca Pelletti, Walter Kahlenborn

Layout: adelphi | Figures by Steffen Kalauch

Publisher: adelphi research gemeinnützige GmbH
Alt-Moabit 91
10559 Berlin
+49 (030) 8900068-0
office@adelphi.de
www.adelphi.de

Photo credits: taka1022 – shutterstock.com

Contents

Summary

The EU Taxonomy for Sustainable Activities ("taxonomy") is expected to help shift capital flows towards greater sustainability. The **European Sustainable Finance Survey 2022** assesses where asset managers (AM) and asset owners (AO) stand with regard to putting the taxonomy to use and how they perceive the challenges and impacts of the taxonomy. The following results are based on input (through surveys and interviews) from 21 AOs, AMs and associations as well as an analysis of 57 annual/sustainability reports and 221 fund prospectuses:

- **The taxonomy is currently far from AM/AOs' primary tool for sustainable investing but is expected to become more relevant in the future**. AM/AO consider the taxonomy to be more than a reporting tool but are not yet fully decided on how else to use it. Target-setting and engagement with investee companies appear to be the most attractive options, albeit still only indicated as relevant by less than half of the survey respondents. Additionally, AM/AO will use the taxonomy to select sustainable investments – but only as one tool among others, especially given that the taxonomy currently only covers part of the sustainable investment universe. Using the taxonomy as a negative screening tool is, for the most part, not an option for AM/AO. Overall, AM/AO are only starting to learn how to use the taxonomy.
- **AM/AO comply with mandatory entity-level reporting requirements according to the Non-Financial Reporting Directive (NFRD) but are hesitant to provide figures on the taxonomy alignment of financial products.** For entity-level reporting, AM/AO determine taxonomy eligibility themselves and with the help of third-party providers while first-hand data is still unavailable. They mostly adhere to mandatory disclosures but also publish voluntary information, e.g. to illustrate taxonomy eligibility of assets that are outside the scope of mandatory reporting. For their sustainable financial products, however, most of the assessed funds had reported zero percent taxonomy alignment of sustainable investments by summer 2022. The most important reason cited for this low figure is to prevent greenwashing claims, given that reliable data to back up taxonomy-related commitments is still limited.
- **Insufficient availability and quality of data is the most prominent concern for AM/AO**. Taxonomy usage is currently constrained by limitations in data availability, especially for assets that do not fall under the Non-Financial Reporting Directive (NFRD). Available data, in turn, is difficult to interpret and compare, e.g. because the taxonomy and related guidance leave room for interpretation and because figures are often presented without sufficient explanation. These shortcomings can lead to reputational risks for AM/AO that disclose entity- or product-level taxonomy data. AM/AO expect the market to converge around adequate data quality over time. Moreover, the expansion of corporate sustainability reporting in Europe and internationally, such as through new sustainability reporting standards and regional/national taxonomies outside of the EU, will enhance the availability of data. AM/AO note that expectation management is crucial as long as data is insufficient.
- **AM/AO are concerned about the narrow scope of the taxonomy, yet do not fully agree about options for expanding or complementing the taxonomy.** The taxonomy's focus on certain activities and asset classes limits its usability for steering portfolios. AM/AO confirm that expanding the taxonomy to include the missing environmental objectives will make it more relevant. Moreover, many survey and interview participants support the notion of a "transition taxonomy" that identifies and supports activities that drive the economic transition towards great sustainability. However, some participants also caution that the definition of "sustainable" should not be watered down any further and that adding to the taxonomy may make it too complex for AM/AO.

- **Including controversial activities in the taxonomy will harm its status as a "gold standard" but does not have an immediate impact on many AM/AOs' investment strategies.** Many survey participants expect the uptake of controversial activities in the taxonomy, especially fossil gas and nuclear energy, to harm its credibility to clients. However, they also state that their understanding of "sustainable investments" remains mostly unchanged and that they will continue to make investment decisions based on the sustainability strategies previously defined on the entity- and product-levels.
- **The taxonomy is considered a complex tool and leaves particularly smaller AM/AO in need of support.** Another challenge for using the taxonomy to guide investment decisions and prevent greenwashing is the complexity of taxonomy-related assessments and reporting. Smaller AM/AO in particular find it difficult to fully understand taxonomy data and thus request support for applying the taxonomy, e.g. through capacity building, facilitated peer exchange and automatic information on taxonomy updates. Such support must acknowledge the fact that challenges vary between types of AM/AO and the asset classes they invest in.
- **Although its practical use is still limited, the taxonomy is having a positive effect on the market**. Despite challenges, many AM/AO confirmed that the taxonomy has a positive effect on the market because it brings sustainability-related concerns to the forefront of political discussions and on the desks of management boards.

Introduction

The European Sustainable Finance Survey (EUROSFS) aims to contribute to the effective application of the EU Taxonomy for Sustainable Activities ("taxonomy") by eliciting and widely communicating market participants' views of the tool and ideas for overcoming hurdles. The first **EUROSFS surveys** explored perspectives on the taxonomy from European non-financial companies and commercial banks (2020) as well as public financial institutions (2021).

In its third year, EUROSFS addresses asset managers (AM) and asset owners (AO) as important user groups of the taxonomy.

According to the **EU Commission**, "*[i]n order to meet the EU's climate and energy targets for 2030 and reach the objectives of the European green deal, it is vital that we direct investments towards sustainable projects and activities*."

AM and AO can make an important contribution to shifting capital flows as they select what is being financed. They are increasingly expressing interest in sustainable investing as it opens up new markets and protects their business models in the long term.

The taxonomy was developed to help steer capital towards sustainable activities. Although in itself only a means of defining "sustainable activities", AM and AO can use the taxonomy in many ways to support sustainable development.

Against this background, EUROSFS 2022 aims to answer the following questions:

- How do AM/AO[1] use the taxonomy[2] to help achieve the EU's sustainability-related goals?
- Which challenges do AO/AM encounter when using the taxonomy?
- How could challenges be overcome?

The results are meant to help AM/AO, their support organisations and policy makers in making the best use of the taxonomy.

[1] Across the report, AM and AO are mostly referred to together ("AM/AO") given that the taxonomy usually presents similar opportunities and challenges for both groups. However, certain aspects apply more clearly to either AM or AO and are marked as such.

[2] In most cases across this report, "taxonomy" refers to the taxonomy for environmental objectives 1 (mitigation) and 2 (adaptation), as defined in the Taxonomy Regulation. However, questions around the additional objectives as well as the taxonomies for social and transitional activities were also discussed with individual AM/AO. Answers are marked accordingly.

Conceptual framework

EUROSFS 2022 intended to elicit how AM/AO use the taxonomy to help achieve the EU's sustainability-related goals. The following conceptual framework provides an overview of how the taxonomy *could* be used. It helps to compare current use against the bouquet of potential uses. Readers can thus understand better whether the taxonomy already serves its purpose(s). The conceptual framework is based on desk research and the authors' own thoughts.

How should and could AM/AO use the taxonomy to scale up sustainable investment?

EU Commission: *"The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities. It could play an important role helping the EU scale up sustainable investment and implement the European green deal. The EU taxonomy would provide companies, investors and policymakers with appropriate definitions for which economic activities can be considered environmentally sustainable. In this way, it should create security for investors, protect private investors from greenwashing, help companies to become more climate-friendly, mitigate market fragmentation and help shift investments where they are most needed."*

How can AO/AM use the definitions provided by the taxonomy to prevent and protect themselves against greenwashing, support companies and shift capital, as suggested by the EU Commission? The following options are partly mandatory, partly voluntary.

1. SELECT: The taxonomy sets out to provide a uniform, science-based definition of environmentally sustainable activities. It helps AM/AO understand how strongly investee companies and certain other types of assets, such as real estate, contribute to the EU's environmental objectives through their activities and projects. AM/AO can thus use the taxonomy to inform their investment or divestment strategies and to design credible green financial products. They can compare the degree of taxonomy alignment of different assets (expressing their sustainability performance) and only select those that are in line with their own or their clients'/end investors' investment goals. They can also use the taxonomy's Do No Significant Harm (DNSH) criteria as a minimum standard for investment, thereby serving as a framework for sustainability risk assessment / management.

2. PLAN: AM/AO can also use the taxonomy to set targets and express their ambition. They can determine what share of the total portfolio or of specific financial products needs to be in alignment with the taxonomy's technical screening criteria. One particular form of target setting is the disclosure of "minimum" values: As specified by the Sustainable Finance Disclosure Regulation (SFDR) and complimentary Regulatory Technical Standards (RTS), providers of sustainable financial products need to determine the minimum extent 1) to which these products make sustainable investments as defined by the taxonomy or the SFDR and 2) to which these sustainable investments are aligned with the taxonomy. This approach was introduced to avoid downwards corrections in the alignment figures of financial products once the underlying companies and assets start disclosing their actual taxonomy alignment. Otherwise, use of the taxonomy for target setting and investment decisions is voluntary.

3. **ENGAGE**: AM can engage with potential investees on sustainability criteria as defined by the taxonomy to raise their awareness and help them transition to more sustainable activities. Likewise, the taxonomy can present a framework for discussing sustainable investment criteria between AM and AO. In case of unsuccessful engagement, divestment could be the ultimate consequence of too little (transparency on) taxonomy alignment.

4. **DISCLOSE**: The EU Taxonomy Regulation sets entity- and product-level disclosure requirements for 1) large companies falling under the Non-Financial Reporting Directive (NFRD) and 2) financial market participants offering sustainable financial products as defined in the SFDR, including products with the aim of sustainable investment (Article 9 SFDR) and products that promote environmental, social and governance (ESG) characteristics (Article 8 SFDR). These requirements apply to many AM/AO. If such disclosures are well-prepared, AM/AO can convey helpful information to their investors, clients and wider stakeholder groups and enable them to make informed choices. Although the format and content of mandatory disclosures is predefined to a significant degree, AM/AO can still influence how useful reports are for their audiences. Where and how they disclose can impact the level of access, the size of the audience and the ease of comprehension for readers.

Figure 1 summarizes how AM/AO can use the taxonomy.

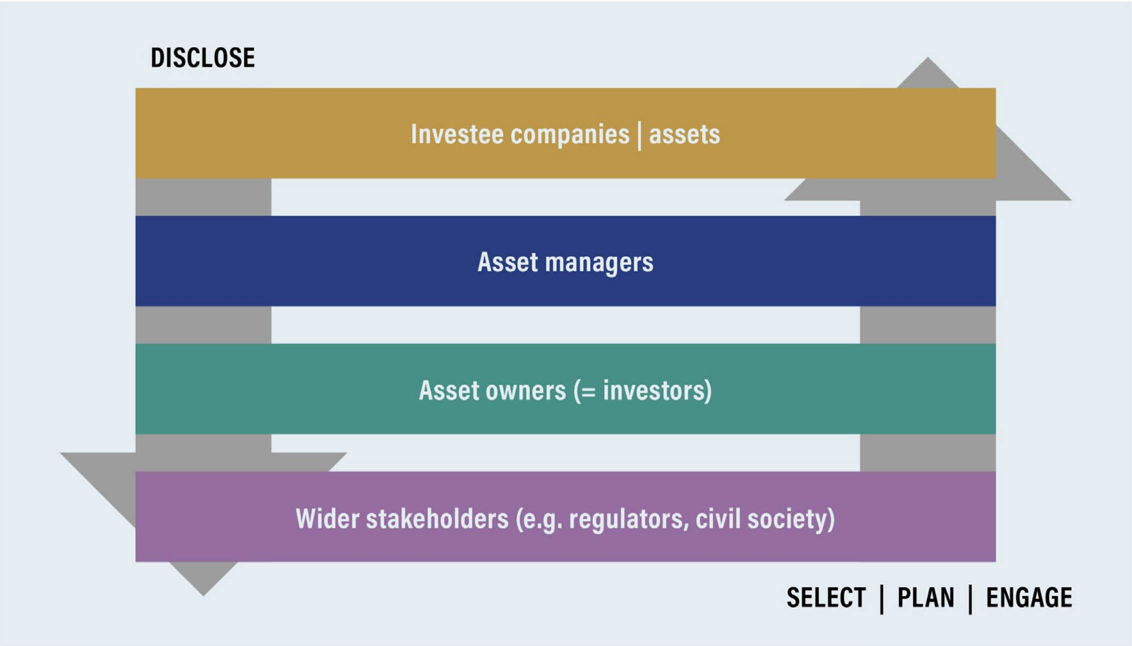

Figure 1: Options to use the taxonomy to support sustainable investment (source: author's own depiction)

The following chapters present results of an assessment of where AM/AO stand with regard to using the taxonomy and whether a positive contribution to financing sustainability can be observed or expected. Yet, as already described, only a few of the ways of using the taxonomy are mandatory, and even these are only just starting to apply. **The results are thus highly preliminary and will have to be studied again over the coming years.**

Findings

Findings draw on input from AM/AO/associations and desk research. *A total of 21 AM/AO and associations participated in the survey and interviews. Additional desk research focused on an analysis of 1) 57 NFRD reports and 2) pre-contractual disclosures provided for 221 Article 8 and 9 funds. See Annex for additional information on the methodology. Together, these sources provide an initial impression of how the market is starting to use the taxonomy.* ***However, given the low degree of participation in the survey, especially from asset owners, findings presented below are only a snapshot of the market and should not be read as representative of the market. Moreover, with both non-financial companies and AM/AO only starting to report taxonomy-relevant information, it is still early to assess the usability and impact of the taxonomy.***

Formulations such as "all/most/some" refer to the AM/AO/associations that participated in survey, interviews or desk research, not to all European or international AM/AO/associations.

Status quo: The taxonomy as a tool for decision making and disclosure

The taxonomy is currently far from AM/AOs' primary tool for sustainable investing, but is expected to become more relevant in the future.

1. AM/AO consider the taxonomy to be more than a reporting tool but have not yet clearly decided how else to use it. As shown in figure 2, almost half (i.e. 7) of the AM/AO that participated in EUROSFS 2022 do not yet know how to use the taxonomy exactly. It is clear, however, that AM/AO intend to use the taxonomy for more than reporting. This finding was confirmed in interviews. Engagement with investee companies and target setting seem to be the most attractive uses of the taxonomy, albeit still only indicated as relevant by less than half of the survey respondents.

Figure 2: Options to use the taxonomy beyond reporting (N=16, multiple answers possible)

2. AM/AO will use the taxonomy as one tool among others to select sustainable investments. Interviews confirmed that investors will look out for taxonomy-aligned companies in the future, with several interviewees even expecting high demand. However, the taxonomy is only one tool among many that AM/AO will use to select sustainable investments (see figure 3). It does not currently serve as the primary tool for many reasons, including that it does not (yet) cover all aspects of sustainability, uncertainty around the future availability and quality of data is still high, it is complex to use, and some AM/AOs' own standards are more ambitious. These challenges are described in greater detail in the chapter "Way forward". Moreover, recent regulation such as the Sustainable Finance Disclosure Regulation (SFDR) also requires or proposes the use of additional tools for identifying sustainable investments, including through the use of principle adverse impact indicators.

> *"The taxonomy should be part of a toolbox. [...] The market can decide which tool is best fit for the particular use."* (AM, USA)

Figure 3: Relevance of the taxonomy for defining environmental sustainability (N=16)

3. AM/AO have started setting targets for taxonomy alignment, yet the number of funds with such targets is limited. 7 out of 16 survey respondents intend to set targets on the share of taxonomy-aligned assets (under management) in the total portfolio or in fund-specific portfolios, making this the most commonly foreseen use of the taxonomy besides engagement with investees. However, respondents likely had different types of targets and ambition levels in mind when answering this question. While one respondent confirmed that by "targets" they refer to the "minimum extent" to which sustainable investments are taxonomy aligned, another respondent reported ambitious targets for total assets under management. Several interviewees mentioned challenges in setting taxonomy targets given the lack of data and the taxonomy's limited scope (described in chapter "Way forward"). However, the analysis of fund prospectuses found a small number of funds that specifically stated taxonomy alignment as their primary investment objective. Due to a current lack of data availability, these funds were not reporting 100% taxonomy alignment but may begin to do so in 2023. While such funds are a strong indication of taxonomy use as a tool for steering sustainable investments and for target setting, they represented less than 1% of the funds analysed. It was further confirmed in an interview that some new funds will explicitly target taxonomy alignment as their investment objective.

> *"It's agreed that it's not possible to be very ambitious with regard to taxonomy alignment."* (AM, Belgium)

> *"Our newest fund needs to be fully aligned with the taxonomy."* (AM, Spain)

4. The taxonomy will likely be used for engagement with investees and clients. 7 out of 16 respondents plan to engage with investees on the taxonomy, mostly to better understand taxonomy-related data and question results. Engaging with non-retail clients is also an option for 6 respondents, whereas engagement with retail clients is foreseen only by 4 respondents. This is against the background that 10 out of 16 survey participants agreed that "[t]he taxonomy is too complex for investors to understand – they will not use it to guide their decision making" (see figure 4).

5. Using the taxonomy as a negative screening tool is generally not an option for AM/AO. Only 3 out of 16 survey respondents plan to use the taxonomy's DNSH criteria as a minimum standard for investments even if they do not explicitly contribute to environmental sustainability. One respondent is considering divesting from entities whose activities are not (sufficiently) taxonomy aligned. Neither topic was further discussed in interviews.

AM/AO comply with mandatory entity-level reporting requirements according to NFRD but are hesitant to provide figures on the taxonomy alignment of financial products.

6. For entity-level reporting, AM/AO determine taxonomy eligibility themselves and with the help of third-party providers while first-hand data is still unavailable. AM/AO falling under the NFRD have to report the taxonomy eligibility of their assets (under management) for the first time in 2022. Although 2022 is also the first year that NFRD counterparties are required to publish taxonomy figures, relevant information was still largely unavailable at the time that many AM/AO were assessing their share of taxonomy-eligible assets for public disclosure. The review of 57 NFRD reports showed that in-scope AM/AO thus determined taxonomy eligibility using a combination of data from third party providers and their own information (e.g. on the asset class, such as real estate, or on NACE codes to indicate the primary economic activities of counterparties).

7. AM/AO mostly adhere to mandatory disclosures but also publish voluntary information in their NFRD-compliant reports. The NFRD defines certain mandatory reporting requirements (applying only to certain asset classes) but allows for voluntary reporting on the taxonomy eligibility/alignment of other assets. Of the 57 reports analysed in the desk research, about 32% provided voluntary disclosures, with transparency being the most commonly cited reason for inclusion along with limited data available for mandatory disclosures. For many AM/AO who had low mandatory disclosures (including 0%) due to an absence of data or activities in their portfolio being outside the scope of the taxonomy, presenting voluntary disclosures is one way to signal their willingness to embrace sustainability and provide greater transparency regarding their sustainable endeavours. Additionally, voluntary reporting also allows for companies to provide the eligible proportion of their full operations or investment profile as it may, for example, include both NFRD and non-NFRD entities.

8. Fund managers mostly disclose 0 percent taxonomy alignment of sustainable investments. As specified in the RTS/SFDR, investments may be considered "sustainable" if 1) they contribute to an environmental or social objective, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices or if 2) they are taxonomy aligned. Financial product providers need to determine to what minimum extent sustainable investments are aligned with either one of these two definitions. 84% of the analysed Article 9 fund prospectuses and 42% of Article 8 funds mentioned that underlying investments contribute to (at least) one of the six environmental objectives listed in the taxonomy. However, only 4.4% of the screened Art. 9 funds identify taxonomy alignment to be higher than 0%, and none of the Art. 8 funds determine minimum taxonomy alignment higher

> *"Taxonomy alignment will initially be in the low single-digit range. You cannot steer a portfolio based on such a quota."*
> (AM, Germany)

than 0%. The most important reason cited for this in interviews is to prevent greenwashing claims, given that reliable data to back up taxonomy-related commitments is still limited. More funds disclosed the share of sustainable investments as defined by option 1, though many funds did not disclose the exact share of sustainable investments at all. It was mentioned several times in interviews that the criteria for option 1 are better defined and easier to assess than taxonomy criteria. However, it was also said that better data and the expected rise in demand for taxonomy-aligned investments will lead to greater disclosure of taxonomy alignment in the future.

Way forward: Challenges and solutions

Insufficient availability and quality of data is the most prominent concern for AM/AO.

9. The use of the taxonomy is currently constrained by limitations in data availability, especially for certain asset classes. Non-financial companies will only have to provide data on their taxonomy alignment from 2023 onwards. Nevertheless, it is expected that even with company disclosures the quality of data will remain a major hurdle for the coming years (see finding #12). For other asset classes, including small- and medium-sized enterprises (SMEs), non-EU companies and sovereigns, data availability is even lower, posing challenges for AM/AO with high percentages of their portfolios invested in these assets. All interview participants and 53% of the reviewed NFRD reports directly mentioned that limited or non-existent client data leads to issues with providing mandatory disclosures. All survey participants have either SMEs or non-EU clients in their portfolios. The lack of data also affects the usability of the taxonomy to guide investments.

10. Taxonomy-related figures are difficult to interpret and compare. The taxonomy is meant to increase uniformity in the definition of "sustainable activities" but several factors make it difficult to interpret taxonomy-related data and compare it between companies, data providers and years:

"We compared our results with competitors and found it shocking how difficult it is to actually compare them." (AM, Germany)

- Given the lack of first-hand taxonomy data, data providers and AM/AO have to determine taxonomy eligibility/alignment themselves using "equivalent information" – a lack of detailed guidance for doing so causes a great variety of approaches in the reports and prospectuses assessed.
- Interviewees note that the first NFRD reports published by non-financial companies lack an explanation of methodology, making it difficult to understand how figures are determined and how to interpret differences between companies.
- Taxonomy alignment figures are not necessarily indicative of a company's sustainability. Low alignment may, for example, be the result of a conservative approach to confirming compliance when taxonomy criteria are unspecific and data quality and quantity is unsatisfactory.
- Whenever taxonomy criteria are based on directives, resulting taxonomy alignment is highly country specific, given that directives are enacted into national law differently. An example is the real estate sector, in which one criterion to prove the sustainability of buildings is a Class "A" European Energy Performance Certificate (EPC). However, EU countries were able to set stricter standards than suggested in the underlying EU directive. As a result, the EPC class of the same house can vary in different countries and so can its classification as sustainable.

Insufficient interpretability and comparability prevent AM/AO from understanding the development of the market and from basing investment decisions on this understanding.

11. Lack of high-quality data causes reputational risks for AM/AO. Especially in the first year(s) of taxonomy reporting, while market participants are still learning how to report taxonomy data and external assurance is voluntary, AM/AO have to base their reporting on unreliable data. Unclear or even factually wrong disclosures pose a major reputational risk for AM/AO. In light of recent controversies around sustainability marketing of fund managers, interview respondents perceived high reputational risks when using the taxonomy as a communication tool. To avoid risk, many AM/AO report zero or low alignment or choose not to label their financial products as sustainable, even if they could be classified as such (indicated by 3 out of 16 survey participants). Potential reputational risks are exacerbated by the timing mismatch between regulations. Since August 2022, AM/AO have to ask clients about their sustainability preferences and invest their capital accordingly. If clients express a preference for taxonomy-aligned investments, AM/AO need to determine which investments qualify as sustainable – which interviewees noted is difficult if taxonomy data is missing. As a result, AM/AO cannot provide adequate products and fulfil their duties towards clients. Several interviewees expressed frustration that this timing mismatch was not prevented by the EU Commission by way of delaying the applicability of respective regulations.

> *"From a reputation perspective, nothing is more dangerous than promising too much and ultimately not meeting the requirements."* (AM, Germany)

> *"If you see how data is gathered and managed and processed – even with future assurance, it's unclear who takes responsibility for data quality."* (AM, Belgium)

12. The expansion of corporate sustainability reporting in Europe and internationally will partially enhance the availability of data. AM/AO are aware of the fact that more data will become available in the future. The introduction of the Corporate Sustainability Reporting Directive (CSRD) will increase the amount of available data for European large corporates and, from 2026, SMEs. Internationally, the development of a climate reporting standard by the International Sustainability Standards Board might boost data availability for investments contributing to the taxonomy's climate goals but less for the other four environmental goals. Furthermore, data availability might increase for companies based in regions or countries that are implementing their own green or sustainable taxonomies with similar criteria. Nevertheless, additional reporting will suffer from the same challenges described above – lack of reliability, interpretability and comparability. Interviewees thus expressed the need for international harmonization and for continuing to seek an approach that minimizes reporting requirements while maximizing informational value (especially for SMEs).

13. AM/AO expect for the market to converge around adequate data quality over time. Survey and interview participants tend to trust that data quality will generally become better in the future as companies and data providers compare their data outputs to those of others and model best practices from results that get the most public approval. Moreover, external verification is becoming mandatory, which will further improve the quality of data. However, even external verification has significant variation between providers, and it is unclear who will take responsibility for data quality. This will have to be clarified.

> *"Preparers need to learn how to disclose, users need to learn how to use the results."* (AO, Europe)

> *"Our preferred data provider showed very high taxonomy alignment. Its new figures are now lower and more in line with other providers."* (AM, Belgium)

14. As long as data is insufficient, training and expectation management are crucial. AM/AO need to comply with disclosure and other requirements, such as asking clients about sustainability preferences. To avoid reputational risks, financial advisors – i.e. those that explain figures to clients – will have to be trained in order to understand the different elements of the taxonomy. Several interviewees also mentioned that official communication by the EU Commission on the expected quality of results and the underlying challenges would be helpful – not to reduce market participants' ambitions, but to manage expectations while the market is still developing.

15. Official guidance will be helpful to improve data – if it becomes available soon. All survey participants would find it helpful to develop more guidance on the use of "equivalent data" and on how to score companies in the absence of data. However, interviewees mentioned that such guidance should be provided quickly to avoid interference with market standards that may develop over time. Additionally, or alternatively, it is crucial for authorities to support non-financial companies in reporting so that AM/AO can then use that data.

> *"It's tricky because companies hire consultants and get different answers, so they make strategies based on that and don't want the EU Commission telling them they are doing things wrong."* (AO, Sweden)

Besides lack of data, AM/AO identify several challenges that reduce the usefulness of the taxonomy for steering capital towards a sustainable economy.

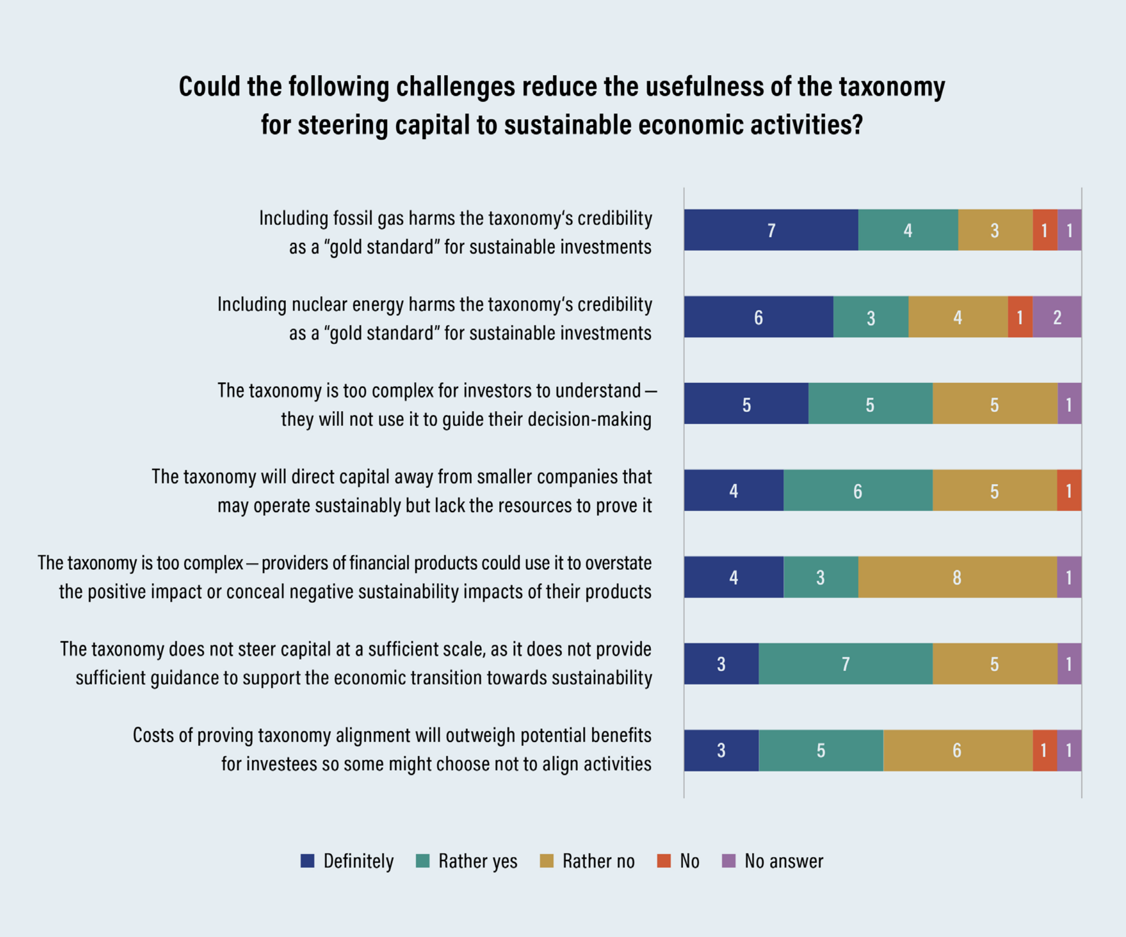

Figure 4: Challenges that reduce the usefulness of the taxonomy (N=16)

AM/AO are concerned with the narrow scope of the taxonomy, yet do not fully agree about options for expanding or complementing the taxonomy.

16. The concentration of the taxonomy on certain activities and asset classes limits its usability for disclosures and investment steering. 33% of NFRD reports reviewed mention issues with providing disclosures given the current limited scope of the taxonomy. Limitations exist with regard to both the types of assets for which taxonomy alignment can be reported and the activities that can be considered sustainable:

> *"As of today, the impact of the taxonomy is not great due to the limited coverage. But it will have a major impact once it reaches market maturity"* (AM, Germany)

- Key performance indicators (KPIs) for entity-level eligibility and alignment reporting are limited to certain types of assets. Exposures to non-NFRD companies and central governments, for example, should not be considered when determining which parts of a financial companies' assets (under management) are taxonomy aligned (although non-NFRD companies should be considered in the denominator of the KPIs). Hence, AM/AO that invest mostly in SMEs (such as private equity firms), hold highly diversified portfolios (such as insurances), or invest in non-EU companies (such as certain fund managers) will have comparatively low alignment. As a result, some of the survey participants are in favour of changing the rules as to which entities can be considered for taxonomy reporting. Whereas 3 respondents are in favour of not reporting for such "excluded" entities because it is too difficult, another 3 want to allow for full inclusion in KPIs to better reflect taxonomy alignment of portfolios.
- Many benchmarks or portfolios are diversified and invested in sectors that are currently not covered by the taxonomy. This includes sectors such as pharmaceuticals or consumer products. The taxonomy's focus on activities that substantially contribute to an environmental objective – rather than only avoid harm to objectives – thus results in low levels of taxonomy alignment for funds in these sectors. However, while this is perceived as a challenge by some, others see this as an opportunity to ensure an ambitious definition of "sustainable activities".

Overall, AM/AOs face difficulties in explaining low levels of alignment to (retail) investors and in meeting the large demand for sustainable investments.

17. AO/AM emphasise the need to support the economic transition. As green economic activities are considered well-funded (e.g. renewable energy), AM/AO point out that more funding is needed to transform unsustainable or neutral activities. Moreover, demand for impactful/sustainable investments by far exceeds taxonomy-eligible/-aligned assets. A transition taxonomy that recognizes, fosters and finances the transition is an option that around three quarters of survey participants find valuable. However, several interview participants cautioned that a transition taxonomy could dilute the definition of "sustainable". Others point to the fact that expanding the taxonomy concept to the entire economy may increase complexity too much for AM/AO.

> *"The taxonomy was originally created to identify* sustainable *activities. With the discourse about a transition taxonomy the concept of sustainability is also being extended."* (AM, Germany)

18. Expanding the taxonomy by the missing environmental objectives will make it more relevant. AM/AO anticipate and welcome that as the framework of the taxonomy expands to include more economic activities and environmental objectives, their share of aligned activities will also expand. Some participants and interviewees thus called for urgent implementation of the four missing environmental objectives.

> *We always think about new products. As the climate space fills up, appetite for biodiversity funds is growing.* (AM, USA)

Including controversial activities in the taxonomy will harm its status as a "gold standard", but does not have an immediate impact on many AM/AOs' investment strategies.

19. For controversial activities, AM/AO mostly rely on their own standards. Public discussions around the criteria definitions for certain activities – most prominently the fossil gas and nuclear energy sectors, but also others such as forestry in the case of Finland – are harming the credibility of the taxonomy for clients and affecting its usefulness as a quality label, as indicated by several interviewees and survey participants (see figure 4). However, as many AM/AO already have defined entity- and product-level investment strategies, the inclusion of such activities in the taxonomy appears to have a limited impact on sustainable investment practices. The survey showed that most respondents will continue to treat fossil gas and nuclear energy as they did before, whereas only one respondent will now consider them sustainable even though this was not the case before. Three survey participants are still undecided and prefer to wait for the market and clients to take a clearer stance on these controversies.

The taxonomy is a complex tool and leaves smaller AM/AO in particular need of support.

20. Its complexity makes the taxonomy hard to handle for many AM/AO. 10 out of 16 AM/AO confirm that they either definitely or most likely lack the required expertise, tools and procedures to conduct taxonomy assessments internally. This prevents them from determining taxonomy alignment for entities that do not report themselves and for which no third-party data is available (e.g. SMEs). The lack of technical expertise additionally makes it difficult for some AM/AO to assess their investees' taxonomy-related disclosures and ask meaningful questions. Despite this challenge, only 3 respondents indicated that (taxonomy-related) reporting requirements kept them from labelling funds as sustainable. At the same time, taxonomy assessment is also difficult for investee companies and some investors agreed that high costs (including for internal taxonomy-related capacity building) may keep investees from classifying their activities as taxonomy aligned. The lack of expertise is especially evident for smaller entities (e.g. AM/AO with few staff members but large balance sheets). Seven survey respondents expressed concern that the lack of capacity to fully understand taxonomy-related data could allow financial product providers to either overstate the positive impact of their financial products or conceal negative sustainability impacts.

> *"If taxonomy assessment needs complex or lengthy internal research then it cannot be done by small companies, they would get squeezed out from sustainable activity."* (AM, Hungary)

21. AM/AO request support for applying the taxonomy. Capacity building with training courses, guidelines, templates, etc. is perceived as rather/very helpful by 13 out of 16 survey respondents. However, such capacity building needs to be tailored closely to different target groups. Respondents are also in favour of facilitated peer exchange – if organized in small homogenous groups. Newsletters and e-mail notifications on taxonomy-related changes is perceived as rather/very helpful by 12 respondents. The idea to establish an official helpdesk that can answer questions is supported by 9 respondents but rejected by 4. One of the interviewees explained that questions should not be discussed in bilateral settings, i.e. between the helpdesk and individual AM/AO. Guidance should instead be published for all AM/AO to access, use and comment on.

> *"We would like to have significantly more support from those who invented the taxonomy. This includes people to contact in case we have questions."* (AM, Germany)

Although its practical use is still limited, the taxonomy has positive effects on the market.

22. Despite challenges, many AM/AO confirmed in interviews and survey responses that the taxonomy has a positive effect on the market. One of the most relevant impacts of the taxonomy is putting the topic of sustainable investment at the heart of political discussion and on the agenda of management boards. The implementations of the taxonomy, SFDR and NFRD ensure that sustainable investment indicators now have to be addressed from multiple directives and have become a core issue for both investees and investors.

> *"The taxonomy has brought the sustainability dialogue to the forefront."* (AO, Finland)

> *"Risks and opportunities are there but it is simply required to have that regulatory push."* (AM, Belgium)

Annex

Methodology

Survey methodology

EUROSFS 2022 consisted of two distinct surveys – one addressing AM/AO and the other addressing their associations – to collect a wide range of opinions on the taxonomy.

Survey for AM/AO: See https://surveys.adelphi.de/index.php/162564?lang=en

The survey invitation was shared with a large number of AM/AO via newsletters (e.g. UNPRI, FNG) and through direct e-mailing. The survey was answered by 16 AM/AO. Of these, 9 provided written responses to the survey and participated in in-depth interviews and 7 provided only written responses. Table 1 provides an overview of the countries where survey and interview respondents are located.

Country	Survey	Interviews
Belgium	1	1
France	0,5[3]	0,5
Germany	6,5	3,5
Liechtenstein	1	1
Poland	1	1
Spain	1	1
Slovenia	1	-
Sweden	1	-
Switzerland	1	-
US	2	1
TOTAL	16	9

Table 1: Number of participants per country

Type of Institution	Survey	Interviews
Investment firm which provides portfolio management	4	2
Fund manager	5	4
Investment firm *and* fund manager	4	2
Investment firm *and* fund manager *and* insurance	1	-
Pension fund	1	-
Private equity	1	1
TOTAL	16	9

Table 2: Distribution of the partcipating AM/AO by institution type (respondents were given the choice to identify as more than one type of institution)

[3] One participant is based in France and Germany

Survey for associations: See https://surveys.adelphi.de/index.php/361729?lang=en

The survey invitation was shared with AM/AOs' associations by e-mail. The survey was answered by 5 associations. Of these, 3 provided written responses to the survey and participated in in-depth interviews, one provided only written responses and two participated only in an interview. Table 3 provides an overview of countries covered by the survey and interviews.

Country	Survey	Interviews
Belgium	-	2
Finland	1	1
Hungary	1	1
Portugal	1	-
Sweden	1	1
TOTAL	4	5

Table 3: Countries covered by survey and interviews

Desk research methodology

As part of the desk research, two types of document were researched and analysed: 1) entity-level reports that AM/AO publish to comply, among other things, with disclosure requirements specified by the NFRD / Article 8 Delegated Act; 2) fund prospectuses that contain information on financial products' sustainability according to the SFDR / RTS.

NFRD/Article 8 research: A review of 200 asset managers and asset owners was undertaken to see whether or not taxonomy-relevant information had been provided as of early August 2022. These 200 AM and AOs were randomly selected using data from Morningstar, the Sovereign Wealth Fund Institute and the European Fund and Asset Management Association on the largest asset managers and owners in Europe. An initial review of the annual reports and sustainability/ESG reports from 2021 for these 200 AM/AOs was conducted to determine if taxonomy-eligible disclosures were made. From there, 57 total reports (30 by AM and 25 by AO) were found to contain said disclosures and a systematic review was performed to see what information was disclosed, how it was disclosed and to identify any key trends and/or issues.

Country	Number of NFRD reports
Austria, Hungary, Liechtenstein, UK, Slovenia	1 each
Italy, Switzerland	2 each
Belgium, France, Norway, Spain	3 each
Denmark	5
Finland, Sweden	6 each
Netherlands	8
Germany	11
TOTAL	57

Table 4: Countries covered by NFRD desk research

SFDR research: An analysis of 221 Article 8 and Article 9 funds from 50 different AM was conducted in August 2022 to ascertain the degree to which the taxonomy is currently being used in SFDR disclosures. The AM were chosen at random, and AM with no Article 8 or 9 funds were not considered. The funds analysed had underlying investments in equities, bonds, and other assets. Green bond funds were excluded from the analysis due to having their own sustainability criteria.

SFDR fund classification	Number of funds analysed
Article 8	130
Article 9	91

Table 5: Number of Article 8 and 9 funds analysed

Country	# of AM per country	Country	# of AM per country
Germany	9	Netherlands	2
UK	8	Spain	2
Switzerland	7	Austria	1
France	6	Belgium	1
Sweden	3	Finland	1
USA	3	Italy	1
Denmark	2	Liechtenstein	1
Luxembourg	2	South Africa	1

Table 6: Asset managers analysed per country

The main research question for this analysis was the following: **To what extent have asset owners started using the sustainability criteria as defined by the taxonomy to guide their investment choices?** More specifically, the analysis screened for the following questions:

1. Did the prospectus state that underlying fund investments either contribute or intend to contribute to one or more of the taxonomy objectives?
2. Did the prospectus state that underlying fund investments are taxonomy eligible or aligned, are screened for taxonomy eligibility, or would seek higher exposure to taxonomy-eligible investments when data becomes more readily available?
3. Did the prospectus state that the taxonomy technical screening criteria are used or will be used to screen investments?
4. Did the prospectus state that all or a portion of the underlying fund investments consider the taxonomy "do no significant harm" criteria?
5. Did the prospectus provide a minimum percentage of investments that are taxonomy eligible or aligned?

This screening was conducted by searching for key words including *taxonomy, SFDR, Article 8, Article 9, DNSH, technical screening criteria,* and *disclosure regulation*. For prospectuses not in English, these words were translated to the relevant language.

Criteria	% of Art. 8 funds that mention criteria	% of Art. 9 funds that mention criteria
Objectives mentioned	42%	84%
Eligibility mentioned	32%	73%
DNSH mentioned	42%	47%
TSC mentioned	13%	25%
Minimum threshold	0%	5%

Table 7: Percentage of funds that mention criteria screened for in analysis

Taxonomy-related reporting requirements for AM/AO

The following taxonomy-related disclosure requirements may apply to AM/AO, depending mostly on their size and on the financial products they offer:

NFRD / Article 8 reporting

Who? AM/AO falling under the Non-Financial Reporting Directive (NFRD, 2014_95), i.e. large public interest entities. The NFRD will be updated to become the Corporate Sustainability Reporting Directive (CSRD) in the coming years and will then apply to all large companies and listed small- and medium-sized enterprises, expanding the range of in-scope AM/AO.

What and when? As specified in the Taxonomy Regulation (TR, 2020_852), "Article 8" Delegated Act (2021_2178) and FAQs (European Commission 2021/2022), in-scope AM/AO have to report on how and to what extent their assets (under management) are taxonomy eligible/aligned:

- In 2022 and 2023, an initial simplified reporting approach is applied whereby financial companies only need to report on their proportion of taxonomy-*eligible* activities, irrespective of whether the activities meet any and/or all of the technical screening criteria.
- From 2024, financial companies need report on their proportion of taxonomy-*aligned* economic activities.

AM/AO have to make certain mandatory disclosures but can also disclose information voluntarily:

- *Mandatory* reporting requirements apply only to certain assets, such as investments into companies that fall under the NFRD. Mandatory disclosures must be based on direct information provided by the respective counterparties.
- Reporting on the taxonomy eligibility/alignment of other assets, such as taxonomy-aligned debt securities that are issued by central governments, central banks or supranational issuers or exposures to non-NFRD companies, is *voluntary*. The degree of taxonomy alignment of such exposures must be reported on separately from mandatory disclosures but should not be given more prominence. Figures can be based on estimated data. This option allows for more leeway for disclosure in the case that financial institutions have difficulty in obtaining required information from their counterparties or investees during the first few years, and enables them to report on the eligibility of their full balance sheet or investment profile.

SFDR / RTS reporting

Who? AM/AO that that fall under the definition of financial market participant (FMP)[4] or act as financial advisers.

What and when? As specified in the TR, Sustainable Finance Disclosure Regulation (SFRD, 2019_2088), Regulatory Technical Standards (RTS, 2022_1288), European Supervisory Authorities (ESA) clarifications (JC 2022 23) and an ESA Supervisory Statement (JC 2022 12), in-scope AM/AO have to disclose various types of entity- and product-level information – including but *not limited* to the taxonomy.

[4] Insurance undertakings making available Insurance-Based Investment Products (IBIPs), Institutions for Occupational Retirement Provision (IORPs), Manufacturers of pension products, Pan-European Personal Pension Product (PEPP) providers, Alternative Investment Fund Managers (AIFMs), Undertakings for Collective Investment in Transferable Securities (UCITS) management, Investment firms or credit institutions providing portfolio management

Taxonomy-related information has to be disclosed only for Article 8 and Article 9 financial products[5], including in pre-contractual disclosures, periodic reports and on websites. More specifically, managers of Article 8 or 9 financial products that make **sustainable investments into economic activities that contribute to an environmental objective as defined by the taxonomy** need to disclose the following:

01-12/22 for investments contributing to the first two environmental objectives defined in the TR[6], **according to the TR itself**:	**From 01/23** for investments contributing to the first two env. objectives defined in the TR, and from 01/24 for investments contributing to all env. objectives, **according to the RTS and using the templates provided in the RTS**:
• information on the environmental objective(s) to which the investment underlying the financial product contributes; • a description of how and to what extent the investments underlying the financial product are in taxonomy-aligned economic activities Since the RTS only apply from 2023, the ESAs' have provided supervisory expectations for compliance with these requirements during the interim period. Disclosures made in 2022 may also voluntarily follow the requirements of the RTS.	• to which environmental objective(s) the sustainable investments contribute and how • to what minimum extent[7] such investments are aligned with the taxonomy (including a graphical representation and additional descriptions, see RTS Articles 15 and 19) • the minimum share of investments in transitional and enabling activities • in period reports: how the percentage of taxonomy-aligned investments compared with the previous reference periods

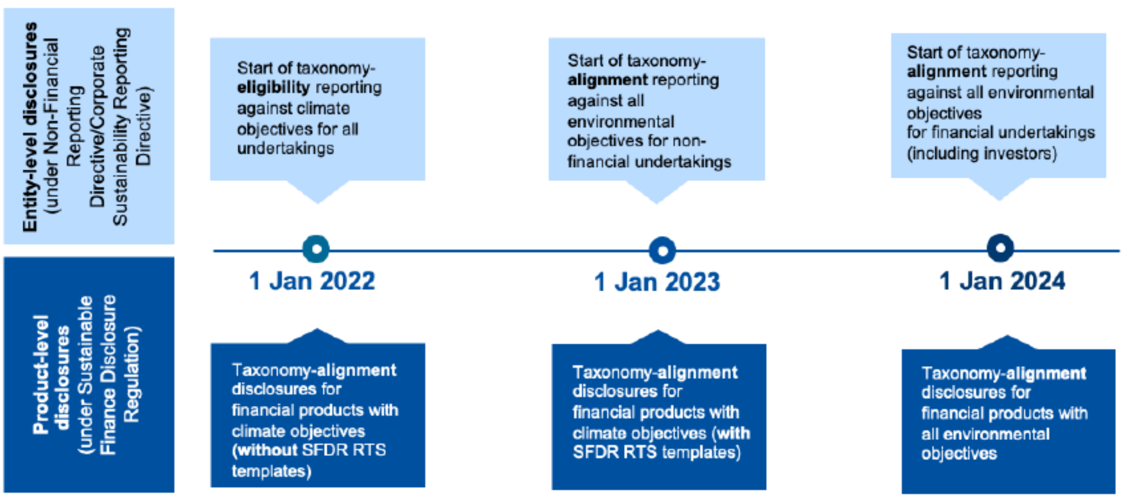

Figure 5: Timeline for entity- and products-level disclosures under NFRD and SFDR (source: UN PRI 2022)

[5] Article 8 products: Financial products that promote environmental and/or social characteristics; Article 9 products: Financial products with sustainable investment as their objective
[6] The taxonomy defines six environmental objectives: 1) Climate change mitigation, 2) Climate change adaptation, 3) The sustainable use and protection of water and marine resources, 4) The transition to a circular economy, 5) Pollution prevention and control, 6) The protection and restoration of biodiversity and ecosystems
[7] The ESAs consider that the commitments on the "minimum proportion" of taxonomy-aligned investments are intended to be binding commitments to ensure transparency to end investors on the taxonomy ambitions of the financial product.

Acknowledgements

The authors thank the survey participants and interviewees for their time and support. The authors also thank the organizations that supported the implementation of the survey: UN PRI, EFAMA and others.

Abbreviations

AM	Asset manager
AO	Asset owner
CSRD	Corporate Sustainability Reporting Directive
DNSH	Do no significant harm
EPC	Energy Performance Certificate
ESA	European Supervisory Authority
ESG	Environmental, social, and governance
EUROSFS	European Sustainable Finance Survey
FMP	Financial market participant
KPI	Key performance indicator
NACE	Statistical classification of economic activities in the European community
NFRD	Non-Financial Reporting Disclosure
RTS	Regulatory Technical Standards
SFDR	Sustainable Financial Disclosure Regulation
SME	Small and medium-sized enterprise
TR	Taxonomy Regulation

References

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.* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2178&from=EN

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 (…).* *https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32022R1288&from=EN*

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*. https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

European Commission, n.d.: *EU taxonomy for sustainable activities*. https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en

European Commission (2021/2022): FAQs: 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? https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-article-8-report-eligible-activities-assets-faq_en.pdf

Joint Committee (JC) of the EU Supervisory Authorities (2022): Clarifications on the ESAs' draft RTS under SFDR, JC 2022 23, 2 June 2022. https://www.esma.europa.eu/press-news/esma-news/esas-provide-clarifications-key-areas-rts-under-sfdr

Joint Committee (JC) of the EU Supervisory Authorities (2022): Updated Joint ESA Supervisory Statement on the application of the Sustainable Finance Disclosure Regulation, JC 2022 12, 24 March 2022. https://www.esma.europa.eu/press-news/esma-news/esas-issue-updated-supervisory-statement-application-sustainable-finance

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.* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R2088&from=de

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.* https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020R0852&from=EN

UN PRI (2022): Investor briefing, EU taxonomy, updated April 2022. https://www.unpri.org/download?ac=14786