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EBA Regular Use

Opinion of the European Banking Authority on the disclosure requirement on environmentally sustainable activities in accordance with Article 8 of the Taxonomy Regulation

Response to the European Commission's call for advice on KPIs and methodology for disclosure by credit institutions and investment firms under the NFRD on how and to what extent their activities qualify as environmentally sustainable according to the EU taxonomy regulation

Introduction and legal basis

Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment (Taxonomy Regulation)¹ requires in Article 8 that any undertakings subject to disclosure obligations under Directive 2014/95/EU on non-financial reporting (NFRD)² shall disclose in their non-financial statements or consolidated non-financial statements information on how and to what extent their activities are associated with economic activities that qualify as environmentally sustainable under that Regulation. In September 2020, the Commission sent a call for advice (CfA)³ to the three ESAs on key performance indicators (KPIs) and methodologies for the implementation of these disclosures by the undertakings under their remit (credit institutions and investment firms in the case of the EBA).

The CfA includes three specific questions that the EBA is asked to answer:

- What information should banks and investment firms subject to the NFRD disclose (e.g. as part of their prudential and broader ESG disclosures) on how their financial or broader commercial activities align with economic activities identified as environmentally sustainable in the EU taxonomy, whether carried out in-house or performed by third parties? Which financial or commercial activities should be included/excluded?
- If turnover, OpEx and CapEx were not considered appropriate, what alternative indicators would achieve the same purpose? What KPIs are best suited to disclose information identified in (1) above? What should constitute the numerator and the denominator for a specific KPI for banks and investment firms?
- Could the green asset ratio be adapted to include taxonomy-related disclosures?

The EBA's competence to deliver an opinion is based on Article 16a(4) of Regulation (EU) No 1093/2010⁴, as the EBA may, upon request, provide technical advice to the Commission on the topics related to its area of competence.

¹ 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, (OJ L 198, 22.6.2020, p.13).

² 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, (OJ L330, 15.11.2014, p.1).

³ https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/200915-sustainable-finance-taxonomy-call-for-advice_en.pdf

⁴ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors⁵, the Board of Supervisors has adopted this opinion, which is addressed to the Commission.

General proposals

This Opinion puts forward the EBA advice on KPIs and related methodology for the disclosure by credit institutions and by investment firms of information on how and to what extent their activities related to economic activities that are environmentally sustainable in accordance with the Taxonomy Regulation. It also advises on the qualitative information that institutions should disclose under Article 8 of the Taxonomy Regulation and on policy recommendations to the Commission, with a view to facilitating transparency and disclosure by institutions.

The EBA recommends the following:

Scope of the disclosures – Determination of activities to be included and definition of the numerator and denominator of the KPI

When assessing which financial and commercial activities should be included in the information that banks and investment firms should disclose, the EBA has considered the nature of all financial activities (investments and lending) and commercial activities (services provided other than lending and asset management) and also if the sustainability assessment in line with the Taxonomy Regulation can be conducted either on the basis of mandatorily disclosed information or application of the taxonomy screening criteria. Considering both perspectives, the EBA recommends that the following scope should be included at this stage, while providing, as part of this Opinion, policy recommendations aimed at enlarging this scope in due course:

- Where institutions' counterparties or clients will be obliged to disclose relevant information (in accordance with Article 8 of the Taxonomy regulation), or where it is possible to reasonably assess the alignment of their investing or lending portfolio with the Taxonomy through the application of the taxonomy screening criteria to the activities and counterparties financed, the EBA's advice is that those activities should be included in the disclosures.
- Conversely, where counterparties and clients are not obliged to disclose relevant information and their economic activities cannot be mapped or assessed according to the taxonomy screening criteria in a systematic and comprehensive way that ensures the reliability of the information disclosed, the EBA's advice is not to include these activities in the information to be disclosed. While this proposal is proportionate, the EBA recognises that certain exposures, such as government and central banks, cannot be considered at this stage and advises on a sequential approach in the Policy recommendations section of this Opinion to gradually extend the scope of the disclosures to cover all activities and exposures.
- The KPI ratios should always be measured consistently, so if certain activities/investments are excluded from the numerator they should also be excluded from the denominator. Including

⁵ Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

them in the denominator but not in the numerator would in practice be equivalent to assuming that no part of the activity is associated with environmentally sustainable activities, which is inaccurate, as in reality there is no methodology or public information that allows that sustainability to be assessed. Alternatively, the EBA's advice is that institutions should disclose together with the value of the KPI, information on its coverage (e.g. proportion of total assets covered by the KPI). This approach aims at ensuring that the KPIs disclosed are comparable across institutions, and at the same time meaningful, preventing the possibility of improving the value of the KPI without actually increasing the proportion of sustainable investments, for instance, by reducing those investments (e.g. sovereign bonds) whose sustainability cannot be assessed at this stage.

EBA advice to the Commission on key performance indicators for credit institutions' disclosures

KPIs in terms of turnover, capital expenses (CapEx) and operational expenses (OpEx) proposed by Article 8 of the Taxonomy Regulation for non-financial undertakings are not considered appropriate for credit institutions:

- a KPI in terms of turnover is not relevant given the variety of counterparties and economic activities financed by banks, the different sources of income they rely upon and the structure of their profit and loss accounts;
- on the other hand, the main sources of credit institutions' greenhouse gas emissions (GHG) are scope 3 emissions coming from their counterparties, and not scope 1 direct GHG emissions or scope 2 GHG emissions linked to their own consumption of purchased electricity, heat, or steam. Consequently, indicators defined in terms of OpEx or CapEx devoted to investments or maintenance of activities aimed at reducing scope 1 and 2 GHG emissions are not relevant for credit institutions either.
- The same reasoning and conclusions apply to investment firms.

The EBA recommends to the Commission that the following indicators should be applied as an alternative.

Green asset ratio - Credit institutions should disclose their green asset ratio (GAR) to show the extent to which the financing activities in their banking book (including loans and advances, debt securities and equity instruments in the banking book) are associated with economic activities aligned with the EU Taxonomy and are therefore Paris Agreement- and SDG-aligned.

- The GAR should cover all exposures in the banking book to financial and non-financial corporates (NFC) including SMEs, households (residential real estate, house renovation loans and motor vehicle loans only) and local governments/municipalities (house financing), including loans and advances, debt securities, equity instruments and repossessed real estate collaterals.

- Exposures to general governments other than municipalities and to central banks should not be considered at this stage in either the numerator or the denominator, due to the lack of an applicable taxonomy or of standard disclosure obligations for these counterparties. The Commission should consider the eligibility of sovereign bonds and/or central bank exposures for the KPI when reliable disclosures or a methodology for deriving the extent of their taxonomy alignment are available.
- Credit institutions with subsidiaries outside the EU: the EBA acknowledges the additional challenges of collecting relevant information for exposures to non-EU counterparties, as the EU Taxonomy and the NFRD apply only at EU level, and a proportionate approach is being proposed. The EBA recommends that these institutions should disclose their GAR at EU level, for exposures to EU counterparties. In addition, given the relevance of their non-EU exposures, they should identify lending and equity exposures in the banking book to non-EU counterparties that pertain to sectors (NACE sectors 4 levels of detail) covered by the taxonomy. Then, proxies should be used to determine, on a best effort basis, estimates and ranges on the part of those exposures aligned with the Taxonomy, and this information should be disclosed separately from the EU GAR with appropriate caveats.

Trading portfolio - The EBA recommends that assets in the **held for trading portfolio** are excluded from the computation of the GAR, given their volatile and variable nature and that the purpose of this portfolio is different from that of the banking book. The EBA advises that, alternatively, credit institutions should disclose the following information, taking into account a proportionate approach.

- Institutions should separately disclose information on the overall sustainability, composition, trends and limits, and investment policy of their trading book.
- In addition, the EBA recommends that those **credit institutions with a significant trading book**, above a minimum threshold⁶, should provide more detailed and granular disclosures on the proportion of absolute transactions (purchases plus sales carried out during the disclosure period) on debt and equity securities relating to corporates subject to NFRD disclosure obligations that are taxonomy-aligned compared to total transactions on debt and equity securities relating to corporates subject to NFRD disclosure obligations.

Off-balance-sheet exposures – The EBA recommends that institutions should disclose a KPI on the proportion of taxonomy-aligned financial guarantees backing lending exposures, and a KPI on proportion of taxonomy-aligned assets under management, for guarantee and investee companies subject to NFRD disclosure obligations.

Fee and commission income - Furthermore, the EBA recommends that institutions should disclose information on the part of their services other than lending and asset management associated with economic activities that qualify as environmentally sustainable. For this purpose:

⁶ In particular those institutions that do not meet the conditions set out in Article 94(1) CRR or the conditions set out in Article 325a(1) CRR

- Institutions should show the proportion of their fee and commission income, generated by services other than lending and asset management, related to NFCs subject to the NFRD, and linked to economic activities aligned with the Taxonomy, based on the information on the percentage of taxonomy-aligned turnover (or relevant KPIs in the case of financial corporates) that their customers will have to disclose in accordance with Article 8 of the Taxonomy Regulation.

Methodology

The EBA specifies in detail in the attached report the methodology for the estimation of the GAR and other KPIs for the objectives of climate change mitigation (CCM) and climate change adaptation (CCA), and gives general guidance for the other objectives, as the screening criteria are still to be defined. The EBA recommends the following methodology for the estimation of the GAR.

- Credit institutions should determine the level of alignment of specialised lending exposures with the Taxonomy on a case by case basis, based on the level of alignment with the taxonomy screening criteria of the project and activity financed, and on ad hoc information provided by the counterparty.
- For general purpose lending/financing to corporates, taxonomy alignment should be determined based on the proportion of the turnover (or relevant KPIs for financial corporates) of the counterparty related to taxonomy-aligned economic activities, based on the information that these will have to start disclosing from January 2022, in accordance with Article 8 of the Taxonomy Regulation, or on information collected on a bilateral basis as part of their credit review and monitoring process for corporates not subject to NFRD disclosure obligations.
- For residential real estate loans, commercial real estate exposures to non-NFRD NFC, housing loans to municipalities, retail car loans, and repossessed real estate collaterals, the estimation of the GAR should be based on the energy performance of the underlying collateral/asset, based on the energy performance certificate label (EPC), in line with the screening criteria proposed in the Taxonomy for the acquisition of buildings (old and new), renovation of buildings, and for transport in the case of car loans.
- Institutions are asked to disclose the aggregate GAR and the breakdown by environmental objectives (for climate change mitigation and climate change adaptation initially), and for stock and new loans, to show the current position of the institution (stock of loans) and the evolution towards sustainability (new loans). The disclosure of the GAR should also include a breakdown between transitional/adaptation activities (activities that are substantially contributing to the objectives of climate change mitigation and adaptation), and enabling activities (those activities that enable other activities that substantially contribute to the climate change objectives). Finally, institutions should include a breakdown on the part of the GAR related to specialised lending, to show the extent to which they are financing their counterparties' investment (CapEx) aimed at becoming more sustainable.

- Finally, institutions should show the overall level of alignment of their eligible financing activities (including lending and equity holdings) with the Taxonomy. For this purpose, they should disclose the **total green asset ratio of the institution (TOTAL GAR)**, showing the aggregate ratio for all eligible on-balance-sheet exposures, based on the calculation of the partial KPIs explained in the previous paragraphs. Institutions should disclose together with the value of the KPI, the coverage of the TOTAL GAR (percentage of institutions' total assets considered in the GAR calculation), in order to facilitate the comparability of disclosures across institutions.

For the computation of the KPIs for off-balance-sheet exposures, and for the trading portfolio when relevant, the methodology should be similar to that proposed for the GAR calculation, based on the guarantee companies' and investee companies' own disclosures, with the exception of financial guarantees and AuM in those cases where the financing has a special purpose, where the assessment should be made taking into account the underlying loan (for financial guarantees) or debt security (for AuM).

Timeline

In the interests of proportionality:

- A transition period until December 2022 is proposed for the GAR on the stock of loans when the counterparty is subject to the NFRD, and until June 2024 otherwise. Proxy information in terms of estimates and ranges can be disclosed during this period, including as a fallback solution the use of sector-based alignment coefficients estimated under a common methodology developed by an independent EU body⁷.
- The first disclosure for the financial year 2021 should not apply retroactively: For those disclosures that are applicable from 1 January 2022, the first disclosure should cover the financial year 2021 only, and for those disclosures applicable from 1 January 2023, the first disclosure should cover the financial year 2022 only.

Credit institutions should disclose the information required by using the templates included in Annex I to the report enclosed with this Opinion.

⁷ The Commission Joint Research Centre (JRC) (in collaboration with the University of Zurich) has estimated coefficients on the level of alignment with the Taxonomy of NFC activity at EU level, by NACE sector, for the environmental objective of climate change mitigation. These coefficients are publicly available in this link: JRC-UZH_Taxonomy-alignment_tool Alessi, L., Battiston, S., Melo, A. S., & Roncoroni, A. (2019). The EU Sustainability Taxonomy: a financial impact assessment. JRC Technical Reports. <https://doi.org/10.2760/347810>

These coefficients could be used by institutions as a proxy for the level of alignment of their counterparties with the Taxonomy to provide estimates and ranges for the objective of climate change mitigation in the absence of relevant data during the transitional period.

EBA advice on key performance indicators for investment firms' disclosures

Investment firms' services and activities are set out in Section A and Section B of Annex I of Directive 2014/65/EU.⁸ The EBA recommends the following KPIs for the disclosure by investment firms' of information in accordance with Article 8 of the Taxonomy Regulation:

- For 'dealing on own account' activities, investment firms should disclose the GAR based on the assets under investment;
- For their investment services and activities other than dealing on own account, investment firms should disclose a KPI based on fees, commissions and other monetary benefits related to their activities;
- The EBA advises that investment firms' ancillary services be left outside the scope of the KPIs and methodology proposed.

The EBA recommends the following scope and methodology for the computation of the KPIs for investment firms' disclosures related to 'dealing on own account' activities.

- Debt securities, equity securities and derivatives (which should be limited to the eligibility of the underlying asset within the EU Taxonomy) in investee firms, including non-financial and financial corporates.
- Investments in sovereign exposures are not considered eligible at this stage, due to the lack of an applicable taxonomy and standard disclosure obligations. Similarly, investments outside the EU should be left outside the scope of the GAR in the absence of common disclosure requirements and methodology, as the EU Taxonomy and the NFRD apply only at EU level. The Commission should consider the eligibility of sovereign bonds or investments outside the EU for the KPI when reliable disclosures or a methodology for deriving the extent of their taxonomy alignment are available.
- Investment firms should calculate the GAR on the basis of the information disclosed by the investee companies regarding the proportion of their turnover (or relevant KPIs for financial corporates) derived from products or services associated with economic activities that qualify as environmentally sustainable in accordance with the Taxonomy Regulation. The GAR should indicate the share of investments linked to activities aligned with the EU Taxonomy in total eligible investments. Investment firms should engage with the investee companies bilaterally when the investee companies are not subject to disclosure obligations under NFRD and such information is not available.

Investment firms' disclosures related to investment services and activities other than dealing on own account.

⁸ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance

OJ L 173, 12.6.2014, p. 349–496

- The KPI should cover all eligible services and activities provided to non-financial and financial corporates.
- The KPI should indicate the extent to which the revenue (i.e. fees, commissions and other monetary benefits) related to their investment services and activities is classified as sustainable. More precisely, investment firms should disclose the share of their revenue from services linked to activities aligned with the EU Taxonomy in total revenue from eligible services.
- Investment firms should rely on the information disclosed by clients for those corporates subject to NFRD disclosure obligations. Investment firms should calculate the KPI on the basis of the information disclosed by the investee companies on the proportion of their turnover (or relevant KPIs for financial corporates) derived from products or services associated with economic activities that qualify as environmentally sustainable in accordance with the Taxonomy Regulation. Investment firms should engage with their customers bilaterally or use proxies and estimates when they are not subject to disclosure obligations under NFRD and such information is not available.

Timeline for the disclosures

In the interests of proportionality:

- A transition period ending in December 2022 is proposed for the disclosure of KPIs when the investee company or customer is subject to the NFRD, and ending in June 2024 otherwise. Proxy information in terms of estimates and ranges can be disclosed during this period, including as a fallback solution the use of sector-based alignment coefficients estimated under a common methodology developed by an independent EU body⁹.
- **The first disclosure for the financial year 2021 should not apply retroactively:** For those disclosures that are applicable from 1 January 2022, the first disclosure should cover the financial year 2021 only, and for those disclosures applicable from 1 January 2023, the first disclosure should cover the financial year 2022 only.

Investment firms should disclose the information required by using the templates included in Annex II to the report enclosed with this Opinion.

EBA advice on qualitative disclosures by credit institutions and investment firms

The EBA recommends to the Commission that the disclosure of the quantitative KPIs should be accompanied by qualitative information to support institutions' explanations and the markets'

⁹ The Commission Joint Research Centre (JRC) (in collaboration with the University of Zurich) has estimated coefficients on the level of alignment with the Taxonomy of NFC activity at EU level, by NACE sector, for the environmental objective of climate change mitigation. These coefficients are publicly available in this link: The EU Sustainability Taxonomy: a financial impact assessment. JRC Technical Reports. <https://doi.org/10.2760/347810>

These coefficients could be used by institutions as a proxy for the level of alignment of their counterparties with the Taxonomy to provide estimates and ranges for the objective of climate change mitigation in the absence of relevant data during the transitional period.

understanding of these KPIs. The EBA advises that institutions should publish qualitative information covering the following aspects:

- Contextual information to help stakeholders understand the quantitative indicators (including at least the scope of assets and activities covered by the KPIs, information on data sources and limitations, and on the use of proxies, estimates and ranges);
- Explanations on the evolution of the level of taxonomy-aligned activities over time, starting from the second year of implementation, distinguishing between business-related drivers and methodological and data-related drivers;
- Description of the use of the Taxonomy in institutions' business strategy (including target-setting), product design processes and engagement with clients and counterparties;
- For institutions that are not required to disclose quantitative information on held for trading exposures, qualitative information on the alignment of trading portfolios with the Taxonomy (overall composition, trends observed, objectives and policy);
- Additional or complementary information to help understand institutions' strategy and the weight of the financing of sustainable activities in their overall activity.

Policy recommendations

The EBA recommends to the Commission a number of actions to support the reliability and comprehensiveness of institutions' disclosures related to the extent to which their activities are aligned with the Taxonomy, taking proportionality into account.

- Pursuing the establishment of an enabling disclosure and data framework, e.g. through the review of the NFRD (broadened scope of application, mandatory and standardised requirements, central data point) and better access to registers on EPC.
- Developing an equivalence framework between the EU Taxonomy and other national or regional taxonomies, and aiming for international standards and criteria, in order to allow a better assessment of the taxonomy-alignment level of non-EU exposures and clients.
- Extending the scope of the Taxonomy as a step towards more encompassing disclosures – first by completing the Taxonomy for all economic activities and environmental objectives and by considering actions to develop a low or negative impact Taxonomy and a social Taxonomy.
- Considering the development by an independent EU body, such as the European Commission's Joint Research Centre, of a coefficients based common methodology on sector taxonomy alignment for all environmental objectives, a methodology that institutions could apply as a fallback solution in the absence of relevant information.
- Taking a sequential approach for the disclosure of information on taxonomy-aligned activities by introducing a review clause in the delegated act, in order to monitor the first taxonomy-

related disclosures of institutions and assess the possibilities of adjusting disclosure requirements going forward, e.g. by further extending the scope of disclosures to additional asset classes or types of counterparties, including expanding them in the case that the scope of Taxonomy is broadened, and in particular for sovereign bonds and central bank exposures.

Specific comments and supporting analysis

The Report annexed to this Opinion develops the analysis which was carried out to substantiate the different recommendations to the European Commission and presents, in the corresponding sections, a more detailed illustration of the rationale behind each recommendation.

This Opinion and the supporting report will be published on the EBA's website.

Done in Paris, 26 February 2021

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