ERM SUSTAINABILITY INSTITUTE

THE NEW DISCLOSURE LANDSCAPE

Unsung cornerstone of ESG disclosures:

The evolving role of EU Taxonomy reporting

December 2023

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Companies slow to realize EU Taxonomy's vital role in ESG disclosures

The EU Taxonomy Regulation, which classifies what activities companies can claim as sustainable, is the underappreciated foundation of the EU's entire disclosure ecosystem. While other parts of this ecosystem, like the Corporate Sustainability Reporting Directive (CSRD) and the Sustainable Finance Disclosure Regulation (SFDR), are drawing a lot of headlines and frantic corporate and investor attention, the EU Taxonomy mostly lingers in the background, with most companies giving it only cursory attention.

The results of our second EU Taxonomy assessment across the EU are a case in point. 2022 marked the second year companies and financial institutions were expected to disclose which economic activities are classified as potentially sustainable, so-called "Taxonomy-eligible activities". Also, for the first time, non-financial companies had to disclosure what percentage of their eligible activities were conducted sustainably, the so-called "Taxonomy-aligned activities".

Room for improvement

For both, the results are mixed. The EU Taxonomy focuses on Turnover, capital expenses (CapEx), and operational expenses (OpEx). For all three categories, the average Taxonomy-eligibility percentages companies reported barely budged since 2021, even though eligible activities have expanded with the introduction of the Complementary Climate Delegated Act. Eligibility scores also fluctuated considerably from country to country.

The average reported Taxonomy-aligned percentages for 2022 were low and concentrated in just a few sectors, indicating that companies still have a long way to go on alignment.

Another sign that many companies underestimate the importance of the EU Taxonomy is the flaws in the execution of the Taxonomy's mandatory requirements. Inconsistencies we encountered include unsubstantiated Taxonomy alignment, the absence of mandatory disclosure tables in reporting, and not taking full stock of Taxonomy-eligible activities.

Taxonomy results also vary significantly from country to country, indicating a lack of unified interpretation of the EU Taxonomy.

Deep ties with CSRD and SFDR

However, neglecting the EU Taxonomy comes with serious risks. Companies should not forget their EU Taxonomy classification needs to be firmly in place before they can adequately satisfy the reporting requirements under the CSRD and/or SFDR. Disclosing how company activities align with the EU Taxonomy is a mandatory part of both. This cannot be a back-of-the-envelope exercise: starting in 2025, the CSRD requires that EU Taxonomy classified activities are third-party assured, replacing the current voluntary assurance process.

In essence, this means that CSRD disclosures will only pass external assurance if Taxonomy eligibility and alignment information are present and credible, and activities will only be deemed sustainable if all screening criteria for EU Taxonomy alignment are met. This includes the thousands of non-EU companies that must report in line with the CSRD. Companies failing to do so risk monetary fines on top of increased liability and reputational damage.

Other parts of the disclosure ecosystem, like the Corporate Sustainability Due Diligence Directive (CSDDD), which largely focuses on supply chains, will likely also lean on the Taxonomy classification to assess if corporate supply chains are sufficiently sustainable and measure future improvements.

Neglecting the EU Taxonomy is risky

Last but not least, Taxonomy-eligible activities are about to explode in scope. The current eligible activities, as listed in the Climate Delegated Acts, focus on the potential contribution to climate change mitigation and adaptation. From 2024 onwards, the Environmental Delegated Act will add eligible activities with the potential to positively contribute to circular economy, pollution prevention and control, biodiversity and ecosystem preservation, and the protection of water and marine resources.

Companies must realize that the EU Taxonomy is the foundation of the EU disclosure ecosystem, underpinning the policy objective of reorienting capital flows in line with sustainability imperatives. With the start of CSRD reporting just a year away, they should lose no time implementing a comprehensive system for mapping Taxonomy-eligible activities and transparently screening to what extent these activities are Taxonomy-aligned. Their efforts must also pass third-party scrutiny.

As our EU Taxonomy assessment results indicate, many companies have not put in enough effort yet. But it is also clear that companies face considerable hurdles to get it right, like the time-consuming Technical Screening Criteria to assess Taxonomy alignment and opaque boundaries for what counts as eligible activities. Below is a summary of the highlights of our assessment of the fiscal year 2022.

Highlights of 2022 Taxonomy reporting	What does this tell us?
Average Taxonomy-eligibility has barely changed since 2021 **Turnover:** 27% ↓ | **CapEx:** 39% ↓ | **OpEx:** 29% ↓ Average Taxonomy alignment was a fraction of eligibility figures Turnover: 9% | CapEx: 16% | OpEx: 12% but varied strongly from country to country. (Countries included: France, Italy, Germany, Spain, Netherlands).	The EU Taxonomy sets very ambitious alignment criteria, which are not mandatory. This prevents many companies from achieving high Taxonomy-alignment, especially considering that the Taxonomy has not been around for too long and companies need some time to adapt to the new requirements. Geographical differences in the average alignment may be driven by different assumptions and interpretations of the regulation across countries and the types of companies included in the sample.
Over half of the companies we looked at reported zero alignment on Turnover and Opex. For CapEx, which captures companies' forward-looking expenses, 62 percent reported more than zero alignment, while 22 percent reported a Taxonomy-aligned CapEx of more than 25 percent.	Reporting 0 percent aligned Turnover derives from two distinct situations: a company might not have any eligible Turnover in the first place. The second scenario is that a company has some eligible Turnover but cannot support it with proof it is Taxonomy-aligned. Similar considerations apply for CapEx, although in this case, the percentage of companies reporting 0 percent alignment is lower because companies can have capital expenditures unrelated to the core business.
There are significant sectorial differences in Taxonomy-alignment reporting. Utilities and the real estate sectors have shown the most pronounced combination of high Taxonomy-eligibility and alignment. However, the majority of sectors combine low eligibility and low alignment.	The level of eligible Turnover highly depends on whether industries are covered by the **Climate Delegated Act** and the **Complementary Climate Delegated Act.** The Turnover-related activities carried out by the real estate and the utility sectors are well covered in the Delegated Acts. Likewise, the high eligibility of CapEx is related to the inherent nature of investments needed in these two sectors, which primarily relate to costly energy infrastructure and buildings.
In all countries, companies reporting eligible Turnover report high eligible CapEx (100 percent of cases) and OpEx (81 percent of cases) as well. Without eligible Turnover, more than 80 percent of companies still report eligible CapEx and OpEx, except in the Netherlands, where it drops to 40 percent of companies.	The majority of companies in the sample seem to share the common understanding that CapEx and OpEx can and should be assessed and reported even without any eligible Turnover. The differences observed in the Netherlands might derive from different assumptions and interpretations of the regulation due to national common practices accepted and implemented by companies, advisors, and auditors.
Many companies run into reporting issues. The main ones are 1) a lack of clarity on how to interpret and apply the assessment criteria; 2) the assessment of activities outside of the European Union when criteria reference European legislation; and 3) insufficient information or missing documentation to prove alignment.	Reporting on the EU Taxonomy is still challenging in its second year of application. The Taxonomy-alignment criteria are often complex and require a thorough assessment and documentation process. Companies struggle due to practical challenges, uncertainty on how specific requirements should be applied, and the lack of information to assess the criteria. Further guidance by the European Commission and further adjustment and standardization of the criteria are urgently needed.

Key market insights

- Currently, EU Taxonomy eligibility only covers climate change mitigation and the climate change adaptation objectives. With the Environmental Delegated Act, which covers the remaining four environmental objectives of the Taxonomy, starting in 2024, companies' average eligibility and alignment figures could significantly change due to the inclusion of sectors and economic activities that have been out of scope. This offers companies with high ambitions more possibilities to increase the eligibility and alignment figures reported so far. On the other hand, it also expands the range of activities that need to be screened for those with lower ambitions.
- The scope of companies that will have to report on their EU Taxonomy-eligible activities will significantly increase with the Corporate Sustainability Reporting Directive (CSRD), which will apply in 2025 for the first time. This means that companies currently not in the Taxonomy scope need to monitor the CSRD implementation timeline and conditions to determine whether and when they will be required to report.
- Along with the CSRD, other EU Green Deal initiatives, such as the Sustainable Finance Disclosure Regulation (SFDR), will further expand the scope of application of the Taxonomy and include smaller companies driven by requests of financial institutions. So, the application of the Taxonomy may be required independently by investors, even if a company is not officially subject to the regulation.
- Lastly, applying Taxonomy criteria is gradually pushing companies towards implementing structural changes in their operations and processes to increase their Taxonomy-alignment figures and streamline reporting in the coming years. During our work with clients, we observe that companies desiring to increase their Taxonomy-alignment are evaluating the necessary actions and resources to achieve this. On the other hand, there is a desire to standardize and simplify the reporting process as much as possible, especially for companies struggling with the administrative burden of the requirements while having limited alignment ambitions.

Key recommendations

- Prepare for mandatory third-party assurance of your company's EU Taxonomy results (as part of CSRD reporting starting in 2025) by creating a structured company process for assessing eligibility and alignment and ensuring your reporting practices are in line with the mandatory requirements under the EU Taxonomy.
- Proactively assess how the Environmental Delegated Act will impact your EU Taxonomy eligibility, alignment requirements, and opportunities. The Act will add eligible activities relating to circular economy, pollution prevention and control, biodiversity and ecosystem preservation, and the protection of water and marine resources. Companies should also assess how the expansion will impact future requirements in other parts of the EU disclosure ecosystem, e.g., CSRD and CSDDD.
- Set a strategic ambition and benchmark current EU Taxonomy results against other peers in your industry. After mapping all relevant existing and new eligible activities, companies should set clear goals for levels of alignment in their strategic interest. Companies should benchmark their individual Taxonomy eligibility and alignment figures against those of the sector to which they belong. This exercise will help companies understand their own relative position and inform their future strategy around taxonomy implementation.
- Watch for regulatory updates and push EU regulators for more clarity. More standardization and guidance on eligibility assessment and interpreting the Taxonomy's Technical Screening Criteria for alignment are urgently needed. This will lower the administrative burden of reporting for companies and avoid differences in reporting practices between countries and industries, improving the comparability of results.

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About this report

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In 2021, non-financial companies only had to disclose their "Taxonomy-eligibility" figures, which are related to economic activities that are in the scope of the EU Taxonomy. In 2022, they also had to disclose their "Taxonomy-alignment" figures for the first time. Taxonomy-aligned activities can be considered environmentally sustainable according to the criteria in the Regulation and its Delegated Acts.

As Taxonomy-eligibility disclosures alone do not give any information about whether an activity carried out by a company is sustainable, looking at the first-time Taxonomy-alignment disclosures of non-financial entities allows us to get a clearer picture of where companies stand on their path towards environmental sustainability. The primary intent of this report is to analyze the current combinations and patterns of Taxonomy-eligibility and Taxonomy-alignment figures disclosed by non-financial entities across several European countries and reflect on possible underlying drivers. This expert briefing seeks to answer the following questions:

- What lessons can be learned from the experience of non-financial undertakings in the first-year reporting on Taxonomy-alignment?
- Are there any patterns or industry specificities that drive different levels of eligibility and alignment?
- What challenges are companies facing to reach Taxonomy-alignment?

The report also contains some insights about the second year of Taxonomy-eligibility disclosures of financial undertakings for fiscal year 2022. Similar to last year, financial undertakings are exempt from the publication of Taxonomy alignment figures until 31 December 2023.

In part one, we present the main quantitative results of our research based on publicly reported information from listed companies in France, Germany, Italy, Spain, and the Netherlands. The companies included in this research were selected based on their inclusion in the leading stock index in each country: CAC 40 (France), DAX 40 (Germany), IT 40 (Italy), IBEX 35 (Spain), and AEX/AMX (Netherlands). As financial and non-financial undertakings have different Taxonomy performance indicators to report and face different challenges in gathering underlying data, ERM decided to present financial and non-financial undertakings separately. Finally, we discuss the discrepancies between mandatory requirements, common practices, and relevant future developments.

"The primary intent of this report is to analyze the current combinations and patterns of Taxonomy-eligibility and Taxonomy-alignment figures disclosed by non-financial entities across several European countries and reflect on possible underlying drivers."

In part two, we reflect on industry-specific patterns that might have been influencing different levels of eligibility and alignment. We also reflect on the main drivers of the results presented in part one for non-financial undertakings by investigating in greater detail which challenges companies have been facing in achieving high Taxonomy-alignment figures.

In the conclusion, we define key recommendations flowing from earlier parts of the report.

This report is a follow-up to last year's publication Over Two Years with the EU Taxonomy: An ERM Expert Briefing on its Impact on the Global Reporting Landscape. For this reason, the structure of this expert briefing has been kept very similar to last year's.

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Part one: Mixed bag

Insights from 2022 Taxonomy results

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It is still early days for the EU Taxonomy disclosures, and companies are working to get their heads around its requirements. In 2022, non-financial companies needed to report on both eligibility and alignment for the first time. Financial companies were allowed to only report on eligibility for one more year. Furthermore, the assessment criteria for financial and non-financial companies differ. That is why this report will cover both categories separately.

Overall, the results are mixed. Eligibility reporting is inconsistent across countries and sectors; many mandatory requirements under the EU taxonomy are not or are insufficiently implemented, and alignment scores are still low. Part of this is because the EU Taxonomy assessment criteria are often complex and open to multiple interpretations.

The other part is that many companies have not given the EU Taxonomy the attention it deserves, often missing the vital importance of the EU Taxonomy for other more attention-grabbing parts of the EU disclosure ecosystem. For example, companies will find it hard to adequately satisfy the disclosure requirements of the CSRD or SFDR without properly doing their EU Taxonomy homework first.

CapEx wins, but inconsistencies blur the picture

- Findings for non-financial companies

In this section, we present the results of the Taxonomy-eligibility as well as of the first year of Taxonomy alignment reporting of non-financial undertakings based on ERM analysis of publicly available information for listed companies in five European countries: Germany, France, Italy, Spain, and the Netherlands.

Insights on Taxonomy-eligibility

- **The overall average eligibility across all countries and all three indicators for fiscal year 2022 (Turnover: 27% | CapEx: 39% | OpEx: 29%) is comparable to the average eligibility calculated for fiscal year 2021 in last year's research (see Table 1), with minor deviations that range from +1% for CapEx to -3% for OpEx.** More significant discrepancies from last year's eligibility figures can be observed on a country-by-country basis, where, in some cases, the deviation is up to +8 percent compared to the previous year. For example, the average eligible CapEx in Germany has risen from 38 percent to 46 percent. In other countries, eligibility figures went down. The changes are partially explained by a slight change in the sample of companies included in the analysis but also point to reporting inconsistencies among countries. However, the overall reporting trend for eligibility has remained relatively stable across all indicators compared to 2021. Companies have limited possibilities to influence their Taxonomy-eligibility. Still, since the introduction of the Complementary Climate Delegated Act on gas and nuclear-related activities, which has expanded eligible activities for 2022, a rise in eligibility numbers would have been likely. Regional inconsistencies in CapEx and OpEx reporting further imply that eligibility is likely underreported.
- **The reason why eligible CapEx keeps being the highest figure (39%) is that CapEx figures often factor in forward-looking information for up to five years into the future (in the form of a "CapEx plan").** In contrast, Turnover and OpEx, except OpEx forming a part of the CapEx plan, relate to the previous fiscal year only. **Another reason for higher CapEx figures is that capital expenditures can occur independently of any Turnover-generating activities.** This means that even if a company cannot report eligible Turnover because its core business is not in the scope of the Taxonomy, it may still report eligible CapEx related to typical non-sales related activities such as investments in real estate. In principle, this also applies to OpEx. However, in practice, **the lower average OpEx eligibility figure (29 percent) is partially explained by the fact that such expenses are lower than CapEx and that several companies have used the materiality-based exemption to avoid reporting on this indicator.**
- **The average eligibility** (and alignment; see Table 2) **of CapEx and OpEx is the lowest in the Netherlands** (eligible CapEx: 23%; eligible OpEx: 16%). **Only 40 percent of Dutch companies without eligible Turnover (around half of the Dutch sample) reported any eligible CapEx and only 14 percent reported any eligible OpEx.** For comparison:
  - In Germany, 90 percent of companies with no eligible Turnover report eligible CapEx, and 40 percent report eligible OpEx.
  - In France, 92 percent of companies with no eligible Turnover report eligible CapEx, and 8 percent report eligible OpEx.
  - In Spain, 80 percent of companies with no eligible Turnover report eligible CapEx, and 80 percent report eligible OpEx.
  - In Italy, 89 percent of companies with no eligible Turnover report eligible CapEx, and 44 percent report eligible OpEx.
- **On the other hand, we have a strong correlation between eligible Turnover and eligible CapEx and OpEx: 100 percent of companies having at least some eligible Turnover also report CapEx, and 81 percent report OpEx.** We believe different assumptions and interpretations of the Taxonomy Regulation may have been the drivers of the diverging percentages across European countries and the inherent nature of the type of companies included in the sample.

So, how does Taxonomy alignment among countries compare? It is important to note that the sector mix heavily influences alignment differences among countries, so no firm conclusions can be drawn from them. Still, they provide some insights into the differences in Taxonomy-alignment reporting stemming from diverging assumptions and interpretations of the Taxonomy Regulation (e.g., national common practices accepted and implemented by companies, advisors, and auditors). After this section, we will cover the impact of sectors on Taxonomy-alignment.

Table 1: Movements under the surface

Average percentage eligibility of Turnover, CapEx, and OpEx on a country-by-country basis

		TURNOVER	CAPEX	OPEX
Country	**Number of non-financial undertakings included in the analysis**	**Average of A - Turnover - Eligible (in %)***	**Average of A - CapEx - Eligible (in %)***	**Average of A - OpEx - Eligible (in %)***
France	35 (FY 2021:33) ↑	26% (FY 2021: 28%) ↓	42% (FY 2021: 47%) ↓	24% (FY 2021: 27%) ↓
Germany	34 (FY 2021:30) ↑	29% (FY 2021: 24%) ↑	46% (FY 2021: 38%) ↑	34% (FY 2021: 29%) ↑
Spain	24 (FY 2021:23) ↑	36% (FY 2021: 37%) ↓	43% (FY 2021: 50%) ↓	36% (FY 2021: 41%) ↓
Italy	27 (FY 2021:26) ↑	31% (FY 2021: 37%) ↓	45% (FY 2021: 42%) ↑	42% (FY 2021: 42%) ↔
Netherlands	40 (FY 2021:34) ↑	19% (FY 2021: 21%) ↓	23% (FY 2021: 24%) ↓	16% (FY 2021: 23%) ↓
Total	**160** (FY 2021: 146) ↑	**27%** (FY 2021: 29%) ↓	**39%** (FY 2021: 40%) ↓	**29%** (FY 2021: 32%) ↓

Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.
*The average eligibility for each KPI has been determined by adding up the average percentage of category A1, "Eligible and aligned," and category A2, "Eligible but not aligned," reported by companies within the mandatory disclosure tables.

NON-FINANCIAL UNDERTAKINGS:

Insights on Taxonomy-alignment

- **The overall average alignment across all countries is 9 percent for Turnover, 16 percent for CapEx, and 12 percent for OpEx (see Table 2).** The average alignment across all three indicators is much higher in Spain and Italy than in France, Germany, and the Netherlands. The national differences are likely a mix of different sector breakdowns per country and different interpretations of the EU Taxonomy assessment criteria.
- **Alignment on Turnover and OpEx across all countries is heavily concentrated.** 55 percent of all companies we looked at reported a 0 percent Taxonomy- aligned Turnover, and 56 percent did the same for OpEx. **CapEx has a more balanced spread, with 38 percent reporting 0 percent alignment (see Figures 1-3).** One reason for the relatively high concentration is that specific sectors are more exposed to the EU Taxonomy due to their economic activities than others.

Table 2: Local flavors

*Average percentage eligibility and alignment for Turnover, CapEx, and OpEx on a country-by-country basis**

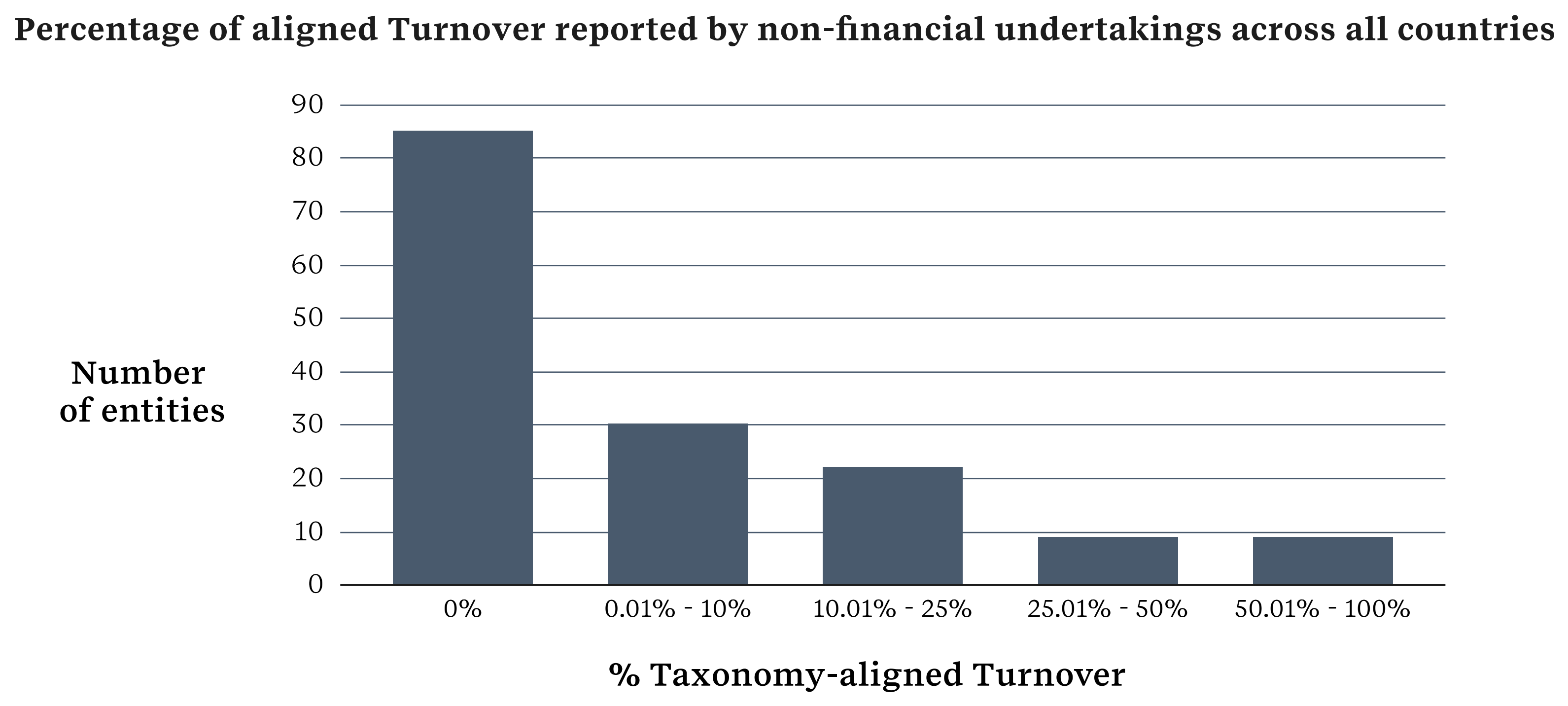
Country	Number of non-financial undertakings included in the analysis	TURNOVER: Average of A1 Turnover - Eligible and aligned (in %)	TURNOVER: Average of A2 Turnover - Eligible but not aligned (in %)	TURNOVER: Average of B Turnover - Non-eligible (in %)	CAPEX: Average of A1 CapEx - Eligible and aligned (in %)	CAPEX: Average of A2 CapEx - Eligible but not aligned (in %)	CAPEX: Average of B CapEx - Non-eligible (in %)	OPEX: Average of A1 OpEx - Eligible and aligned (in %)	OPEX: Average of A2 OpEx - Eligible but not aligned (in %)	OPEX: Average of B OpEx - Non-eligible (in %)
France	35	6%	19%	75%	11%	31%	59%	8%	16%	76%
Germany	34	3%	26%	71%	13%	33%	55%	10%	25%	66%
Spain	24	19%	17%	66%	29%	14%	59%	22%	13%	65%
Italy	27	15%	16%	69%	28%	18%	55%	25%	16%	58%
Netherlands	40	7%	12%	81%	8%	15%	77%	5%	11%	84%
Total	**160**	**9%**	**18%**	**73%**	**16%**	**23%**	**62%**	**13%**	**16%**	**71%**

Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

*Statistics include companies that only reported on eligibility for 2022 due to a fiscal year diverging from the calendar year. For such companies, the reported eligibility figures were classified under category A2, "Eligible but not aligned" of the respective Indicators.

Figure 1: Over half of companies report zero 'sustainable' Turnover

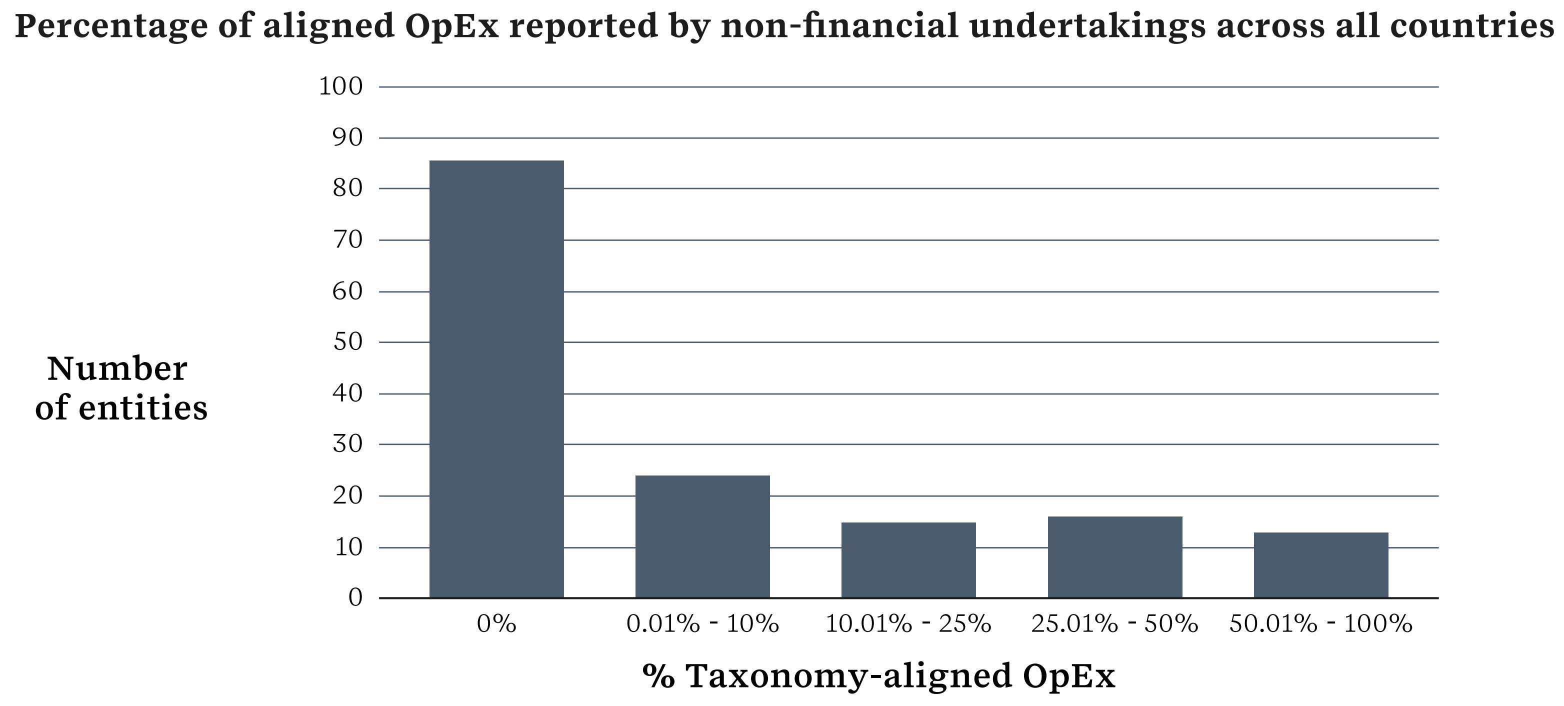
Percentage of aligned Turnover reported across all countries



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets; n=155.

Figure 2: The situation is the same for zero 'sustainable' OpEx

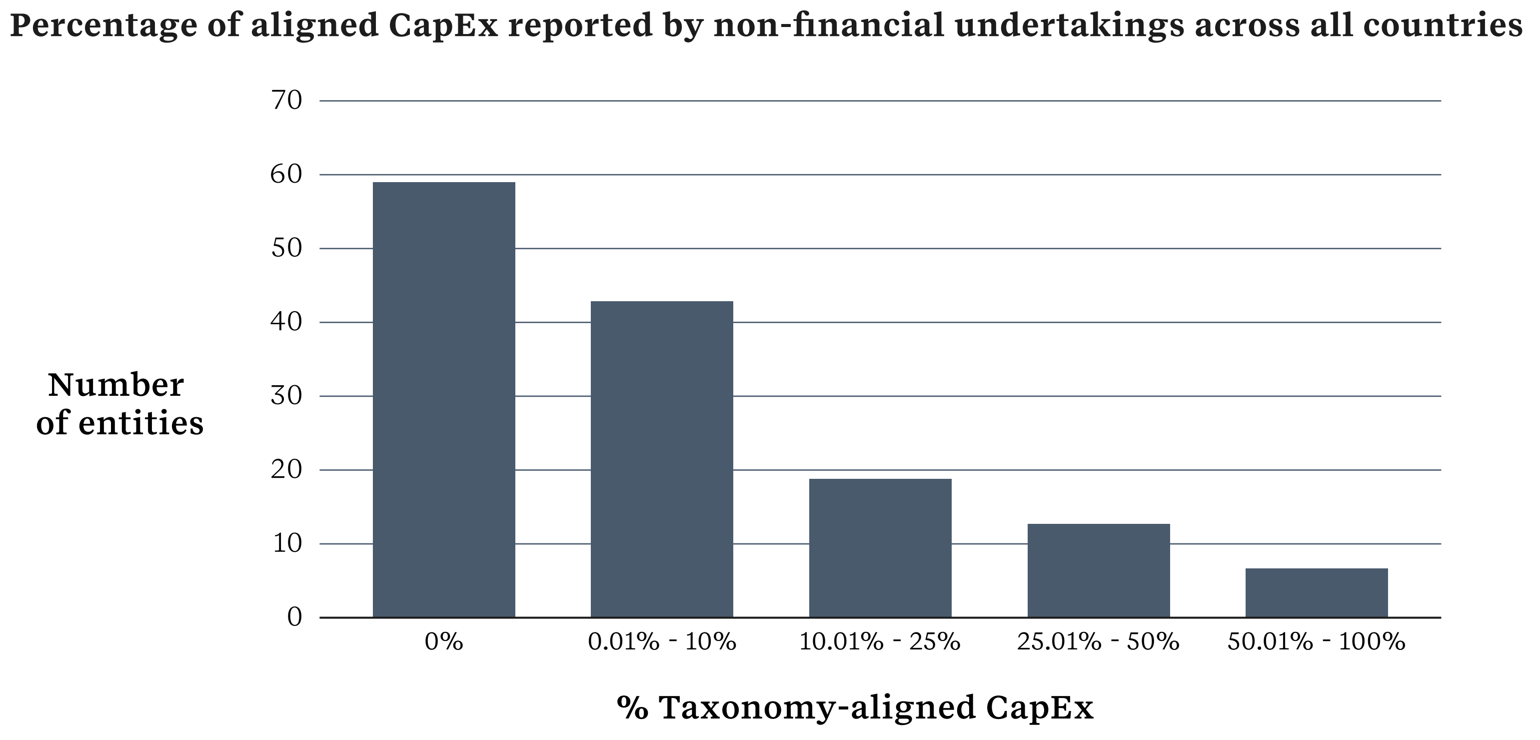
Percentage of aligned OpEx reported across all countries



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets; n=154.

Figure 3: 'Sustainable' CapEx is more evenly spread

Percentage of aligned CapEx reported across all countries

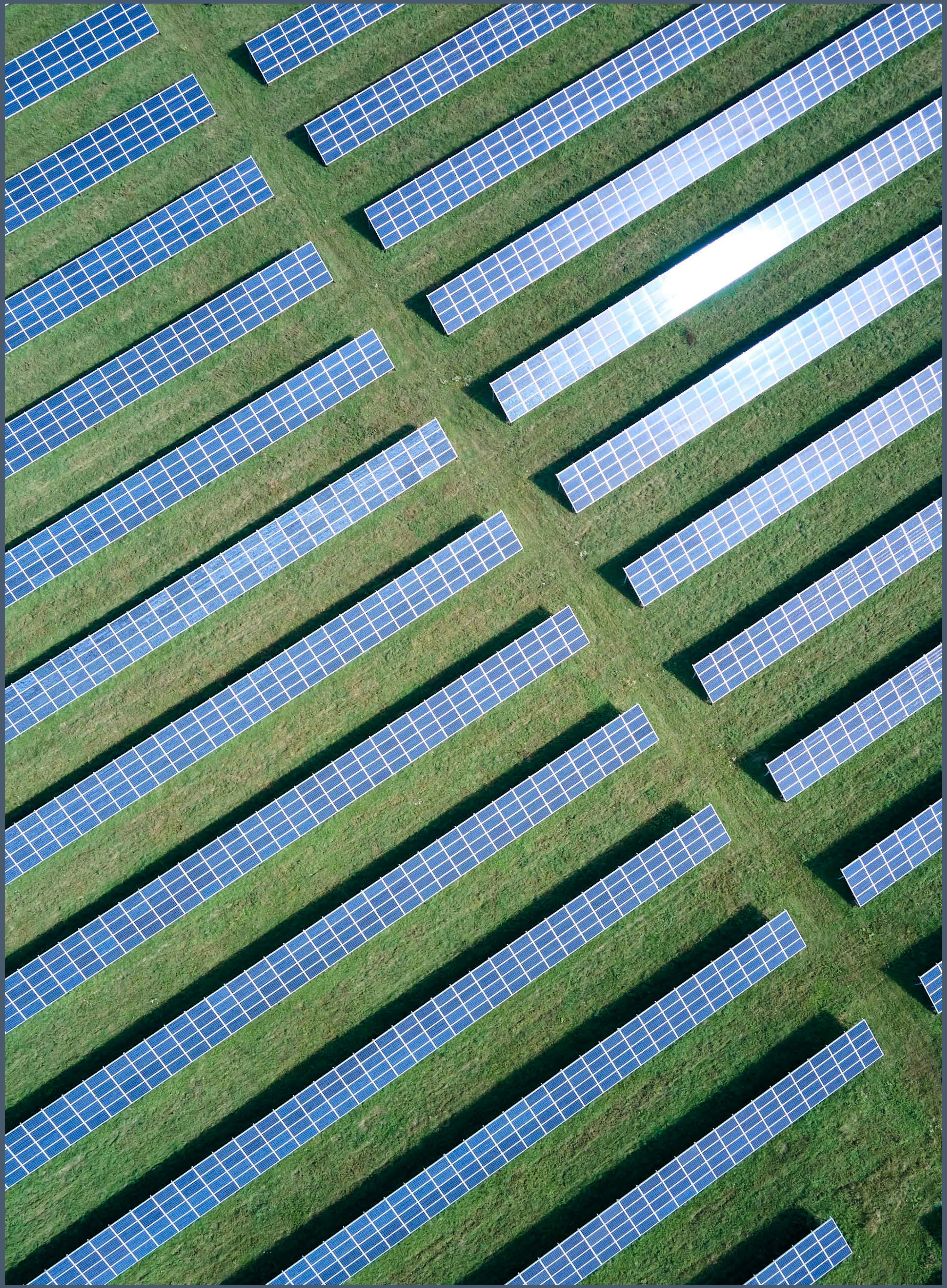


Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets; n=155.

NON-FINANCIAL UNDERTAKINGS:

Insights on sectorial differences in alignment

- **The sectors that do not have any eligible Turnover, and thus 0 percent alignment, are the ones not covered by the Climate Delegated Act, for example, Consumer Durables & Apparel, Consumer Services & Consumer Staples, Distribution & Retail as well as Food, Beverage, & Tobacco (see Table 3).** However, most companies in these sectors often still report some eligible CapEx and/or OpEx.
- **As expected, based on the current scope of activities included in the Climate Delegated Act, the highest average alignment for Turnover is registered in real estate (REITS + Real Estate Management: 24%-29%), utilities (33%), transportation (18%) as well as in Technology, Hardware & Equipment (18%).** Surprisingly, even entities in sectors with expected low Turnover figures - such as those in the telecommunication services or the media and entertainment industry - have been able to report at least some eligible/aligned Turnover.
- **Very high average alignment figures have been reported for CapEx in the utilities (68%) and the real estate (61%) industry.** Lower but still considerable average alignment figures have been registered in the automotive (17%), energy (22%), materials (18%), technology (25%), real estate management and development (18%), and the transportation (21%) sectors. These are sectors that are also currently covered by the Climate Delegated Act.
- **On average, all industries have at least some eligible CapEx, even if the industries do not have any eligible Turnover;** some examples include the consumer goods and the food and beverage industry. In light of the open question of whether companies with no eligible Turnover should still report CapEx and OpEx, which has led to discrepancies in Taxonomy reporting in the last two years, there is a clear trend towards inclusion regardless of related Turnover-based activities.
- **For OpEx, the highest average percentage alignment has been registered in the utility sector (57%), followed by the Technology, Hardware & Equipment (33%), real estate (22%), and automotive (20%).** In several cases, companies have used the exemption to report OpEx based on the low materiality of the indicator.



Although country comparison offers some insights into Taxonomy-eligibility and alignment, the most influential factor for both is the sector a company is part of. To bring this to the fore, we have clustered our sample into GICS© industry groups to see what expected and unexpected patterns emerge.

Table 3: Real estate and utilities rule *(continues on the next page)*

Average percentage of eligibility and alignment figures for Turnover, CapEx, and OpEx across different industries (based on GICS© industry groups)

		TURNOVER			CAPEX			OPEX		
GICS© industry groups*	**Number of non-financial undertakings included in the analysis**	**Average of A1 - Turnover - Eligible and aligned (in %)**	**Average of A2 - Turnover - Eligible but not aligned (in %)**	**Average of B - Turnover - Non-eligible (in %)**	**Average of A1 - CapEx - Eligible and aligned (in %)**	**Average of A2 - CapEx - Eligible but not aligned (in %)**	**Average of B - CapEx - Non-eligible (in %)**	**Average of A1 - OpEx - Eligible and aligned (in %)**	**Average of A2 - OpEx - Eligible but not aligned (in %)**	**Average of B - OpEx - Non-eligible (in %)**
Automobiles & Components	13	6%	69%	25%	17%	70%	13%	20%	59%	21%
Capital Goods	24	11%	22%	69%	10%	22%	69%	10%	11%	80%
Commercial & Professional Services	5	3%	1%	97%	8%	15%	77%	0%	0%	100%
Consumer Discretionary Distribution & Retail	6	0%	1%	99%	0%	14%	86%	0%	2%	98%
Consumer Durables & Apparel	6	0%	0%	100%	6%	34%	60%	1%	0%	99%
Consumer Services	3	0%	0%	100%	0%	9%	91%	0%	6%	94%
Consumer Staples Distribution & Retail	6	0%	0%	100%	1%	17%	82%	0%	1%	99%
Energy	9	10%	10%	81%	22%	10%	68%	13%	16%	72%
Equity Real Estate Investment Trusts (REITs)	1	24%	65%	11%	61%	35%	4%	22%	75%	3%
Financial Services	6	0%	20%	80%	2%	25%	73%	1%	28%	71%
Food, Beverage & Tobacco	5	0%	0%	100%	2%	12%	87%	0%	0%	100%
Health Care Equipment & Services	6	0%	0%	100%	2%	12%	86%	0%	3%	97%
Household & Personal Products	1	0%	0%	100%	9%	13%	78%	0%	0%	100%

		TURNOVER			CAPEX			OPEX		
GICS© industry groups*	**Number of non-financial undertakings included in the analysis**	**Average of A1 - Turnover - Eligible and aligned (in %)**	**Average of A2 - Turnover - Eligible but not aligned (in %)**	**Average of B - Turnover - Non-eligible (in %)**	**Average of A1 - CapEx - Eligible and aligned (in %)**	**Average of A2 - CapEx - Eligible but not aligned (in %)**	**Average of B - CapEx - Non-eligible (in %)**	**Average of A1 - OpEx - Eligible and aligned (in %)**	**Average of A2 - OpEx - Eligible but not aligned (in %)**	**Average of B - OpEx - Non-eligible (in %)**
Materials	14	13%	23%	66%	18%	23%	59%	13%	20%	68%
Media & Entertainment	2	0%	7%	93%	0%	32%	68%	0%	0%	100%
Pharmaceuticals, Biotechnology & Life Sciences	7	0%	0%	100%	0%	7%	92%	0%	0%	100%
Real Estate Management & Development	2	29%	69%	2%	18%	79%	4%	13%	75%	12%
Semiconductors & Semiconductor Equipment	6	3%	19%	78%	4%	24%	72%	3%	17%	80%
Software & Services	4	0%	28%	72%	0%	36%	64%	0%	19%	81%
Technology Hardware & Equipment	2	19%	40%	41%	25%	47%	29%	33%	37%	30%
Telecommunication Services	6	1%	3%	96%	1%	3%	96%	0%	10%	90%
Transportation	9	18%	19%	68%	21%	17%	65%	12%	15%	75%
Utilities	17	33%	12%	55%	68%	8%	24%	57%	13%	29%
Total	**160**	**9%**	**18%**	**73%**	**16%**	**23%**	**62%**	**13%**	**16%**	**71%**

Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

*Statistics include companies that only reported on eligibility for 2022 due to a fiscal year diverging from the calendar year. For such companies, the reported eligibility figures were classified under category A2, “Eligible but not aligned” of the respective Indicators.

Substantial country-by-country fluctuations

- Findings for financial undertakings

In this section, we present the 2022 EU Taxonomy reporting results of financial undertakings based on ERM's analysis of publicly available information for listed companies in five European countries: Germany, France, Italy, Spain, and the Netherlands.

Unlike non-financial undertakings, financial undertakings have been exempted from reporting on Taxonomy-alignment figures for fiscal year 2022. But not for long; from January 2024 onwards, financial companies must also report on alignment. For now, we have further analyzed their eligibility figures below.

FINANCIAL UNDERTAKINGS:

Insights on Taxonomy-eligibility

- **With an average of 28 percent, eligibility figures of financial undertakings for fiscal year 2022 (see Table 4) are in the same ballpark as reported eligible Turnover and OpEx of non-financial undertakings (see Table 1).** The overall average has not changed compared to the previous year, however, there are deviations on a country-by-country level.
- In some countries, such as France and Germany, there has been a substantial increase in overall eligibility exposure. **Changes are partially due to the inclusion of eligible premiums of insurance undertakings (not included in last year's data),** raising the eligible percentage. **Another reason for country-by-country deviations (including any decreases compared to the previous year) is the expansion of the number of financial undertakings included in the analysis.** In Spain, for example, there has been an overall decrease in eligibility exposure compared to last year because of an outlier in the insurance sector, bringing down the average.
- **On average, the exposure to eligible premiums is the highest (38 percent) in the insurance sector,** with a range that goes from 5 percent to 77 percent. This is **followed by the average eligibility exposure of credit institutions (31 percent),** ranging from slightly over 0 percent to 55 percent, **and by the exposure to eligible investments of insurers (16 percent),** ranging from 2 percent to 27 percent. **Finally, the exposure of asset managers is the lowest (6 percent).** However, the number of asset managers included in the sample might be too low to draw any definitive conclusions.
- Lastly, to get a more comparable picture to last year, we also calculated the eligibility figures, excluding the exposures to eligible premiums of insurance companies. **This resulted in a distribution of the eligibility exposures of financial institutions (see Figure 4) similar to the pattern from last year, with most entities having an exposure between 10.01 percent and 25 percent.**

Dropping the ball

- Discrepancies with mandatory Taxonomy requirements for non-financial undertaking

The quality of Taxonomy data is vital to get a clear picture of both eligibility and the alignment of activities, and thus of the sustainability status of those activities. However, during our research, we recorded several lapses in the reporting that represent, in our view, a hindrance to full transparency and comparability of non-financial entities implementing the Regulation. Below is an overview of the flaws we have encountered.

Table 4: The insurance sector skews results

Average percentage eligibility exposure of financial undertakings, split by type of undertaking

	CREDIT INSTITUTIONS		ASSET MANAGERS		INSURANCE AND REINSURANCE UNDERTAKINGS				
Country	Number of credit institutions*	Average % exposure to eligible activities of credit institutions	Number of asset managers	Average % exposure to eligible activities of asset managers	Number of insurance and re-insurance undertakings*	Average % exposure to eligible investments of insurance and reinsurance undertakings	Average % exposure to eligible premiums of insurance and reinsurance undertakings	Total number of financial undertakings included in the analysis	Total average % eligibility exposure of financial undertakings**
France	4	29%	0	N/A	1	17%	35%	5 (FY 2021: 4) ↑	28% (FY 2021: 18%) ↑
Germany	2	22%	0	N/A	3	17%	65%	5 (FY 2021: 3) ↑	36% (FY 2021: 31%) ↑
Spain	5	42%	0	N/A	1	4%	46%	6 (FY 2021: 4) ↑	37% (FY 2021: 42%) ↓
Italy	9	28%	1	13%	3	12%	23%	12 (FY 2021: 5) ↑	23% (FY 2021: 20%) ↑
Netherlands	3	25%	1	0%	3	22%	25%	7 (FY 2021: 3) ↑	23% (FY 2021: 30%) ↓
Total	**23**	**31%**	**2**	**6%**	**11**	**16%**	**38%**	**35 (FY 2021: 19)** ↑	**28% (FY 2021:28%)** ↔

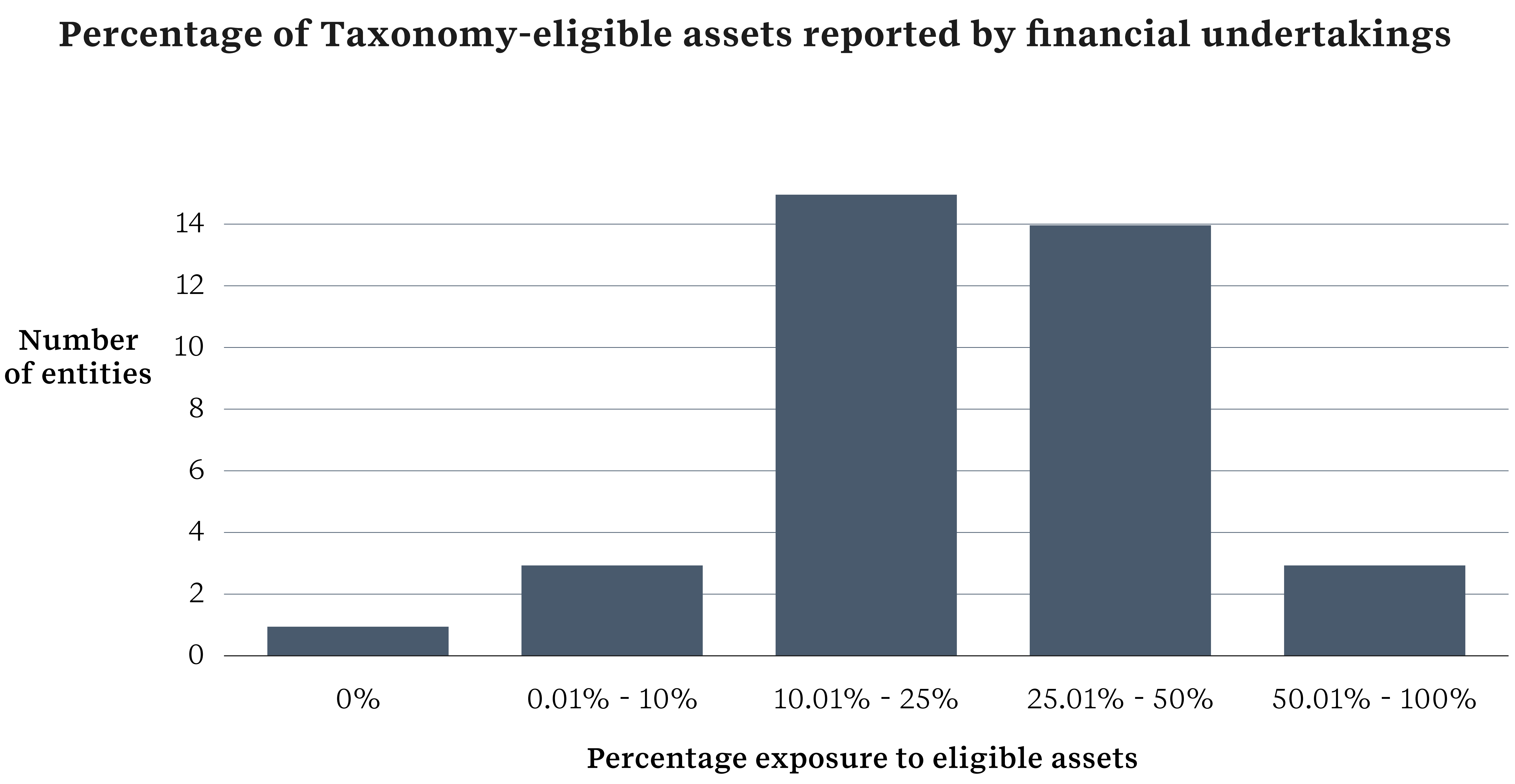
Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

Disclaimer: Please note that the country-level deviations from last year's figures may be explained by the increase in scope of financial undertakings included in the analysis, by the inclusion of the average percentage exposure of insurance and reinsurance undertakings to eligible premiums (which was not included last year) as well as by any differences in the calculation of the reported figures by the financial undertakings, e.g., related to the publication of eligibility shares based on total assets vs. covered assets.

*Please note that one entity reports both the indicators of credit institutions and insurance undertakings. Such entity has been classified separately under both categories but is not counted twice in the "Number of financial institutions included in the analysis." **The figures include the average percentage exposure to eligible premiums of insurance and reinsurance undertakings.

Figure 4: Eligibility results excluding insurance premiums

*Percentage of Taxonomy-eligible assets reported by financial undertakings across all countries**



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.
*The figures exclude the average percentage exposure to eligible premiums of insurance and reinsurance undertakings.

NON-FINANCIAL UNDERTAKINGS:

Observed discrepancies with mandatory requirements and implemented common practices

- **In the absence of any eligible Turnover, several companies do not seem to be investigating the existence of any eligible and aligned CapEx and/or OpEx.** This trend is prevalent in some countries, such as the Netherlands, where 40 percent of companies without eligible Turnover also do not report any CapEx. However, this practice also extends to other countries. We believe this may derive from different assumptions or interpretations of the Taxonomy Regulation commonly accepted within a specific industry, country, or group of stakeholders, including an entity's peers, advisors, and auditors. Nevertheless, as clarified in publications by the European Commission and confirmed by the common practice of the majority of the sample, we believe that CapEx and OpEx reporting should occur independently of Turnover reporting.
- **Several companies do not publish the compulsory disclosure tables for Turnover, CapEx, and OpEx,** which are mandated by the Taxonomy Regulation and its Delegated Acts. Instead, some entities decided to publish shorter versions of such tables or no tables at all (especially when the eligibility and alignment for an indicator are zero). To ensure greater transparency and comparability of the results, we believe that all companies should publish mandatory disclosure tables, which are also much easier to locate in the report than having to research relevant content in the text.
- **Double counting the percent of aligned Turnover, CapEx, or OpEx under both the climate change mitigation and climate change adaptation objectives within the tables.** The Taxonomy clearly states that double counting should be avoided. Companies must make a decision about which objective an activity contributes to.
- **Incorrect reporting of activity names and associated activity codes.** In some instances, the activity codes were mixed up with the NACE classification codes, or the activity names were customized. This practice also challenges comparability with other entities.
- **Omission of the absolute value of the non-eligible OpEx (the denominator) when using the related materiality-based exemption from reporting OpEx.** As stated by the Taxonomy and its complementary documents, the reporting entities exempted from the calculation of the numerator of the OpEx KPI (which is disclosed as equal to zero) must still disclose the total value of the OpEx denominator.
- **No to minimal contextual information about how compliance with the criteria for Substantial Contribution, Do Not Significant Harm, and Minimum Safeguards have been assessed.** This occurred especially when the alignment figures were deemed to be zero.
- **Smaller rounding errors in the published numbers, as in some cases, the percentages of categories A1, A2, and B within the tables do not add up to 100 percent.**

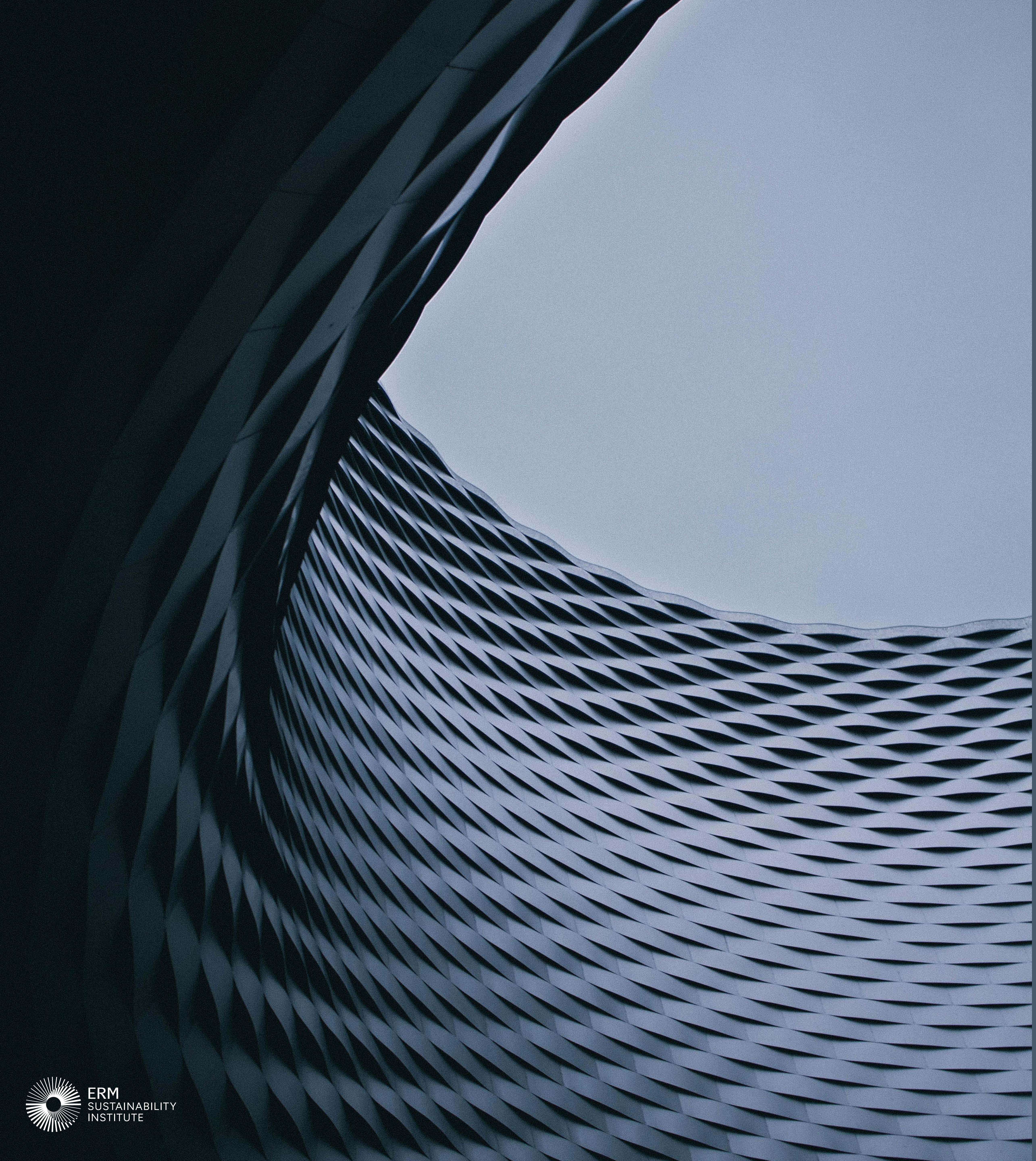
Looking ahead

- Future developments of the EU Taxonomy

The EU Taxonomy is still in its early stages, and companies should be aware that the EU Taxonomy will keep changing in the coming few years, as well as the EU disclosure ecosystem the Taxonomy is an integral part of. The most significant changes on the horizon are the expansion of eligible activities through the introduction of the Environmental Delegated Act and the start of CSRD reporting in 2025. Below is an overview of the most relevant changes concerning the EU Taxonomy.

OUTLOOK

- **While it is representative of the current scope of Taxonomy alignment reporting, which is limited to the climate change mitigation and adaptation objectives, the picture in this research will change when the newly adopted Environmental Delegated Act takes effect (also see Glossary).** Alignment reporting for the four remaining objectives (circular economy, pollution prevention and control, biodiversity and ecosystem preservation, and the protection of water and marine resources) will be required for fiscal year 2024 and might significantly expand the eligibility and alignment figures f industries with core activities that are currently not in scope, while also bringing new challenges due to new and additional criteria that need to be assessed. Additionally, as the Taxonomy is designed to be "a living document," other future updates might address sectors not in scope of the existing Delegated Acts.
- **With the Corporate Sustainability Reporting Directive (CSRD), which will apply for the first time in 2025, the scope of companies that will have to report on the Taxonomy will further increase year-by-year** by including entities that are not in scope of the current Non-Financial Reporting Directive (NFRD), small and medium enterprises as well as companies headquartered outside of the EU which meet certain conditions. For more insights on the CSRD, please refer to ERM's expert briefing "Implementing the CSRD: Preparing for a New Era of ESG Disclosure." With the increasing number of companies having to report sustainability data (including the Taxonomy) in line with the CSRD, we foresee further challenges due to the lower reporting preparedness of many smaller non-European companies. Preparing well ahead of the deadlines for the first-time reporting is essential.
- **Along with the CSRD, the Taxonomy is also linked to other EU Green Deal initiatives, such as the Sustainable Finance Disclosure Regulation (SFDR), further expanding its application scope.** In this context, we are witnessing increasing interest by financial institutions in the Taxonomy-eligibility and -alignment potential of portfolio companies, which are subsequently also reaching out for support in the assessment and decision-making process.
- **Accelerated automated operationalization of the Taxonomy requirements.** Companies had significant challenges with the first-year interpretation and implementation of the alignment criteria due to the complexity and labor intensity of reporting. We already see a trend toward a more automatized operationalization of the Taxonomy requirements and streamlining the reporting for the coming years. We believe that over time, most companies will align towards a common understanding of the requirements, and the output will become more and more comparable, supported by automation, with the aim to get more eligible activities Taxonomy-aligned. To meet this ambition companies will need to structurally change their current processes and operations.



THE NEW DISCLOSURE LANDSCAPE

Part two: Getting a read

An analysis of patterns and challenges in Taxonomy-alignment reporting for non-financial undertakings

Terms like "eligibility" and "alignment" sound impenetrable, but they can give companies valuable information on where they stand regarding sustainability, the opportunities for improvement, or the risks of leaving the current situation unattended. Building on the quantitative research for non-financial undertakings in Part One, Part Two will provide some more insights into the main eligibility-alignment patterns at an industry level and into the challenges and difficulties observed in the context of Taxonomy-alignment. It will solely focus on non-financial undertakings.

Behind the numbers - *Industry patterns in eligibility and alignment*

In this section, we look at the different combinations of eligibility and alignment in various industries and what risks and opportunities arise from them. To make it easier, we have created a visual representation of several eligibility-alignment combinations across all countries and for all three Taxonomy indicators, Turnover, CapEx, and OpEx, using the data in Table 3.

We have also used the same eligibility-alignment combinations as we presented in last year's report. Below is a short recap:

- **High eligibility and high alignment:** a combination of high eligibility and high alignment figures most likely creates a competitive advantage companies want to maintain and maximize.
- **High eligibility and low alignment:** high eligibility figures paired with low alignment figures should trigger a peer review to understand your company's position within the industry and an assessment of the costs and benefits of potential alignment improvements.
- **Low eligibility and low alignment:** Companies may have low eligibility and low alignment figures for different reasons. Low eligibility activities could fit into different categories, such as activities not yet in scope of the Taxonomy, activities with low environmental impact that won't be part of the Taxonomy, and activities that inherently cause significant harm to environmental objectives and, therefore, are not part of the Taxonomy. As we mentioned before, eligible activities could also have been wrongfully omitted. Companies should carefully analyze reasons for low eligibility to develop a future-proof business model.
- **Low eligibility and high alignment:** the combination of low eligibility but high alignment indicates opportunities to be assessed for further utilization. For example, companies should assess whether it will be possible to maintain high alignment levels when scaling up operations in such activities.

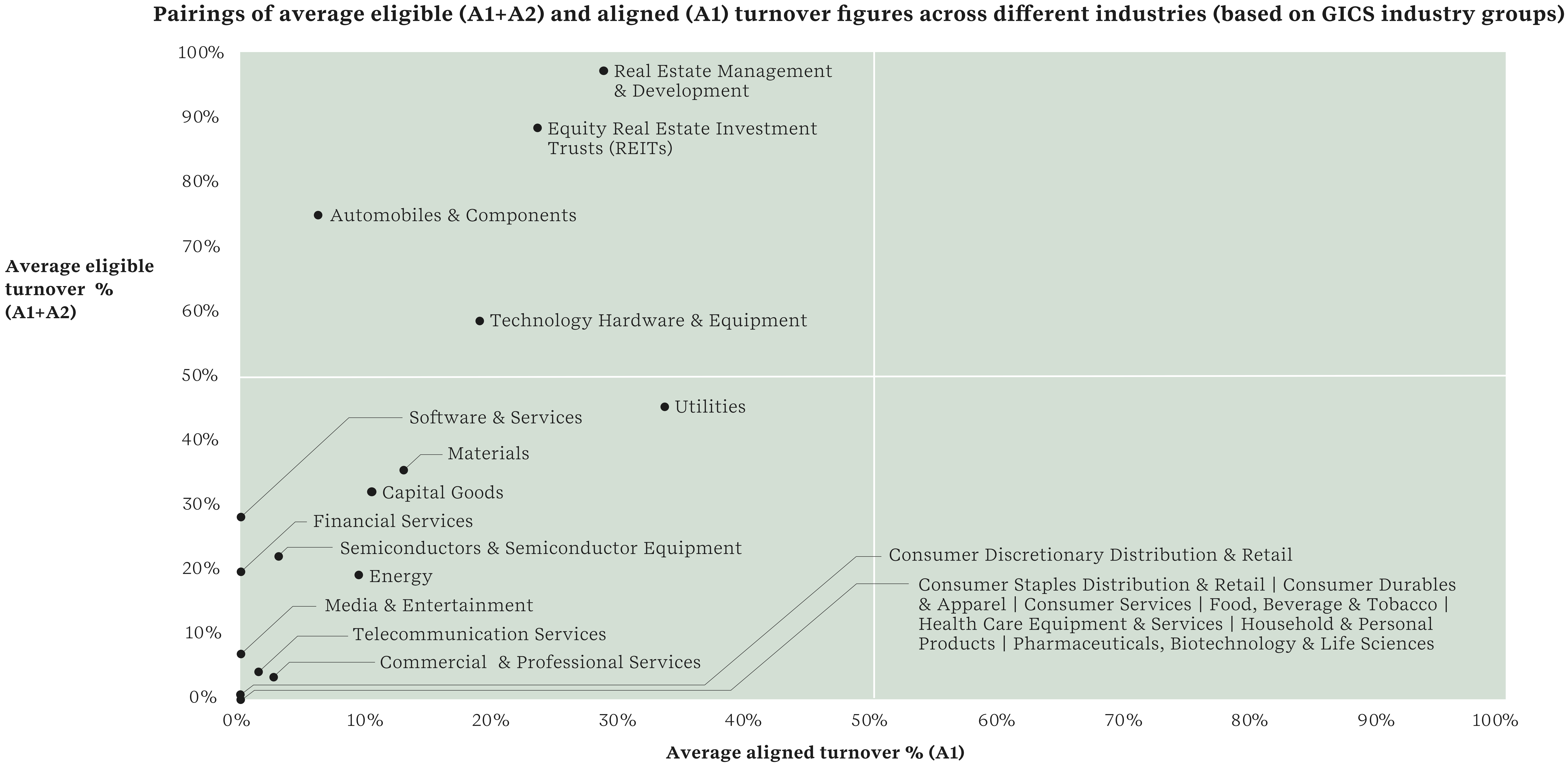
Companies can use the results in this section to benchmark themselves against their peers in the same industry and start a process of better understanding their position and assessing how it should develop in future reporting years.

The Turnover picture

The combinations of average eligibility and alignment for the Turnover indicator vary wildly. Eligibility spreads across the full range from 0 percent to almost 100 percent, but only four sectors have eligibility above 50 percent. The picture for alignment is more concentrated: the average aligned Turnover does not exceed 33 percent, while most sectors remain below 10 percent.

Figure 5: A handful of stars

Combinations of average eligible and aligned Turnover figures across different industries (based on GICS© industry groups)



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

Untapped potential - *Sectors with high Turnover eligibility and low Turnover alignment*

In general, companies can only achieve high Turnover eligibility rates if their core business is in scope of the Taxonomy. But the alignment-level which companies in high eligibility industries reach is highly varied. The sectors with the highest eligibility rates are the real estate sector (including Real Estate Management and Development and Equity Real Estate Investment Trusts), the Automobiles and Component sector, and the Technology, Hardware, and Equipment sector. This is not surprising as they are well represented by the activities under the Taxonomy Regulation. Still, none of these sectors has achieved high alignment (above 50 percent): figures range from 6 percent for Automobiles and Components to 29 percent for Real Estate Management and Development. Companies with high Turnover eligibility but low alignment rates should ask themselves the following questions:

HOW ARE MY PEERS PERFORMING IN COMPARISON?	Answering this question helps a company understand whether any barriers to alignment are due to individual characteristics and specific circumstances or are the same for the whole peer group.
HOW POSSIBLE IS IT TO MOVE QUICKLY TOWARDS ALIGNMENT AND AT WHAT COST?	There might be financial, technological, geographical, or other types of barriers that may not allow companies to reach alignment for their sold products, assets, or services in the short to medium term. At the same time, the value of benefits (reputational, push towards sustainable product development, etc.) may outweigh the costs of increasing alignment.
WHAT PART DO YOU CONTROL, AND WHAT ARE THE LEVERS IN THE SUPPLY CHAIN TO INCREASE ALIGNMENT?	It’s easier to improve alignment when your company is in full control. However, most companies use third-party components, materials, or services, which can influence the final Taxonomy-alignment of an activity. In such cases, companies have limited possibilities to influence their alignment directly and need to engage with third parties.

The undifferentiated mass - *Sectors with low Turnover eligibility and low Turnover alignment*

Most sectors that report 0 percent Turnover eligibility have a core business currently not covered by the Climate Delegated Act. Examples include the following industries: Consumer Durables and Apparel, Consumer Services, Consumer Staples Distribution and Retail, Food, Beverage and Tobacco, Health Care Equipment and Services, Household and Personal Products, Pharmaceuticals, Biotechnology, and Life Sciences.

The second group are sectors with limited eligible Turnover but no alignment. Among them: Software and Services, Financial Services, Media and Entertainment, and Consumer Discretionary Distribution & Retail.

The last group has limited eligibility combined with limited alignment, with one important exception. The Utilities industry reaches relatively high levels of both eligibility and alignment compared to its peers in the same cluster. This is because several activities in the Utilities industry are well in scope of the EU Taxonomy under the section "Energy" of the Climate Delegated Act and the Complementary Climate Delegated Act on gas and nuclear-related activities.

In general, having low eligibility and low alignment implies that companies should ask themselves the following questions:

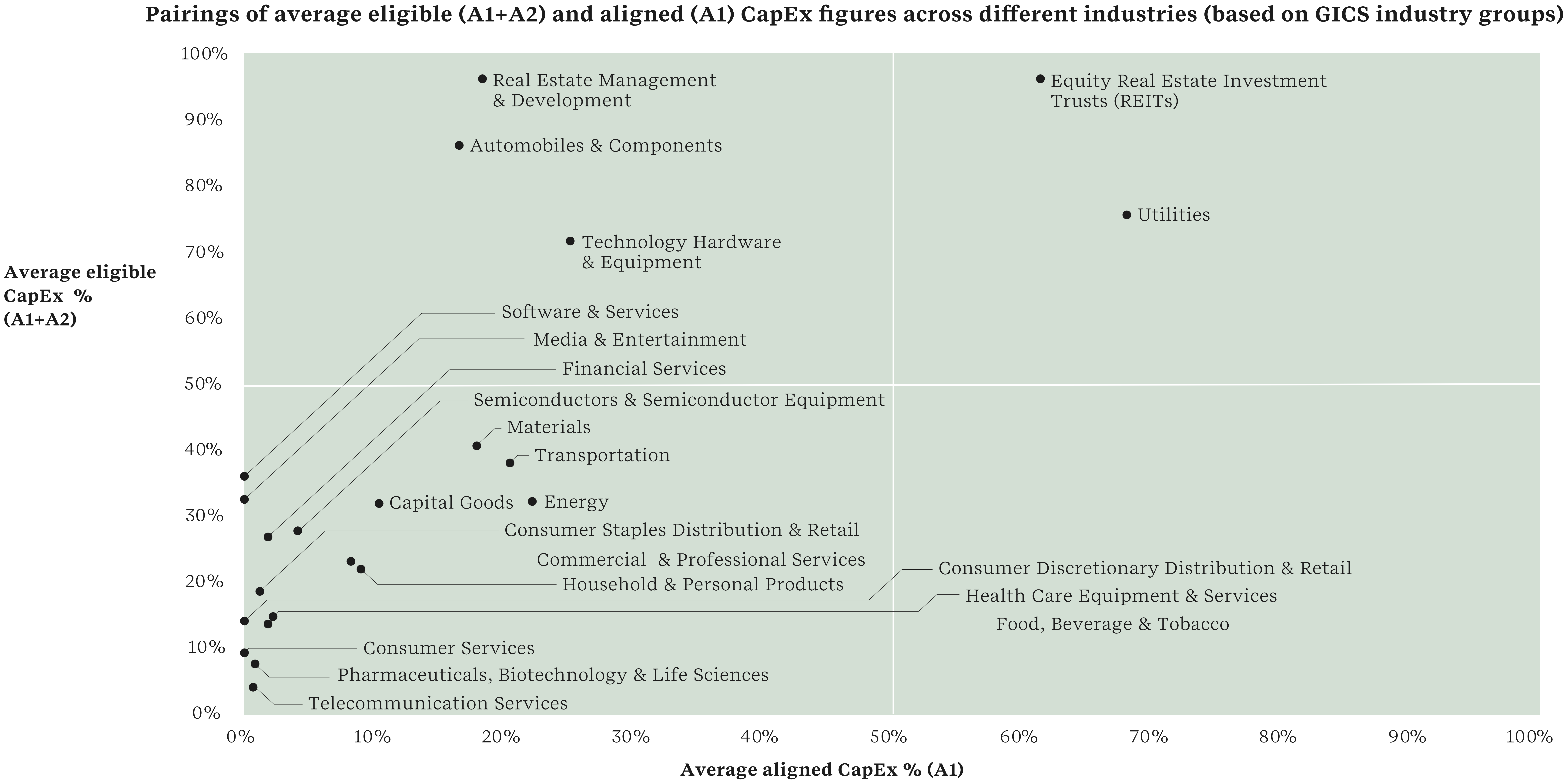
IS YOUR COMPANY'S LOW ELIGIBILITY A RESULT OF ACTIVITIES WITH NO SIGNIFICANT IMPACT OR ACTIVITIES THAT ARE INHERENTLY UNSUSTAINABLE, OR ARE YOU UNDERREPORTING ELIGIBLE ACTIVITIES?	Sectors currently excluded from the Taxonomy are either de-prioritized by the European Commission due to their limited negative impacts, or they are excluded upfront due to their inherent negative impacts. Such sectors will likely not be included in further revisions of the Delegated Acts. However, companies should closely assess whether their activities fall under those categories or are eligible. Starting in 2025, the CSRD demands that EU Taxonomy reporting is assured by a third party, which is unlikely to overlook omitted eligible activities. Although companies are currently encouraged to have their EU Taxonomy results voluntarily assured, not all companies do. Some underreporting may also result from misinterpreting the EU Taxonomy assessment criteria by third-party auditors.
IS THE BUSINESS MODEL STILL FUTURE-PROOF?	If low eligibility figures are due to inherently unsustainable activities, companies should assess whether their activities are economically viable in the long run and if they need to start developing alternative activities. This question is especially relevant for companies in the Energy sector.
HOW WILL THE INTRODUCTION OF THE ENVIRONMENTAL DELEGATED ACT IMPACT ELIGIBILITY?	As we mentioned, the Environmental Delegated Act will introduce a range of new eligible activities. So, companies should start investigating how their eligible activities will expand and what their likely alignment scores will be.

The CapEx and OpEx picture

The combination model is most relevant to assess risk and opportunity considerations for companies based on the Turnover combinations of eligibility and alignment. However, additional conclusions can be drawn considering CapEx and OpEx figures. CapEx, for example, gives you a forward peek into where companies may want to focus in the future. So, we have also created visual representations of eligibility-alignment combinations for CapEx and OpEx across the different industries, but we have focused our analysis on some key observations.

Figure 6: Betting on the future

Combinations of average eligible and aligned CapEx figures across different industries (based on GICS© industry groups)



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

Green investments - *Sectors with high CapEx eligibility and high CapEx alignment*

Contrary to Turnover, two sectors have made it to the high CapEx eligibility and high CapEx alignment quadrant: the Utilities (68 percent alignment) and the Equity Real Estate Investment Trust (61 percent alignment) sectors. This is partially due to the nature of these sectors; both demand substantial investments in assets related, for example, to electricity-related infrastructure or buildings, which are both covered by the Taxonomy. However, the fact that their alignment figures are high means that the CapEx in both sectors have a high level of sustainability, much higher compared to their Turnover. This indicates that the sectors believe sustainability is crucial for their future commercial interests.

Room for improvement - *Sectors with high CapEx eligibility and low CapEx alignment*

Similar to Turnover, several sectors are in the high eligibility-low alignment (below 50 percent) category, namely the Real Estate Management and Development, the Automobiles and Component, and the Technology, Hardware, and Equipment sectors. So, what is behind the fact that these sectors chose less green investments than Utilities and REITs? It could be that companies cannot reach alignment for assets acquired from third parties, for example, due to a lack of information to prove alignment, especially when the CapEx falls under the category “Purchase of output” of the Taxonomy eligible and aligned activities. But it could also be that companies see no benefit or feel no pressure to make more sustainable choices.

In the case of the Real Estate Management and Development sector, it would be interesting to investigate what explains the big difference in CapEx alignment compared with the Equity Real Estate Investment Trust sector, as the underlying activities and criteria are the same.

Green testing - *Sectors with low CapEx eligibility and low CapEx alignment*

Unlike Turnover, all sectors have at least some eligible CapEx, even if the levels are pretty low and CapEx is not directly connected to the company's core business. The average alignment is also higher, especially for the Materials, Transportation, and Energy sectors, which also have higher eligibility due to greater inclusion of related activities under the Taxonomy. In general, the higher alignment figures may indicate that many sectors at least explore sustainable activities in the future as an alternative to their less sustainable activities in the present.

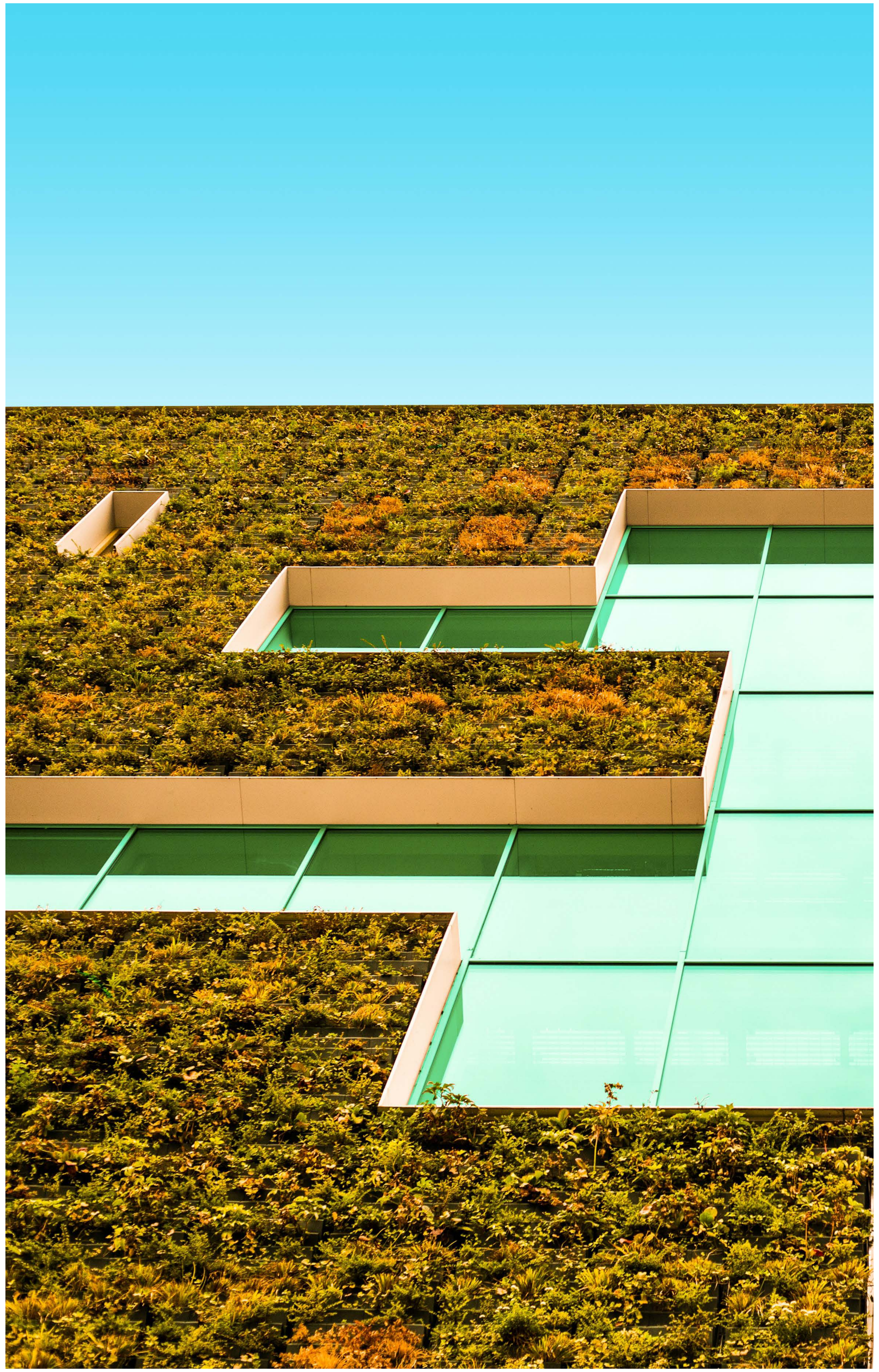
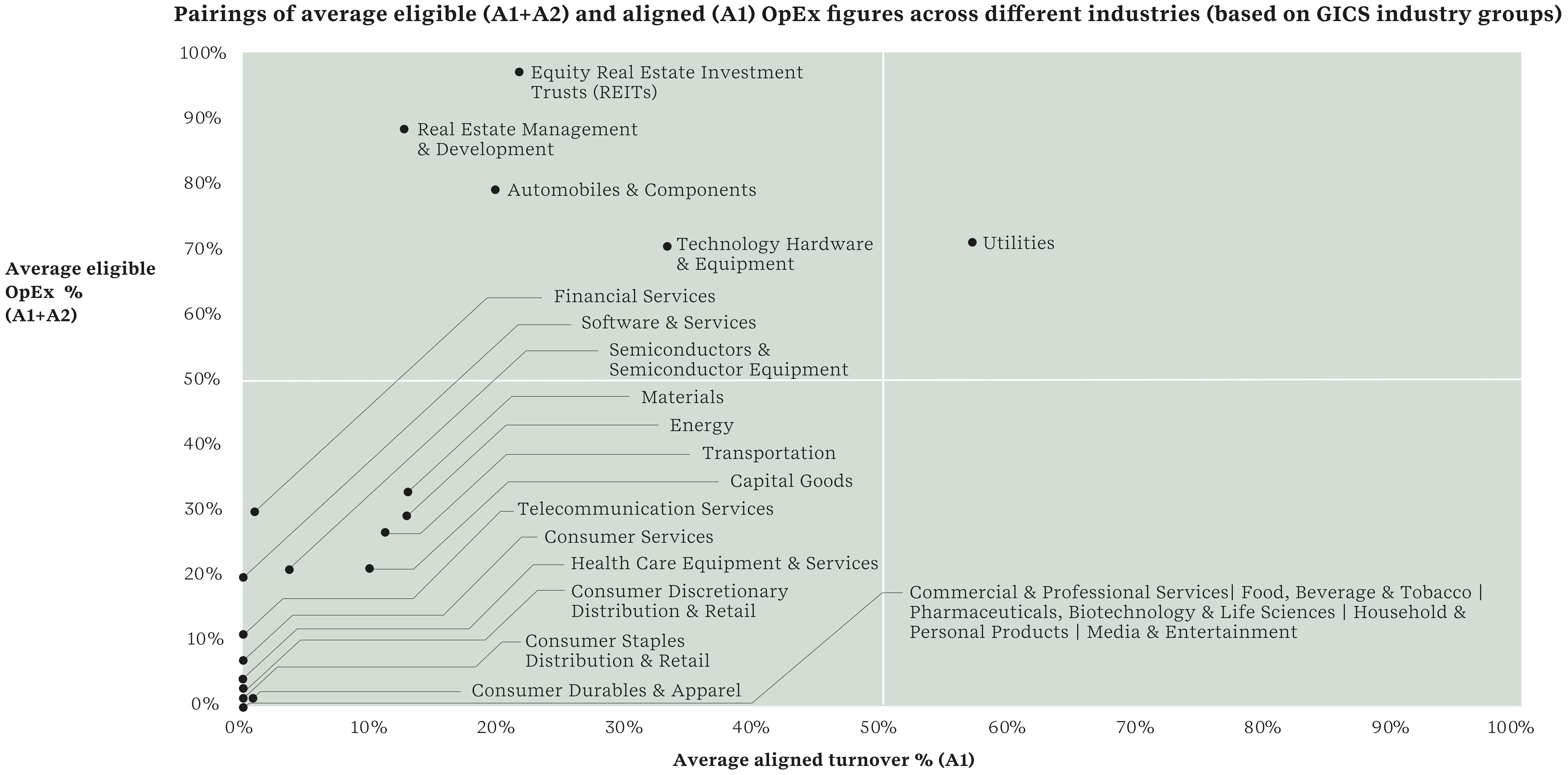


Figure 7: Utilities stand out

Pairings of average eligible and aligned OpEx figures across different industries (based on GICS© industry groups)



Source: publicly available data disclosed by listed non-financial undertakings for fiscal year 2022 in selected European markets.

When looking at the possible combinations of average eligibility and alignment for the OpEx, you see a pattern similar to that for CapEx.

Sole survivor - *Utilities only sector with high OpEx eligibility and high OpEx alignment*

Only the Utilities sector is categorized in this cluster since infrastructural investments typically come with maintenance and repair costs. And green infrastructure investments come with green repair and maintenance costs.

No surprises - *sectors with high OpEx eligibility and low OpEx alignment*

The same sectors for Turnover fall into this quadrant for OpEx: the real estate sector (including Real Estate Management and Development as well as Equity Real Estate Investment Trusts), the Automobiles and Component sector, and the Technology, Hardware, and Equipment sector. Again, it's noticeable that REITs did not maintain their position in the high alignment category, unlike CapEx.

Immaterial - *sectors with low OpEx eligibility and low OpEx alignment*

Unlike CapEx, we again see sectors with no eligibility and no alignment. This is partially because OpEx is often not material enough to be reported, so some companies have used the materiality-based exemption not to report it. The Taxonomy definition of OpEx is also quite restrictive compared to the financial accounting definition of OpEx, limiting the universe of eligible expenditures. The only sectors differentiating themselves in terms of slightly higher alignment figures compared to Turnover are the Transportation, the Energy, the Materials, and the Capital Goods sectors. These sectors are characterized by high CapEx investments that result in corresponding OpEx for repairing and maintaining these assets.

Lack of clarity - *Main challenges towards Taxonomy-alignment*

In the last section, we mapped how every industry has its unique eligibility-alignment combination and what factors influence it. In this section, we want to go a little deeper into why companies find it particularly hard to report on alignment and what reasons they give for not reporting higher figures. In general, companies can report on the three components of alignment (also see Glossary): Substantial Contribution (SC), Do No Significant Harm (DNSH), or Minimum Safeguards (MS).

The level of explanation companies give for why some or all of their Turnover, CapEx, and OpEx are not Taxonomy-aligned varies greatly. Some companies provide no information at all, not even specifying which of the three alignment levels is unmet. At the other extreme, companies offer a high level of detail, including the deviation to all quantitative Taxonomy-alignment criteria and commenting on each eligible activity separately, creating a best-practice benchmark. Below, we summarize some of the most common challenges observed during our research.

NON-FINANCIAL-UNDERTAKINGS:

Observed challenges faced in reporting Taxonomy-alignment

- **Lack of clarity on interpreting and applying the alignment assessment criteria.** In the first year of reporting alignment, companies are still partially struggling to understand and apply the assessment criteria. In some cases, this resulted in reporting zero alignment as a conservative approach to avoid risks of overstatement.
- **The alignment assessment of activities outside the European Union, specifically when the criteria refer to EU laws or standards.** As the Taxonomy requires the assessment of the alignment criteria worldwide, it has been challenging for companies to assess criteria derived from European legislation in non-European countries due to the absence of related processes or monitoring mechanisms, as opposed to European countries.
- **Lacking information and missing documentation to prove alignment.** Collecting appropriate information and evidence for proving the alignment of an activity is essential, especially in light of limited assurance requirements. Such cases often resulted in a conservative approach where entities decided to report zero alignment for an activity. The lack of information can be especially problematic in the case of any CapEx or OpEx in the category “Purchase of output” of Taxonomy-eligible/aligned activities. This category covers the purchase of assets or services from third parties, and it can be challenging to obtain all the information necessary to assess the alignment of the asset or service.
- **No eligibility as a reason for no alignment.** Many companies whose core business is currently not in scope of the Delegated Acts state that for this reason, they have no eligibility for the indicators and thus no alignment. While this might be accurate for Turnover, we believe there is an unresearched potential for having at least some eligible/aligned CapEx or OpEx in some cases. We decided to list this as a challenge because we observed that entities often perceived the absence of eligibility and alignment as a disadvantage compared to entities with many eligible/aligned activities and tried to justify it by pointing to zero eligible Turnover. However, we would encourage companies to more closely investigate whether they have eligible CapEx and Opex, even if there is no eligible Turnover (see the framework suggested in Chapter 4.1)
- **Alignment with the Substantial Contribution (SC) criteria of the climate change adaptation objective.** Almost all entities have classified their activities under the climate change mitigation objective rather than climate change adaptation whenever such activities were listed under both objectives. Since for such activities, the real differentiator between the two objectives are the SC criteria, as the DNSH criteria and the MS are comparable, we believe that aligning an activity with the SC of climate change adaptation is perceived as being more challenging. There is just one entity in our sample that intentionally classified all of its activities under climate change adaptation, while the same activities were also listed under the mitigation objective.
- **The calculation and assessment of the OpEx indicator.** Many companies struggle with this. Based on our experience with clients, this is due to the substantial differences between the Taxonomy definition of this indicator and the financial accounting OpEX definition used in existing financial accounting systems and processes. This often results in the need for ad hoc, manual calculations of the indicator, resulting in a high effort compared to the actual materiality of the indicator (several companies use the materiality-based exemption and thus report 0 percent eligibility and aligned OpEx) compared to Turnover or CapEx. For this reason, we believe the coming years will see an increasing trend toward automating and digitizing the processes for calculating Taxonomy indicators. However, this will require profound changes in the current IT- and financial accounting setup.

Conclusions and recom-mendations

Conclusions and recommendations

Companies finished the second year of EU Taxonomy reporting with mixed results. Part of it is due to the complexity of Taxonomy-reporting. On the other hand, we believe many companies underestimate the vital role of the EU Taxonomy in the EU disclosure ecosystem, which has led to insufficient effort to implement it and inadequate understanding of the risks and opportunities.

Companies will need to put in more work. But what concrete steps should they take to maximize the benefits of the EU Taxonomy while managing the risks and ensuring the reporting efforts remain manageable? In this section, we make several practical recommendations flowing from parts one and two of this report.

Prepare for mandatory third-party assurance of your company's EU Taxonomy assessment results (required for all companies in scope of the CSRD, starting in 2025) by creating a structured company process for assessing eligibility and alignment and ensuring your reporting practices are in line with the mandatory requirements under the EU Taxonomy.

Assess how the Environmental Delegated Act will impact your EU Taxonomy requirements and opportunities. The Act will expand eligible activities in four new areas: circular economy, pollution prevention and control, biodiversity and ecosystem preservation, and the protection of water and marine resources. Companies should also assess how the expansion will impact future requirements in other parts of the EU disclosure ecosystem, e.g., CSRD, SFDR, and CSDDD.

Set a clear ambition for your level of Taxonomy-alignment. Once a complete analysis of the existing and new eligible activities has been completed, companies will need to reassess where they are, where they need to be on eligibility reporting in the next few years and where they want to be on alignment to help build a sustainable profile. Companies will need to set clear strategic goals and ambitions. This can be influenced by factors like how companies want to differentiate themselves from their peers if the benefits from high alignment outweigh the costs and future regulatory developments.

Benchmark your Taxonomy results against peers in your industry. We encourage companies to benchmark their individual Taxonomy eligibility and alignment figures against the average figures of their sector, using our analysis in part two. Although the representativeness of the sector sample should be carefully considered before jumping to conclusions, such an exercise will help companies understand their own relative position and inform their future strategy around taxonomy implementation.

Benchmark your Taxonomy results against companies in other countries. A similar exercise at a country level could offer additional insights. As described in Part One, there are differences in eligibility and alignment figures at a country level. While some of these differences might be caused by the type of companies included in the sample, it is worth investigating differences in results with country-specific drivers, such as commonly accepted interpretations and assumptions of the criteria, and whether these differ substantially from other countries.

Review your discrepancies with mandatory requirements and common practices. The EU Taxonomy only works as a transparency tool and will only help companies make viable sustainability claims if all results are comparable and underpinned by the same logic. So, companies should review our list of observed discrepancies in Part One, assess which ones apply, and correct them. This is all the more urgent now mandatory third-party assurance is on the horizon.

Assess your IT systems readiness for automatized operationalization of the EU Taxonomy requirements and streamlining reporting. Automating the process will be crucial to keep reporting workloads manageable and maximize the benefits of high Taxonomy-alignment levels. But it will most likely take some modifications of your company's existing systems.

Watch for regulatory updates and push EU regulators for more clarity. The EU urgently needs to simplify and standardize the EU Taxonomy's assessment criteria and set clear rules for their interpretation. This will lower the administrative burden of reporting for companies and avoid differences in reporting practices between countries and industries, improving the comparability of results.

Glossary

To maximize usefulness for the reader, this glossary is not in alphabetical order but follows the logical structure of the EU Taxonomy Regulation and its components.

EU Taxonomy Regulation - EU Regulation 2020/852, commonly called the "EU Taxonomy," establishes a classification system for environmentally sustainable economic activities, as it defines specific criteria that an activity must comply with to be deemed sustainable. The EU Taxonomy imposes disclosure obligations for both financial and non-financial institutions. It represents a vital transparency tool in the effort to redirect investments and capital flows towards sustainable projects and activities. On the other hand, while imposing some mandatory disclosures, the EU Taxonomy does not represent a compulsory list of activities to invest in, and companies are not required to ensure their economic activities meet the criteria of the Taxonomy. Nevertheless, it motivates companies to strive to reach a level of environmental performance that financial markets recognize as "green."

Environmental objectives - The Taxonomy Regulation establishes six environmental objectives:

1. Climate change mitigation
2. Climate change adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention and control
6. Protection and restoration of biodiversity and ecosystems

For an economic activity to be classified as environmentally sustainable according to the EU Taxonomy, it must contribute to achieving at least one of these objectives. Hence, for each of the objectives, the EU Taxonomy defines a list of activities that could potentially contribute to achieving such objectives, along with the conditions that must be met by each activity to be deemed environmentally sustainable.

Taxonomy-eligible/eligibility - Each of the Delegated Acts under the EU Taxonomy Regulation (please also see "Climate Delegated Act," "Complementary Climate Delegated Act," and the "Environmental Delegated Act" in this glossary) contains a list of economic activities covering any of the six environmental objectives (see above). Whenever a company carries out an activity listed under one of the Delegated Acts, this activity is considered "Taxonomy-eligible." If an activity is Taxonomy-eligible, it is in scope of the EU Taxonomy. The assessment of Taxonomy-eligibility is based on the "Description of the activity" provided for each activity in the Delegated Acts. To be Taxonomy-eligible, an activity carried out by a company needs to match such description perfectly. However, the existence of Taxonomy-eligible activities does not give any information about the environmental sustainability of such activities, as this is covered by the concept of "Taxonomy-alignment."

Taxonomy-aligned/alignment - For each of the Taxonomy-eligible activities listed under the Delegated Acts, the Taxonomy defines specific criteria (the so-called "Technical Screening Criteria") that define whether an eligible activity can also be considered "Taxonomy-aligned," where "aligned" is a synonym of "environmentally sustainable." So, if an activity is Taxonomy-aligned, it is environmentally sustainable. The assessment of Taxonomy-alignment is based upon three pillars, as an eligible activity needs to comply with simultaneously:

- The “Substantial Contribution” (SC) criteria
- The “Do No Significant Harm” (DNSH) criteria
- The Minimum Safeguards (MS) criteria

Only if all of these criteria are met can an activity be defined as taxonomy-aligned and hence as environmentally sustainable.

Substantial Contribution (SC) criteria - Criteria set out individually for each eligible activity in the Delegated Acts. Such criteria define under which conditions an activity substantially contributes to achieving one of the six environmental objectives.

Do No Significant Harm (DNSH) criteria - Criteria set out individually for each eligible activity in the Delegated Acts. Such criteria define under which conditions an activity does not significantly harm any of the other five environmental objectives to which it does not substantially contribute.

Minimum safeguards (MS) criteria - Criteria set out in the EU Taxonomy Regulation and applicable to all activities. These include the following international standards and frameworks:

- the OECD Guidelines on Multinational Enterprises,
- the UN Guiding Principles on Business and Human Rights,
- the ILO Core Labour Standards and
- the International Bill of Human Rights.

Such criteria define under which conditions the activity complies with minimum social, human rights, labor rights, consumer rights, and anti-corruption-related requirements.

Taxonomy performance indicators - The mandatory key performance indicators to be disclosed by non-financial undertakings include the share of Taxonomy-eligible and Taxonomy-aligned Turnover, CapEx, and OpEx that is associated with economic activities listed under any of the Delegated Acts. The mandatory key performance indicators to be disclosed by financial institutions differ based on the type of financial entity. Until 31 December 2023, financial institutions benefit from an exemption to disclose taxonomy-alignment figures and must only report the proportion of their total assets of exposures to taxonomy-non-eligible and taxonomy-eligible economic activities.

Delegated Acts - The EU Taxonomy Regulation is supplemented by a series of delegated and implementing documents, including:

- The “Climate Delegated Act”
- The “Complementary Climate Delegated Act”
- The “Environmental Delegated Act”
- The “Disclosures Delegated Act”

Climate Delegated Act - Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021, also known as the “Climate Delegated Act,” lists activities related to climate change mitigation and climate change adaptation objectives. An amendment of the text of the Climate Delegated Act was published in the Official Journal in November 2023; such amendment includes additional activities related to climate change mitigation and climate change adaptation objectives and introduces some changes for existing activities.

Complementary Climate Delegated Act - Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022, also known as the “Complementary Climate Delegated Act,” includes additional gas- and nuclear-related activities related to the climate change mitigation and the climate change adaptation objectives.

Environmental Delegated Act - Published in the Official Journal in November 2023, this act includes activities related to the sustainable use and protection of water and marine resources, the transition to a circular economy, the pollution prevention and control, and the protection and restoration of biodiversity and ecosystems objectives.

ERM SUSTAINABILITY INSTITUTE

Authors

Claudia Funk, ERM
Johann Weicht, ERM
Katja Görtz, ERM

Contributors

Agnesa Ajvazi, ERM
Paul Degott, ERM
Laura Ditges, ERM
Onur Durmus, ERM
Björn Ehlers, ERM
Eva Enchelmaier, ERM
Ferdinand Faust, ERM
Rasika Gynedi, ERM
Ali Hasan, ERM
Laura Noriega, ERM
Ann-Kathrin Petersen, ERM
Marwan Saad, ERM
Ferdinand Schnell, ERM

Reviewers

Aiste Brackley, ERM
Jacco Kroon, ERM

Design

Camila Avilés Ilama, ERM
Eleanor Powell, ERM

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Website: sustainability.com