Ref. Ares(2020)4805202 - 15/09/2020

CALL FOR ADVICE TO THE EUROPEAN SUPERVISORY AUTHORITIES ON KEY PERFORMANCE INDICATORS AND METHODOLOGY ON THE DISCLOSURE OF HOW AND TO WHAT EXTENT THE ACTIVITIES OF UNDERTAKINGS UNDER THE NFRD QUALIFY AS ENVIRONMENTALLY SUSTAINABLE AS PER THE EU TAXONOMY

With this Call for Advice, the European Commission invites the European Supervisory Authorities (ESAs) to develop advice determining key performance indicators (KPIs) and associated methodology that undertakings subject to the Non-Financial Reporting Directive (NFRD)[1] should use to disclose information on how and to what extent their activities are aligned with those that qualify as environmentally sustainable under the EU taxonomy, in line with Article 8 of the Taxonomy Regulation[2]. In order to achieve this, the ESAs should investigate with the relevant stakeholders appropriate metrics and data analysing the impacts these might have on undertakings, including in terms of costs. The content of the advice should be adequate to form the basis for an impact assessment for a delegated act based on the Taxonomy Regulation that the Commission will adopt by June 2021.

The request is made in accordance with the founding Regulations establishing the ESAs[3], which establish the obligation to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, including through ensuring the integrity, transparency, efficiency and orderly functioning of financial markets.

The advice should be based on qualitative and, when feasible, quantitative sources. The evidence discussed in the advice should be based on data samples from public and commercial databases, data submitted to the ESAs by the supervised entities and qualitative sources of information, which might include a review of the most relevant literature, where available. It may also include, but should not be limited to, concrete examples or case studies, based on the experience of the ESAs in their supervisory capacity.

The need for this request and the scope of the work have been agreed between Commission staff and the ESAs. Commission staff kindly request the delivery of the final advice by February 2021. The Commission, in close cooperation with the ESAs, may revise and/or supplement this request and revise the timetable accordingly.

The European Parliament and the Council will be informed about this request, which will be available on the website of the Directorate-General for Financial Stability, Financial Services and Capital Markets Union once it has been transmitted to the European Supervisory Authorities.

[1] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ L 182, 29.06.2013, page 19, as subsequently amended.

[2] 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, 22.06.2020, page 13.

[3] Regulations (EU) No 1093/2010, 1094/2010, 1095/2010 and 2019/2175 of the European Parliament and of the Council.

1. CONTEXT

By June 2021, the Commission will complement the recently adopted Taxonomy Regulation with a delegated act setting forth requirements for undertakings subject to the NFRD (i.e., large listed undertakings, large banks and large insurance undertakings with more than 500 employees). Such requirements will specify the content and presentation of information on how and to what extent their activities are associated with the EU taxonomy, including the methodology to be used. The delegated act should take into account the specificities of both financial and non-financial undertakings subject to the NFRD.

Article 8 of the Taxonomy Regulation states that non-financial undertakings under the NFRD shall disclose the proportion of their turnover, capital expenditures (CapEx) and operating expenditure (OpEx) associated with environmentally sustainable economic activities, as per the EU taxonomy. Article 8 does not specify equivalent indicators on taxonomy-alignment for financial undertakings under the NFRD (i.e., mainly large banks and large insurance undertakings), leaving this task to the delegated act.

The Commission's guidelines on reporting climate-related information[4] provide a useful starting point, since in their annexes they identify KPIs that both banks and insurance companies could use to report sustainability-related data. However, the scope of KPIs to be developed under Article 8 has to be narrower, since it needs to focus solely on taxonomy-alignment. For example, the following KPIs based on the guidelines have been modified to refer to the EU taxonomy, and could be considered by the ESAs as a starting point for their analysis.

For banks:

- Proportion of total assets invested in taxonomy-compliant economic activities.

For insurance and reinsurance undertakings:

- Proportion of total assets invested in taxonomy-compliant economic activities.
- Proportion of total non-life insurance underwriting exposure associated with taxonomy activities.
- Proportion of total reinsurance underwriting exposure associated with taxonomy activities.

The Commission invites the ESAs to consider whether to further refine these indicators for financial undertakings, for example to exclude certain assets from the calculations (e.g., derivatives, trading book exposures, central bank reserves, for banks) and to assess the need of having different indicators for taxonomy-compliant financial services (e.g. climate risk insurance as a proportion of total insurance underwriting activities/gross written premiums) and for investments into taxonomy-compliant economic activities. The ESAs should also analyse whether all existing activities should be covered retroactively or only those relevant to the time period as of the when the disclosure rules start to apply[5]. Some activity-level

[4] Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information OJ C 209, 20.6.2019

[5] The disclosures under Article 8 apply as of 1 January 2022 for the environmental objectives of climate change mitigation and adaptation, and as of 1 January 2023 for the other four. The obligations relate to the previous financial year respectively (the disclosure obligation for 1 January 2022 covers the financial year 2021, the disclosure obligation for 1 January 2023 covers the financial year 2022).

information on taxonomy-alignment may also be hard to come by, suggesting the need to think of possible proxy-indicators.

2. SCOPE OF THE EXERCISE

The Commission invites ESMA, EBA and EIOPA to investigate and determine the content and presentation of relevant KPIs and associated methodology that should be used by different financial undertakings under their remit, in order for such undertakings to disclose their degree of taxonomy-compliance under Article 8 of the Taxonomy Regulation. Further, the ESAs are asked to consider how the three indicators for non-financial undertakings in Article 8(2) of the Taxonomy Regulation could be further specified and to determine appropriate methodologies.

In developing their advice, the ESAs are also invited to take into account that clarity is needed on how undertakings ought to determine whether their investments are associated with economic activities considered environmentally sustainable under the EU taxonomy. Namely, as set out in Article 8 and as proposed by the Technical Expert Group (TEG), whose recommendations constitute the basis for the Commission's draft delegated act on technical screening criteria for selecting economic activities to qualify as environmentally sustainable, both turnover resulting from an undertaking's investment and capital/operational expenditure constituting the investment itself should count[6]. However, the conditions can vary for different types of investments and environmentally sustainable activities. In this respect, the TEG proposed that eligible taxonomy-aligned turnover should vary depending on the environmental objective that the economic activity from which the turnover is derived contributes to, as set out in the table below, whereas for capital expenditures and operational expenditures it should not.

Financial metric	Climate change mitigation	Climate change adaptation
Turnover	Can be counted where economic activity meets Taxonomy technical screening criteria for substantial contribution to climate change mitigation and relevant DNSH criteria.	Turnover can be recognised only for activities enabling adaptation. Turnover cannot be recognised for adapted activities at this stage[7].
CapEx/OpEx	Can be counted where costs incurred (capex and, if relevant, opex) are part of a plan to meet Taxonomy technical screening criteria for substantial contribution to climate change mitigation and relevant DNSH criteria.	Can be counted where costs incurred (capex and, if relevant, opex) are part of a plan to meet Taxonomy technical screening criteria for substantial contribution to climate change adaptation and relevant DNSH criteria.

[6] Turnover reflects where a company currently is relative to the taxonomy and can be used by investors as a proxy for assessing how green a company is for equity exposures. Expenditures, in contrast, give investors a good sense of a company's direction of travel and is a key variable for investors assessing the credibility of a company's strategy in terms of improving its environmental performance.

[7] Allowing for turnover from adapted activities to count could be misleading: once the "substantial contribution" to adaptation of an activity is made (i.e. it is made resilient to climate change), it is questionable if the turnover associated with that activity (which may or may not have environmental benefits) should count as sustainable.

The issue of “what counts” matters for accurate disclosures of taxonomy-alignment throughout the investment chain: for undertakings carrying out sustainable economic activities under their disclosure obligation under Article 8, for financial market participants offering their services in relation to financial products under their disclosure obligations under Articles 5-7 of the Taxonomy Regulation[8] and for end-investors themselves. Consistency and clarity will help prevent different interpretations of what can count as ‘taxonomy-aligned’, minimise the risk of greenwashing, and consolidate the overall usability and appeal of the EU taxonomy. In this respect, the ESAs are invited to ensure consistency in the advice requested here and in the draft technical standards under Articles 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088.

In gathering evidence, qualitative sources and relevant literature should be complemented, where feasible, by quantitative evidence, such as data from public and commercial databases. We also expect the ESAs to engage with the most relevant stakeholders by means of an already planned or *ad hoc* stakeholder interaction or consultation, in order to develop the requested advice.

The three ESAs are asked to consider the following questions. In developing their advice, all ESAs are invited to provide data or estimates on the expected impacts, including costs, of the proposed disclosures and methodologies for relevant stakeholders.

EBA:

1. 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?

2. 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?

3. Could the green asset ratio be adapted to include taxonomy-related disclosures?

EIOPA:

1. What information should (re)insurance companies subject to the NFRD disclose (e.g. as part of their prudential and broader ESG disclosures) on how their insurance activities correspond to those identified as environmentally sustainable in the EU taxonomy? Should there be a difference between insurers and reinsurers, and between insurance and reinsurance activities?

2. Should they disclose how financial or commercial activities beyond insurance underwriting are directed at funding economic activities identified as environmentally sustainable in the EU taxonomy? If yes, what information should they disclose? Are turnover, CapEx and OpEx appropriate?

3. What should be included in (2)? Could something be excluded and if yes, what types of activities? What should constitute the numerator and the denominator of a possible specific KPI for (re)insurers?

[8] For which ESAs are preparing draft technical standards.

ESMA:

1. What information should any asset management companies subject to the NFRD, notably alternative investment fund managers or UCITS management companies, disclose on how their activities are directed at funding economic activities identified as environmentally sustainable in the EU taxonomy?

2. How should the three KPIs that non-financial undertakings are required to disclose under Article 8(2) of the Taxonomy Regulation be further specified? More specifically:

- Should non-financial undertakings make any further disclosures to accompany the KPIs?
- Should it be specified which KPI/(s) is/are relevant for companies in a given sector?
- What methodology should non-financial undertakings use to report against the identified indicators (allocating turnover/expenditures within the undertaking or group to different economic activities; distinguishing between activities not covered by the taxonomy and activities covered by the taxonomy, but where the undertaking doesn't meet the thresholds/technical screening criteria)?

3. PRINCIPLES

The subject matter of this call for advice is highly focused. It is circumscribed by the requirement of Article 8 to further specify details of the information to be disclosed, and accompanying methodology, for undertakings in relation to the taxonomy. The legal requirement to adopt the delegated act is June 2021. Consequently, the ESAs are invited to consider the task as a targeted one. This may involve shortening some internal deadlines and procedures, e.g. on consultations.

The development of the advice should be based on the following principles:

- **Autonomy:** The ESAs are free to choose working arrangements which they consider most efficient to reach the objectives described in this request, in line with better regulation principles. In particular, the ESAs are invited to utilise existing consultation channels and working formations e.g. on prudential disclosures, to derive the input.
- **Reliable qualitative and quantitative data** should be considered to assess the merits of all recommendations. The advice should aim to build on diverse, but unbiased sources.
- **Justified solution:** the KPIs the ESAs will include in the advice will need to be assessed in terms of their possible impacts while possible trade-offs with other EU objectives should also be considered. As appropriate, the ESAs should consider and justify choices e.g. regarding the need for information which is disclosed to be accurate, useful, usable, and cost-efficient.
- **Cooperation between the ESAs:** The ESAs are free to choose an arrangement for their cooperation, which they consider most efficient to reach the objectives described in this request. While work on questions specific to undertakings in their remit can proceed independently, ESMA, EBA and EIOPA are invited to closely coordinate their work on the advice to ensure consistent and coherent recommendations. The advice can be delivered in the shape of three separate reports by each ESA.
- **Cooperation with other EU bodies:** The ESAs are invited to cooperate with other EU bodies as relevant. Notably, ESAs are encouraged to liaise with the European Financial Reporting Advisory Group (EFRAG), which has been mandated to carry out preparatory

work for possible EU non-financial reporting standards, as well as the Commission's Joint Research Centre.

- **Absence of conflict of interest:** The ESAs shall ensure a transparent and balanced engagement with stakeholders and require, as appropriate, disclosure of sources and avoidance of conflict of interest in the conduct of the discussions and in the development of their advice. Cases involving potential conflict of interest will be duly noted.

4. STEPS AND TENTATIVE TIMETABLE

The advice is expected by February 2021.

The ESAs can choose the best way to approach the exercise in line with the scope and principles defined above. Below a suggested tentative timeline.

Step 1	Formal request sent	September 2020
Step 2	Collecting evidence and stakeholders views and drafting the advice	September 2020 – February 2021
Step 3	Interim drafts and preliminary findings, including KPIs and associated methodology, discussed with the Commission	Continuous
Step 4	Advice finalised	February 2021