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COMMENTS ON TAXONOMY'S REPORTING REQUIREMENTS (Art. 8)

KEY MESSAGES

- 1** This paper summarises the main questions and concerns that companies have in the context of the reporting requirements under Article 8 of the Taxonomy Regulation. We expect it will inform the European Commission when drafting its proposal for a Delegated Act (DA).
- 2** Although companies have a long experience in performing reporting exercises, the new Taxonomy's disclosure requirements will inevitably disrupt their current accounting and reporting systems. The future reporting obligations will intervene in an already well-regulated area and impose significant additional costs due to the establishment of new reporting processes and structures and the implementation of (new) IT systems. These new reporting obligations will also occur at a time when companies' resources are mobilised to manage the impacts of the pandemic crisis. Hence, the importance to make sure corporate reporting requirements are proportionate and fit for purpose.
- 3** In seven specific areas, we expect the Art. 8 DA will bring further clarity:
 - Disclosure obligations should be aligned with the information provided in the companies' financial statements, thus limiting Taxonomy's additional costs and burdens.
 - Providers should be granted a sufficient level of flexibility on how to report on their proportion of turnover, CapEx, OpEx related to environmentally sustainable activities (e.g. structure of the report, format).
 - Reporting requirements for climate change mitigation and climate change adaptation objectives should be delayed until the financial year 2022.
 - Reporting obligations should not negatively affect the companies' competitive advantage, by requiring businesses to disclose confidential information or trade secrets.
 - Disclosure of Taxonomy's indicators should be made at the level of the group, and not per specific sustainable objective and/or economic activity.
 - Companies should not be required to disclose the metrics for economic activities which are not covered by the Taxonomy or for which the criteria are not met.
 - The Commission should set up as soon as possible a helpdesk to respond to practical reporting questions from companies, and ultimately support data quality and comparability.



General remarks on Taxonomy's disclosure obligations

Successful implementation of relevant processes and systems will be crucial to gather meaningful, reliable and comparable data of high quality – in other words, making the Taxonomy work. For this reason and in light of the Taxonomy's disclosure requirements, companies have already attempted to organise internally for a few months now. This shows how much companies recognise the importance to ensure a solid data-gathering process. At the same time, this situation also indicates how much preparation, time, (reporting and verification) costs, and human resources will be needed to comply with the Regulation.

Companies notice that it is extremely challenging to start preparing for complying with the Taxonomy Regulation, as the basis of the corporate disclosure requirements (i.e. the delegated acts setting technical screening criteria and disclosure obligations) has still not been finalised. With such a high level of unclarity, we consider that the schedule for the first application of the new reporting requirements in 2022 for the financial year 2021 is extremely challenging and raises a number of feasibility questions which will have negative effects on data quality and comparability.

In this context, the future delegated act on reporting obligations (due by June 2021) is extremely important: it will clarify the disclosure requirements for undertakings (and financial firms) to comply with the Taxonomy Regulation (i.e. what, when and how to report on). Without these clarifications, not only companies will struggle to comply with their disclosure obligations, but they will also be unable to collect solid data while verifiers/auditors will be unable to assess the companies' reporting. This situation risks undermining the very objective of the Regulation, as not only investors will be unable to take informed decisions, but also financial market participants will be unable to accurately report on the green asset ratio of their respective portfolios.

To effectively support the implementation of the Regulation, avoid confusing users and minimise reporting costs for preparers, we suggest as an overriding principle, that the reporting of turnover, CapEx and OpEx is aligned with the information provided in the company's financial statements. The upcoming DA should therefore be the occasion to ensure that Taxonomy's reporting requirements do not duplicate existing accounting international standards, regulations and issuers' reporting. Furthermore, we suggest that the future DA clearly defines horizontal principles and cross-sectorial standards and methodologies to measure the relevant proportion of Taxonomy-aligned turnover, CapEx and OpEx without putting at disadvantage those companies that have invested in green technologies before the Taxonomy's application. These principles will effectively clarify the companies' reporting obligations, ensure a harmonised approach, while allowing some flexibility on company-specific reporting and practical implementation to avoid unnecessary costs.

To further support the comparability of data between undertakings, we believe that the Commission should take into consideration industry's specific reporting practices as regards the details of the respective requirements, particularly on how to derive or develop the relevant indicators, whilst allowing for flexibility to enable issuers to produce relevant information. This would help clarifying the reporting requirements and producing meaningful and comparable figures. The complexity of a company' reporting exercise should not be underestimated: a company can have thousands of activities to report on, and each of them might have different technical screening criteria which would prevent any use of simple calculating methodologies. Besides, as we expect the technical



screening criteria to change and evolve over time, companies may need to adapt and modify their methodology and organisation accordingly. Furthermore, when drafting its DA, the Commission should consider that other economic actors (particularly SMEs, which are currently not required to make disclosures under the Regulation) may be impacted by the reporting obligations as part of the value chain of the users of the Taxonomy. The Commission shall therefore not only provide proportionate disclosure requirements, but also develop specific guidance to support these economic actors. Also, the Commission should consider establishing a “Helpdesk” for direct clarification of questions of implementation and should provide IT tools to support the data analysis and retrieval. These tools would not only support companies’ reporting exercise but also ensure a high data quality.

Going beyond the Taxonomy’s requirements, we urge the Commission to clarify how these disclosure obligations will fit in the revision of the non-financial reporting Directive (NFRD), which is expected in April 2021, and relevant developments regarding non-financial reporting standards. To be effective and minimise costs, we believe it is necessary to streamline and reach coherence between the various mechanisms: duplications must be avoided, and EU’s non-financial reporting legislations/standards should follow a consistent and logical timeframe.

Finally, we call on the Commission to actively support the development of globally accepted reporting standards that are aligned with international guidelines to optimise costs and improve comparability of the data reported by companies. This would also enable to overcome some of the usability challenges faced by global corporates to apply Taxonomy’s technical screening criteria to their non-EU activities.

Specific comments on Taxonomy’s reporting exercises

a) What should companies report on?

Companies need a full legal clarity on “what” to report on. Art. 8(2) merely sets that companies will have to disclose the proportion of turnover, CapEx and OpEx which is relevant to sustainable activities. As no definition of these metrics is provided in the Regulation, we urge the Commission to clarify the following concepts in its DA:

- **Economic activity** – the DA should clarify the concept of “economic activities”: would companies only report on those activities that generate turnover (e.g. cement production) or any activity corresponding to one of the sub-sector covered by the DA (e.g. transport and shipping activities of a cement producer)? Should companies only refer to “raw materials” when materials are sourced for a taxonomy-aligned activity, and/or whether these materials have been sourced from taxonomy-aligned activities?
- **Enabling activity**: it is unclear whether the definition of ‘directly enabling other activities’ (as from Art. 16) is limited to the next step in the value chain or where it starts and how it relates to the lifecycle perspective. As such, beyond what is already mentioned in the technical screening criteria, the DA should include further clarifications on the topic.
- **Turnover**: the European Securities and Markets Authority (ESMA) suggests in its draft advice to the Commission that “turnover” should be defined in



accordance with the definitions set forth in the Accounting Directive as this is a well-known concept. However, for reporting entities that are used to report turnover in their statement of financial performance according to the definitions in national GAAP/IFRS, a direct reference to the Accounting Directive will be less meaningful and may be confusing. As suggested in our general remarks, we believe that the concept of turnover should be aligned with what is reported in the financial statements. Besides, as we note that not all the consolidations happen at transaction level, the definition of turnover could also include income accounted for under other standards when such income qualifies as arising from an entity's ordinary activity (e.g. joint ventures). Also, it would be extremely important to clarify the application uses. In relation to when turnover can be counted, we expect the DA amends the ESMA's draft advice on climate change adaptation: turnover can be counted not only when the activity enables other activities to undergo climate change adaptation, but also when the activity includes adaptation solutions that substantially reduce the risk of adverse impact on the climate.

- **CapEx:** Capital expenditures will eventually be the most important metric in the reporting exercise, especially for sectors in transition. To provide meaningful indication, we suggest that the definition of "CapEx" mirrors the information included in companies' financial statement in accordance with applied IFRS. The alignment to IFRS or national GAAP is key to give undertakings flexibility to disclose their activities in a consistent way. Similar to what the Platform on Sustainable Finance suggested in its December contribution to the draft technical screening criteria for climate change mitigation and climate change adaptation objectives, we suggest that CapEx should be part of a plan, but that sufficient flexibility of the plan period is granted: some business models might be short whilst others (e.g. infrastructures, R&D projects) may require a long timeframe. A fixed period does not reflect the nature of investment decisions: any management judgment must be taken into account. Also, a requirement to publicly disclose a sustainable project as the only way to have investment costs recognised as part of a plan may put companies in an absurd situation of having to choose between having their investments acknowledged as sustainable or losing a competitive advantage. We expect that the possible required publication of the plan would force companies to disclose business details for individual economic activities which would allow competitors to analyse European companies' business strategies and make use of this sensitive information, which should be avoided at all costs. The DA should recognise that qualitative analysis explaining the changes performed year over year is proportionate to the objective of the Regulation.
- **OpEx:** The DA must clarify how to calculate Operating Expenditures (OpEx) as including all operating expenses that are linked to business activities. We suggest counting OpEx if they are related to an already existing Taxonomy-aligned activity (e.g. selling costs related to Taxonomy-aligned turnover) or if they are part of a plan to make an activity Taxonomy-aligned (e.g. non-capitalised R&D expenditures, costs to prepare CapEx). Possible extensions to purchasing and leasing costs should be initially excluded from the definition – conversely, they could potentially be included following a thorough assessment and once companies are able to comply with the current obligations. Lastly, the DA should specify that the disclosure of the OpEx metric should be made only "when relevant": this addition corrects the level-1 legislation by recognising the



variety of existing business models. This correction has already been made orally by the Commission, but it needs to be formally reported in the actual DA. In this context, the Commission should also clarify the meaning of “relevance”.

- **Uncovered activities:** as per Art. 8, companies are expected to disclose taxonomy-aligned activities only. Entities could voluntarily provide additional data, which could be useful if a company believes the information on these activities (which are still not covered by the Taxonomy Regulation) may be relevant to their investors. For instance, a company may want to report on the sale of downstream products generated from taxonomy-aligned assets (e.g. sale of power generated by renewable sources). However, we recommend the DA avoids obliging companies to report on activities that are not yet covered by the Taxonomy (or that are covered but not Taxonomy-aligned): although companies might decide it is relevant to disclose this data, any requirement to make it mandatory would go against the objective of creating a common classification system and go beyond level-1 text.
- **International activities:** we urge the Commission to clarify how to assess economic activities carried out and/or products or services produced in plants outside of Europe where different metrics (e.g. EU ETS benchmarks) and decarbonisation perspectives (technology readiness, EU starting points, etc.) apply. In particular, companies should be allowed to use proxies for their non-EU economic activities.
- **Materiality:** The DA should clarify how the disclosure requirements in the Taxonomy Regulation should be regarded in light of the materiality principle included in the Accounting Directive. For many reporting entities, the economic activities covered by the Taxonomy Regulation will be of little or no relevance. However, the disclosure requirements apply to all entities falling under the NFRD’s scope. To avoid misleading and unnecessary costs of providing immaterial information, the DA should make it clear that a general materiality principle applies to the disclosure requirements under the Taxonomy Regulation.

b) When should companies prepare their report?

To ensure a meaningful, reliable and comparable data disclosure, it is essential that companies have full clarity about the technical screening criteria for climate and environmental objectives as well as the reporting obligations in terms of methodology, presentation and content before being required to report on their Taxonomy-aligned activities.

The technical screening criteria for climate change mitigation and climate change adaptation objectives will only be formally adopted and published in the EU’s Official Journal in the course of 2021 (i.e. later than what was required in the level-1 legislation), whilst the draft technical screening criteria for the remaining environmental objectives may be proposed some time in 2022. As the Commission requires companies to report on their 2021 financial year, this would mean that they will have to start the data collection processes manually from the beginning of 2021 according to their “best guess”. This situation is hardly satisfying as it implies poor data quality in 2022 and poor Taxonomy reporting (green asset ratio) by financial market participants who depend on corporate



disclosure. Also, it risks damaging companies' reputation on capital markets. Investors have well understood this impossibility and they will eventually treat 2022 as a 'pilot year' and wait until 2023 to start their analysis.

Furthermore, the reporting requirements will only be adopted later in 2021. This means that companies are not able to begin collecting data at the beginning of 2021, because fundamental definitions for economic activities, CapEx and OpEx are still unclear. This situation implies that any data collection exercise that has started before the clarification of these definitions might retrieve information that cannot be accounted for the Taxonomy's reporting obligations. But even when Art. 8 DA is adopted, corporates will have a very limited time to collect the relevant data without the possibility to implement data collection systems in due time. This situation would result in an unproportionate, inefficient and sometimes even impossible workaround to gather data and would have negative effects on data quality which would not meet the demands and expectations of the various stakeholders.

Lastly, this timeline is not only extremely challenging to be implemented but also raises a question of responsibility: if the Commission is encountering delays in adopting the technical screening criteria for climate change mitigation and climate change adaptation objectives, how could companies be able to respect the initially foreseen timeline with no clarification on what and how to report on their Taxonomy-aligned activities?

For these reasons, we second ESMA's reasoning that the future DA should not require retroactive disclosure. However, we think this reasoning is valid for both climate and environmental objectives: no disclosures for unofficial climate change objectives and undefined environmental objectives should be required. As such, the DA should delay the disclosure obligations for climate change mitigation and climate change adaptation objectives until the financial year 2022. Similarly, companies should report on the four remaining environmental objectives only after the relevant technical screening criteria are defined. In this way companies would have enough time and clarity to effectively prepare for their data collection, which would ensure the required data quality. The Commission may also consider establishing a non-mandatory pilot phase for those companies willing to test their reporting systems and economic activities in 2022.

c) How should companies report their Taxonomy's obligations?

The future DA will clarify "how" companies shall report on their activities. We do not expect the Commission to determine the actual format to be used by undertakings to present the data (which would risk not taking into account the peculiarities of each company), but the DA would be essential to determine the scope of the reporting obligations (e.g. granularity).

Bearing in mind the objectives of the Taxonomy Regulation, we think that the publication of the plan for transparency reasons does not outweigh the significant detrimental commercial impact that such a premature disclosure may have: a public report would disclose sensitive strategic information which might be used by competitors, risk reorienting investments by non-EU companies to outside the EU, and ultimately undermine the EU's economic competitiveness and growth. Sustainable investments are often part of strategically important projects, and their premature disclosure may affect the companies' competitive advantage, by disclosing business confidential information and trade secrets. In this context, we strongly encourage the Commission to support a global set of internationally recognised sustainability reporting standards and



requirements (such as globally accepted international reporting standards). This would allow companies to build public trust through greater transparency of their sustainability initiatives, which will be helpful to investors, and avoid putting EU companies at a disadvantage compared to international competitors. This would also set a single trusted set of standards which would reduce local reporting and audit costs.

Companies will have to report on the proportion of their turnover, CapEx and – when relevant - OpEx which is attributable to sustainable activities. We expect the DA will require the publication of the three indicators at the level of the group, and not per specific sustainable objective and /or economic activity. Conversely, a disaggregation into their individual economic activities will disproportionately increase the reporting costs and raise questions on usability and applicability of the Taxonomy's requirements, without generating any concrete benefit including for investors. We suggest that this further granular reporting, at the level of each economic activity and sustainable objective, may be left at the discretion of each undertaking, as it goes beyond what is required by Art. 8. We consider that the alleged risk of double counting is not a sufficient justification to go beyond the level of disclosure obligations set out in Art. 8 because data are typically verified by external auditors. Also, such a granular reporting could be impossible to implement as the NACE classification is not coherent with the one used by the undertakings in their existing reporting exercises.

The DA should clarify that the obligations cover the share of companies' turnover, CapEx and – when relevant - OpEx which are Taxonomy-aligned. We think that the DA should refrain from requiring companies to disclose the metrics for economic activities which are covered by the Taxonomy but for which the relevant criteria are not met (and therefore are not Taxonomy-aligned). This is in line with Art. 8 of the Taxonomy Regulation which specifically requires companies to disclose the proportion of their sustainable activities.

Acknowledging the fact that especially CapEx will often be subject to allocation (e.g. invest in production lines used for eligible and non-eligible products), the DA should clarify that the usage of allocation mechanism may be reasonable, but needs to be described for the addressee to understand how the figures were derived.

Companies are expected to assess their compliance with technical screening criteria at activity line level, whilst reporting procedures and enterprise resource planning will be organised by legal entities or operating units. As it will be difficult for companies to determine the contribution of each site or product line to the revenue (this would require the implementation of a dedicated analytical accounting process), we would recommend the DA to allow for a certain flexibility, notably companies should be allowed to establish and implement new procedures and potentially modify their IT systems as their activities suggest it is best.

Lastly, to reduce the foreseen additional costs, we urge that the Commission opens a helpdesk which would work as a one stop shop providing relevant information to companies. The Taxonomy would require important rearrangements, because companies do not organise their reporting processes and IT systems according to the NACE classification. In some cases, companies may also need to go beyond the NACE code level. We believe that by opening a communication channel, the Commission would effectively support companies' reporting efforts, clarifying their questions of implementation and data analysis and retrieval. All in all, this Commission's practical support to companies will have a positive impact on data quality and Taxonomy's implementation.



Conclusions

We expect this position paper will inform the Commission about the expectations and questions that companies have in the context of the Taxonomy's reporting requirements.

Companies are willing to support an effective implementation of the Sustainable Finance agenda, and the questions above show that they are preparing to report reliable information, in compliance with the Taxonomy Regulation. We recognise the possible game changing opportunities offered by such a classification system. However, to achieve the desired objective, it is necessary that corporates are provided with the exact information and the necessary time, resources, and flexibility to comply with these reporting obligations.

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