PLATFORM ON
SUSTAINABLE FINANCE

A Compendium of Market Practices

How the EU's Taxonomy and sustainable finance framework are helping financial and non-financial actors transition to net zero.

January 2024

Disclaimer

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The considerations below are compiled under the aegis of the Platform on Sustainable Finance and cannot be construed as official guidance by the European Supervisory Authorities (ESAs). As a result, the views and recommendations do not purport to represent or anticipate any future official guidance and views issued by the ESAs which may differ from the contents of this report.

The inclusion of market practices in this report cannot be construed as their endorsement or validation, in particular for the purpose of assessing Taxonomy-alignment of exposures or use of proceeds by the PSF, the ESAs, nor the European Commission. The market practices described in the Annex to this report shall not be deemed to be automatically compliant with the legal obligations under the Commission Delegated Regulation (EU) 2021/2178 or other relevant EU legislation or Commission guidance documents.

List of abbreviations

CSRD	Corporate Sustainability Reporting Directive
CSSSD	Corporate Sustainability Due Diligence Directive
DNSH	Do no significant harm
EBA	European Banking Authority
ESMA	European Securities and Markets Authority
ESRS	European Sustainability Reporting Standards
GAR	Green asset ratio
GIR	Green investment ratio
GSSSB	Green, social and sustainability-linked bonds
GBS	EU Green Bond Standard
GHG	Greenhouse gas
IDD	Insurance Distribution Directive
MIFID	Markets in Financial Information Directive
NFRD	Non-financial Reporting Directive
PAI	Principal adverse impact
PSF	Platform on Sustainable Finance
RRF	Recovery and Resilience Facility
SBTi	Science Based Targets initiative
SDGs	Sustainable Development Goals
SFDR	Sustainable Finance Disclosure Regulation
SPO	Second-party opinion
SSA	Sovereign, supranational and agency
SME	Small and medium-sized enterprise
TSC	Technical screening criteria
UCITS	Undertakings for Collective Investment in Transferable Securities

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About this report

The objective of this report is to consider how the EU sustainable finance framework can be used to support and inform the transition efforts of economic actors, beyond mere regulatory compliance. It presents a compendium of early practices, financial products, instruments and initiatives that market participants are employing to transition their business models and investments. Companies made encouraging initial disclosures in 2023, for example in sectors such as utilities and real estate, demonstrating that capital expenditures associated with the EU Taxonomy can inform the transition of key economic activities.[1]

The findings in this report build on the European Commission's 2023 Recommendations on Transition Finance, the 2023 EU Communication 'A sustainable finance framework that works on the ground', as well as on the 2022 Platform on Sustainable Finance (PSF) data and usability report. They reflect on the evolution of the EU's sustainable finance agenda in recent years, one that has shifted from a focus on promoting transparency, standards and clarity around investor duties to a more holistic and inclusive approach. As the EU concludes a political cycle and starts planning for the work of the next European Commission, it is crucial that the EU's sustainable finance framework can demonstrate how it supports, encourages and enables market participants and the wider financial system to meet the EU's climate and environmental goals under the Green Deal.

The market practices reflect the contributions of seven stakeholder groups, including large corporates, credit institutions, investors, insurers, public institutions, auditors and consultants, and SMEs (small and medium-sized enterprises). They also reflect the early stages of adoption of the EU sustainable finance framework and should not be interpreted as best practice or a 'market standard'. Building on those, the seven stakeholder groups propose peer-to-peer recommendations and invite market actors to engage and share business and financial practices with the EU Platform on Sustainable Finance (PSF) on a regular basis to continue to enhance the value and benefits of the framework.

Finally, the stocktake process undertaken to produce this compendium suggests that the usability of the EU Taxonomy and wider framework needs to be further improved to fully support financial and non-financial actors in transitioning their business models to align with the EU's sustainability objectives. This report presents key recommendations and priorities for the PSF's future work in its advisory role to the European Commission. These derive from the market practices and observations made by the seven stakeholder groups, and build on those identified by the Platform in its previous work on data and usability.

1 Morningstar Sustainalytics, September 2023, EU Taxonomy, SFDR, BMR Data for EU Platform on Sustainable Finance

The market practices span three areas:

1. the use of the EU sustainable finance framework for business strategy, transition planning and target setting;
2. finance and transactions; and
3. reporting, monitoring and assurance.

Business strategy, transition planning and target-setting:

This section includes observations from each stakeholder group on how the EU Taxonomy and the wider sustainable finance framework are used by financial and non-financial actors to structure entity-level transition plans and business strategies to achieve net zero by 2050. Early evidence suggests that market actors have started using the EU sustainable finance framework to prepare for regulatory compliance, in addition to supporting their sustainable business and transition planning strategies on a voluntary basis.

Observations described in this compendium in particular reflect on, and include elements of, the EU Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR) and the Corporate Sustainability Reporting Directive (CSRD).

Finance and transactions

This section includes observations from each stakeholder group on the extent to which EU tools and frameworks are being adopted by financial and non-financial actors when structuring sustainable or transition finance solutions across a range of financial products and instruments, including green and sustainability-linked bonds, loans and investment funds. This trend is expected to accelerate over the next few years, as the availability and quality of sustainability disclosures improve, and as new standards such as the European Sustainability Reporting Standards (ESRS) and the EU Green Bond Standard (GBS) enter into force.

Observations described in this compendium reflect on and include elements of the SFDR, the EU Taxonomy Regulation, the CSRD, the EU GBS and the EU's climate-related benchmarks.

Reporting, monitoring and assurance

This section includes early observations from each stakeholder group of the state of reporting by financial and non-financial actors, and of the processes in place to conduct data collection and verification. Despite remaining challenges, most market participants have started to adapt their practices to comply with the new EU sustainability reporting requirements. Investors have also initiated SFDR disclosures, including entity-level principal adverse impact (PAI) disclosures. Taxonomy alignment reporting for financial institutions is expected to improve in the coming years in parallel with corporate reporting, as data collection and verification processes are implemented.

Observations described in this compendium reflect on, and include elements of, the EU Taxonomy Regulation, the SFDR, the CSRD and the Climate-related Benchmarks.

Peer-to-peer recommendations

This section builds on the market practices and suggests peer-to-peer recommendations to encourage and accelerate the use of the EU sustainable finance framework for strategic and decision-making purposes. The PSF encourages market participants to use the EU sustainable finance framework to inform business transition efforts and invites peers to share business and financial practices with the PSF on a regular basis to continue to enhance the value of the framework. It also encourages market participants across the value chain to continue to build market capacities and understanding of the framework, and to facilitate knowledge sharing.

Corporates	**The Corporate stakeholder group encourages peers to:** ▪ define EU Taxonomy alignment roadmaps and targets using Taxonomy key performance indicators (KPIs) under companies' direct control to enable science-based decarbonisation; set trajectories and net-zero targets; ▪ integrate Taxonomy-aligned capex KPIs and plans as part of the CSRD ESRS transition plan disclosures; build on the EU sustainable finance framework as central element of corporate transition plans; ▪ issue sustainable finance transactions, making use of green or sustainability-linked instruments that are based on KPIs that signal a Taxonomy transition; ▪ actively engage with supply chains and prepare for CSRD ESRS disclosures and the Corporate Sustainability Due Diligence Directive (CSDDD) accordingly; ▪ make use of the EU Taxonomy stakeholder request mechanism to suggest the revision of existing criteria or eligible economic activities of the EU Taxonomy framework; and ▪ consider providing Taxonomy-alignment analysis to credit institutions when they seek activity-specific financing to improve information flows.
Investors	**The Investor stakeholder group encourages peers to:** ▪ use the EU Taxonomy and upcoming CSRD ESRS to support the definition and implementation of entity-level net-zero targets; ▪ use the EU Taxonomy KPIs reported by investee companies in the development and management of green and transition financial products; ▪ use the EU Taxonomy KPIs reported by investee companies to support shareholder engagement and analysis of transition plans and targets at investee company level; ▪ use the EU Taxonomy framework as basis for environmental, social and governance due diligence in project financing and investments in unlisted companies; ▪ continue building capacities of sales staff regarding the EU sustainable finance framework to enhance in a consistent manner end-investors' sustainable finance literacy, with the aim of supporting an effective uptake of MIFID/IDD requirements and sustainability preferences; ▪ continue engaging with data providers to progressively increase the reliability of datasets and their usefulness beyond disclosure obligations; and ▪ enhance the integration and uptake of the EU sustainable finance framework within market-led initiatives.

Credit institutions	**The Credit institutions stakeholder group encourages peers to:** ▪ use the EU Taxonomy and the wider sustainable finance framework in relevant sustainable banking products and services for the purpose of engaging with business and retail clients to support them in achieving their climate transition plans and strategies; ▪ provide high-quality and comparable sustainability-labelled or green financing products, and monitor the positive impact of these products in line with the EU Taxonomy and with reliable market-led sustainable finance frameworks; ▪ enhance the transparency of disclosures at entity-level, including through sourcing data and addressing its limitations, and ensure accountability of sustainability commitments to prevent greenwashing, making use of the EU sustainable finance framework; ▪ raise awareness amongst SMEs and retail clients of the benefits of the EU sustainable finance framework for planning their business strategies, including transition planning, and for improving their access to sustainable finance; ▪ use the EU Taxonomy as a tool to measure alignment (or misalignment) of client entities with the EU environmental objectives, for risk mitigation assessment purposes, as relevant;[2] and ▪ enhance the integration and uptake of the EU sustainable finance framework within market-led initiatives.
Insurers (underwriting)	**The Insurers stakeholder group encourages peers to:** ▪ develop additional market guidance to support the comparability and usefulness of qualitative voluntary disclosures related to the EU Taxonomy underwriting KPIs; ▪ refer to the EU Taxonomy framework for product development purposes to improve comparability and reduce greenwashing concerns; and ▪ enhance the integration and uptake of the EU sustainable finance framework within market-led initiatives.
Consultants and auditors	**The consultants and auditors stakeholder group encourages peers to:** ▪ support their clients to use the EU sustainable finance framework for business strategy development, target-setting and transition finance purposes, in addition to compliance with their reporting obligations and/or for assurance purposes; ▪ ensure training and guidance for auditors and consultants on EU Taxonomy and CSRD ESRS assessments and on the integration of sustainability preferences by financial advisors; ▪ ensure that all advice is in line with appropriate European Commission interpretative and technical guidance; ▪ ensure homogeneity of interpretations among auditing and consulting firms on advice provided about the EU sustainable finance framework; and ▪ support clients with improving internal controls and governance for sustainability performance. **Assurance providers specifically should:** ▪ initiate discussions with clients on the levels proposed for accuracy and completeness of reported information in the ISSA 5000 standard, including on how to enhance and adapt it to the EU sustainable finance framework; and ▪ increase the level and frequency of internal training to improve quality and clarity for assuring the EU sustainable finance framework.

2 Misalignment of client entities with net-zero targets. Note that the EU Taxonomy is not primarily intended to be the main tool to assess financial risks stemming from the transition. Therefore, misalignment risk should not necessarily be the focus in the usability assessment of the Taxonomy.

Public sector	**The public sector stakeholder group encourages peers to:**[3] ▪ accelerate the issuance of green use-of-proceeds bonds directed at economic activities that are EU Taxonomy-aligned, in the process of aligning or transitional; ▪ accelerate gradual uptake of the EU Taxonomy for green use-of-proceeds bonds and alignment with the EU GBS. Elements of the Taxonomy can be applied gradually, starting with substantial contribution criteria, for example, and considering relevant proxies for the do no significant harm (DNSH) criteria and minimum safeguards. This approach is possible when no claim of full EU GBS or Taxonomy alignment is made; ▪ encourage and advise final recipients of the funds to use the EU Taxonomy to plan and monitor their transition strategies. Encourage them to make voluntary use of Taxonomy-based reporting and KPIs, irrespective of whether the activity is fully aligned with the Taxonomy, and/or whether the Article 8 Disclosures Delegated Act allows for mandatory reporting of such exposures; ▪ consider the use of Taxonomy-based reporting and KPIs for early and progressive monitoring of business transition strategies in a way that can be monitored by markets, even when entities are only making use of partial elements of the EU Taxonomy framework (e.g., for substantial contribution, DNSH or minimum social safeguards criteria); ▪ consider using/integrating the EU Taxonomy to tax expenditure programmes, green procurement policies and transfer programmes, including subsidies, where relevant; and ▪ increase awareness across all levels of public administration, within and across ministries and/or departments, to accelerate the uptake of the EU Taxonomy by market actors.
SMEs	**The SME stakeholder group encourages peers to:** ▪ start making the necessary efforts to report on a voluntary basis, starting with the key indicators relevant to business models, activities and clients´ requests.[4] Even if SMEs are not directly in scope of the CSRD (except for listed SMEs), some of the reporting requirements for large enterprises and financial institutions may be passed on to SMEs through various channels (the trickle-down effect); and ▪ make use of the EU sustainable finance framework to support and inform their own transition and greening activities. By preparing sustainability data to meet requests from clients or financiers, SMEs can facilitate and accelerate their access to sustainable finance.

3 The Public Sector encompasses the following Bloomberg-defined categories: Supranationals, Sovereigns, Government Regional, Government Local, Government Development Banks, and Government Agencies.

4 At the time of writing, the Voluntary ESRS for SMEs had not yet been published. The Platform advocates for these voluntary standards to provide information on key indicators that large enterprises and financial institutions require from their suppliers, customers and financial institutions in order to fulfil their reporting duties.

Priorities for the EU Platform on Sustainable Finance to improve the usability of the EU sustainable finance framework

The market practices and observations collected in the stocktake process suggest that the usability of the EU Taxonomy and wider framework needs to be further improved to fully support financial and non-financial actors in transitioning their business models to align with the EU's sustainability objectives. Below are the key recommendations and priorities for the PSF's future work in its advisory role to the European Commission. These derive from the market practices and the observations of the seven stakeholder group, and they build on those identified by the PSF in its previous work on data and usability (2022).

1. **To enhance the usability and scope of the EU Taxonomy framework,** the Platform on Sustainable Finance shall:
    a. advise the European Commission on how to improve the usability of the DNSH technical screening criteria, with a view to contributing to the future revision of the Climate Delegated Act. In addition, the PSF may advise the European Commission on the development of practical guidance to facilitate the implementation of the DNSH criteria. Technical screening criteria are useful tools for target setting and transition planning purposes. However, the process and usability issues related to collecting evidence against the DNSH criteria should be improved to better enable the use of the EU Taxonomy for both reporting and strategic planning purposes. Otherwise, users of the EU Taxonomy are likely to continue to face implementation challenges, undermining the uptake of the EU Taxonomy framework over time. In addition, while the PSF supports the use of estimates for non-EU exposures, these merit further analysis, in conjunction with the review of the Disclosures Delegated Act. The outcome of such a review should seek to enhance usability, and collection of information from Taxonomy users, and it shall also maintain the environmental integrity and performance levels of the EU Taxonomy;
    b. continue to analyse and increase the scope of eligible economic activities and improve existing criteria across all six of the EU's environmental objectives. The PSF will take into consideration requests made via the EU Taxonomy stakeholder request mechanism, as relevant;

c. review progress on the application and usability of the minimum safeguards by all Taxonomy users, building on the PSF analysis and minimum safeguards recommendations published in October 2022, the EU Commission Notice from December 2022 and the Commission Notice from June 2023;[5] and
d. advise the European Commission on how to ease the implementation of certain technical screening criteria applied to some financial services (e.g., retail lending and mortgages, underwriting and public sector finance), and continue to support the European Commission as part of the review of the Climate Delegated Act, as relevant. Finally, the PSF encourages market stakeholders to make use of the EU Taxonomy Navigator, which offers a series of online tools to help users better understand the EU Taxonomy.

2. **To improve the usability of EU Taxonomy KPIs by financial and non-financial entities,** the Platform on Sustainable Finance shall:
   a. advise the European Commission on the usability of the green asset ratio (GAR) as part of the review of the Disclosures Delegated Act. In addition, the PSF may advise the European Commission on the development of practical guidance to credit institutions to facilitate the computation of the GAR. The GAR can become a useful indicator to assess and monitor progress towards the EU environmental objectives. The current GAR excludes coverage of meaningful exposures (e.g., to SMEs, use-of-proceeds instruments from central governments and supranational entities) and access to information remains a challenge for banks to compute, report and use the GAR for strategic purposes (e.g., for retail exposures);
   b. advise the European Commission on the quality and granularity of capex plans issued by non-financial companies, and adequate processes for their implementation;
   c. provide recommendations to the European Commission on the usability of the opex KPI for non-financial companies. While reporting turnover and capex KPIs can help inform strategic business decision making and transition planning, the opex KPI remains unclear to companies across several sectors; and
   d. advise the European Commission on the computation rules and scope of application of the underwriting KPI for insurers. In addition, advise the European Commission on the development of practical guidance for insurers to apply the climate adaptation criteria and to measure risks associated with climate-related perils in that context. For example, the underwriting KPI only applies to adaptation activities and does not recognise the potential contribution of insurance activities to other environmental objectives.

5 European Commission (2023), COMMISSION NOTICE on the interpretation and implementation of certain legal provisions of the EU Taxonomy Regulation and links to the Sustainable Finance Disclosure Regulation (2023/C 211/01)

3. **To enhance consistency, credibility and accelerate the use of transition plans in line with the sustainable finance regulatory framework,** the Platform on Sustainable Finance shall:
   a. advise the European Commission on the consistency and interoperability of transition plans across the EU sustainable finance framework, and on the interactions between the transition plans of financial and non-financial entities; together with providing guidance on the systematic integration of EU Taxonomy KPIs in transition plans to enhance accountability and reliability, in line with the CSRD ESRS E1.1; and
   b. provide recommendations to the European Commission on the use of the EU sustainable finance framework for transition and sustainability-linked debt financing instruments. Market practices suggest that these instruments can be important tools to support companies' and banks' transition and financing strategies.

4. **To continue to support investors' uptake of the EU sustainable finance framework and enhance shareholder engagement,** the Platform on Sustainable Finance shall:
   a. support the European Commission with the SFDR assessment, with the aim of simplifying the regulation by reducing interpretative issues, enhancing its effectiveness and improving coherence with other pieces of the EU sustainable finance regulatory framework. As part of this, the PSF shall advise on the feasibility and relevance of a labelling or classification system that translates to end-investors the complexities and nuances of assessing sustainability performance against the Taxonomy, sustainable investments or PAIs in a clear and simple manner. The SFDR should support the effective differentiation of the types of investments within the policies and guidance (asset classes, public/private and liquid/illiquid);
   b. assess the need for guidance on the coherence between SFDR, MIFID and IDD requirements in relation to sustainability preferences, and in light of the upcoming Retail Investment Strategy; and
   c. advise the European Commission on how to enhance the role of shareholder engagement and proxy voting in the EU sustainable finance framework.[6]

5. **To support the development of a simplified and voluntary taxonomy approach for SMEs and facilitate access to green finance accordingly,** the Platform on Sustainable Finance shall:
   a. advise the European Commission on how to develop a simplified approach inspired by the EU Taxonomy that responds to the needs and capabilities of SMEs and that helps inform their own sustainable transition on a voluntary basis, starting with the climate mitigation objective;

6 In its 2021 Strategy for Financing the Transition to a Sustainable Economy, the Commission said it will explore how the Shareholder Rights Directive II may better reflect impact considerations and global best practices in stewardship guidelines.

b. contribute to the ESRS Voluntary SME (VSME) standard in development by the European Financial Reporting Advisory Group (EFRAG), with a focus on Taxonomy-related metrics and frameworks;[7] and
c. support access to green and transition finance for SMEs in the EU sustainable finance framework. This should include encouraging consistency in the use of the voluntary and simplified approach (point a) and the ESRS VSME for sustainable finance purposes and in financial institutions´ reporting obligations, and the development of simple transition targets.[8]

6. **To improve data collection by all entities,** the Platform on Sustainable Finance shall:
   a. advise the European Commission on how to enhance standardisation and improve the quality and availability of environmental data across the EU to support market actors with Taxonomy-alignment assessments;
   b. advise the European Commission and provide recommendations to auditors and consultants on how to increase homogeneity of interpretations among auditing and consulting firms on advice provided about the EU sustainable finance framework, and second-party opinion (SPO) providers for green bond issuances; and
   c. advise the European Commission on how to enhance the reliability and consistency of PAI and Taxonomy data distributed by data providers.

7. **To advise the European Commission on how to encourage the uptake of the EU Green Bond Standard by issuers that are not in scope of the CSRD** (e.g., public sector, non-EU issuers), the Platform on Sustainable Finance shall provide guidance on the gradual application of the EU Taxonomy to green bonds.

The Platform will further prioritise its workplan based on the above, organise stakeholder outreach as relevant and work to formulate recommendations to be presented in its usability report to the European Commission at the end of its mandate.

7 At the time of writing, the Voluntary ESRS for SMEs had not yet been published. The Platform advocates for these voluntary standards to provide information on key indicators that large enterprises and financial institutions require from their suppliers, customers and financial institutions in order to fulfil their reporting duties.

8 For example, by supporting the integration of exposures to SMEs by credit institutions and other financial institutions as part of their GAR/green investment ratio (GIR), as part of the review of the Article 8 Disclosures Delegated Act.

The EU's sustainable finance framework and transition finance

An estimated €700bn in additional capital will be needed each year from 2021 to 2030, compared with the previous decade, to decarbonise the EU's economy and achieve its environmental targets under the EU Climate Law, Fit for 55 and the Net Zero Industry Act.[9] This will require an alignment of all sources of finance—public, private, national and multilateral, to fund the transition of business models across the whole of the EU's economy.[10]

Over the past five years, the EU has placed itself at the forefront of global policy efforts around sustainable finance. Since the EU's 2018 Action Plan on Sustainable Finance, legislative measures have been adopted that aim to channel private financial flows towards sustainable economic activities. Specifically, the EU has created a sustainable finance regulatory framework composed of three building blocks:

1. the EU Taxonomy;
2. a comprehensive and mandatory disclosure regime for different market actors; and
3. a set of investment tools, including benchmarks, standards, labels as well as financing programmes and advisory services to facilitate the alignment of investment strategies with the EU's sustainability goals.[11]

These initial measures provide transparency, standards, and clarity on investor duties to guide the market towards sustainable investments and activities and help channel financial flows towards sustainable economic activities.

Building on the above, the European Commission's strategy for financing the transition to a sustainable economy sets out a holistic approach for the financial system to fully support the real economy's transition towards meeting the EU's climate and environmental goals under the EU Green Deal. As well as supporting flows of capital towards economic activities that are already environmentally sustainable, the framework addresses the challenge of financing meaningful and credible interim steps in the transition towards sustainable activities across economic sectors. A key objective of this new phase of the strategy is to provide tools and policies that enable market actors across the economy to finance their transition plans and to reach their sustainability targets, regardless of their starting point.

9 The European Commission (2023), COMMISSION RECOMMENDATION (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy

10 The EU Platform is reviewing the investment gap and will monitor capital flows to sustainable investments as part of its 2023–24 mandate.

11 For example, the Invest EU programme and the Innovation Fund.

Recent legislative proposals from the Commission have followed this rationale. The CSRD, adopted in 2022, creates a reporting standard and requirements for transition planning and financing, with a focus on intermediary targets aligned with pathways to limit warming to 1.5 degrees in line with the Paris Agreement.

Finally, the Commission's 2023 Communication on Transition Finance explains how existing tools and measures under the EU's sustainable finance framework (notably the EU Taxonomy as a key element of credible transition plans) can be used to this end.

Once fully implemented, the various policy instruments mentioned above could be combined with other market incentives and/or practices, enabling market actors to effectively plan and fund the transformation of their business models to align with the Paris Agreement and EU's transition to net zero and climate resilience.

The market observations showcased in this report illustrate how market participants are starting to use these tools to transition their activities, highlighting some of the benefits, shortcomings, and early recommendations to further facilitate the transition.

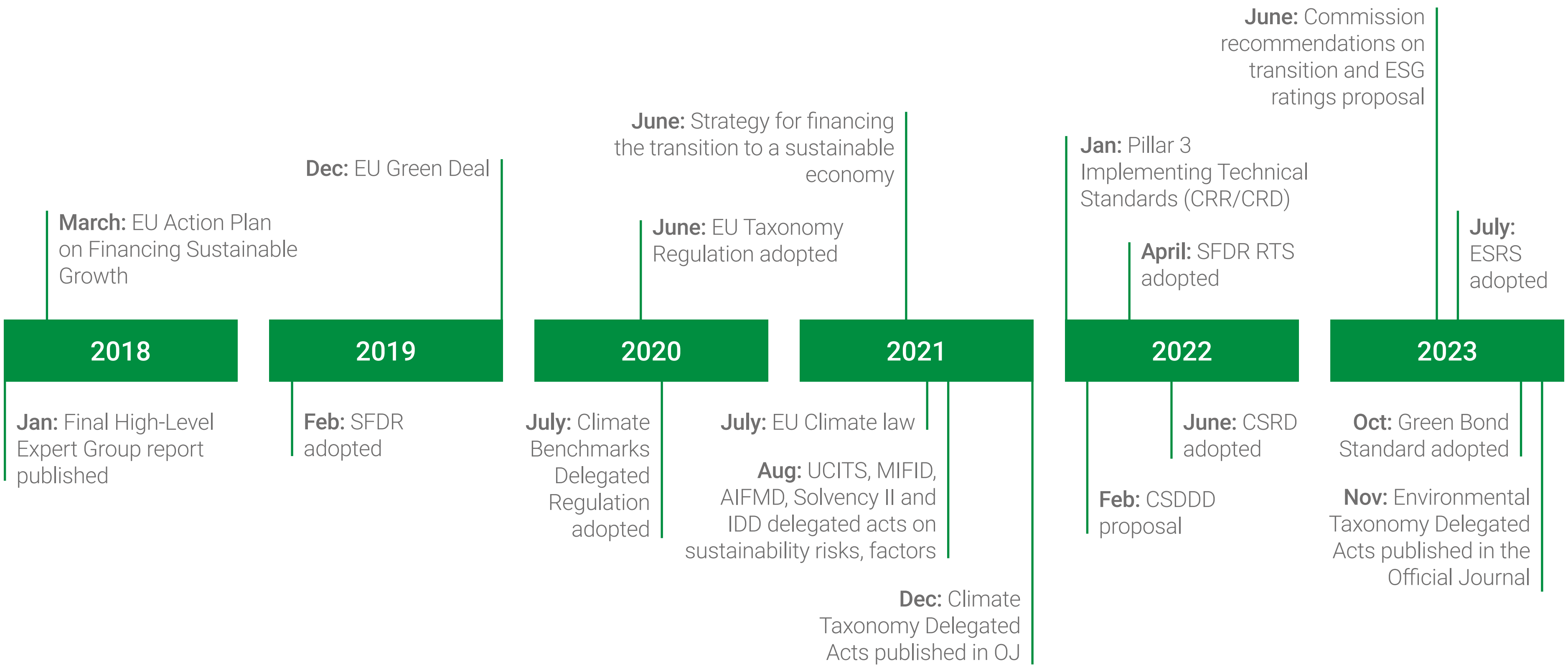


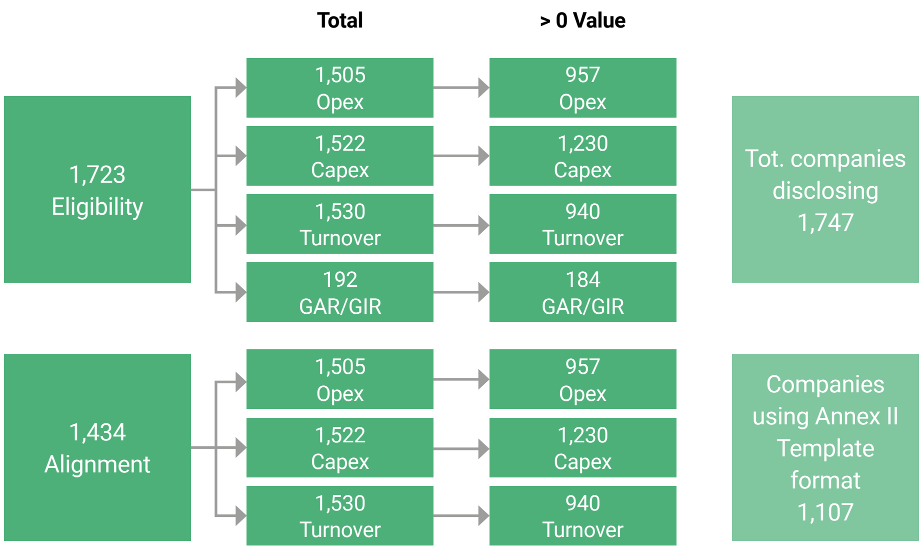
Figure 1: Progress on the EU sustainable finance framework since 2018

Selection of market trends: early adoption of the EU sustainable finance framework

Selected market trends consider early adoption of the EU sustainable finance framework by actors within the value chain. They are indicative figures, considering the very nascent nature of reporting against the EU Taxonomy in particular, and the likely self-selection bias in terms of which companies reported and which have not.

1,747 EU companies report taxonomy metrics

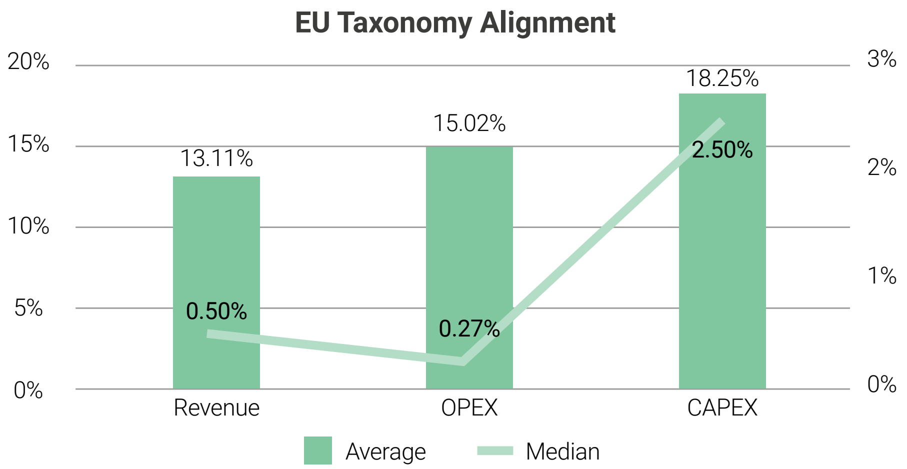
As of December 2023, 1,747 companies have reported at least one Taxonomy metric, of which 1,434 have reported on Taxonomy alignment (FY 2022), including 1 in 2 companies who report capex eligibility are aligned to some extent. Of those 1,747 companies, 1,496 EU27 companies that fall under the NFRD have reported at least one Taxonomy metric.

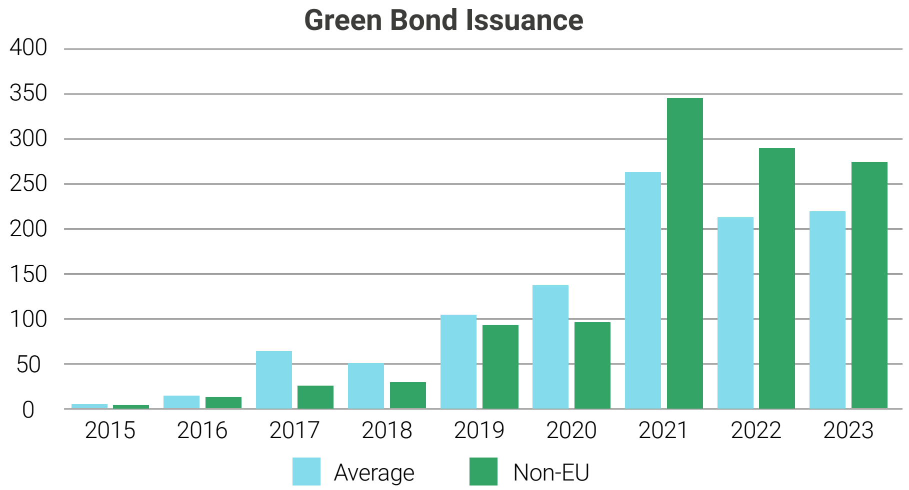


Source: Bloomberg (based on 'As Reported Data' as of December 2023)

Data source: Based on a universe including 15,540 constituents ('BESGPRO Index')

Note: this includes non-EU companies who are voluntarily reporting under the EU Taxonomy.

70% use Taxonomy mandatory templates	As part of its fact-finding exercise conducted in 2023, the European Securities and Markets Authority (ESMA) found that almost all selected issuers that are active in four main sectors covered by the Taxonomy Climate Delegated Act (manufacturing, energy and utilities, construction and real estate, transport and related sectors) disclosed the required Taxonomy alignment KPIs for FY 2022. ESMA found that 70% of issuers used the mandatory templates appropriately, although further improvements are still needed in their use. Positive practices related to the inclusion of clear links with the companies' sustainability strategies were noted. **Source:** Results of a fact-finding exercise on corporate reporting practices under the Taxonomy Regulation, ESMA, October 2023
Average level of capex alignment with the EU Taxonomy is 18%	The average level of capex alignment with the EU Taxonomy is 18%, on a sample of 711 companies, including zero values.  **Source:** Morningstar, September 2023 (data as of August 2023)
69% average Taxonomy-aligned capex for utility companies	Companies within the utilities sector have reported the highest level of capex alignment with the EU Taxonomy, at 69% (on a sample of 75 companies). They are followed by companies within the real estate (26% on a sample of 42 companies) and industrials sectors (16% on a sample of 216 companies). **Source:** Morningstar Sustainalytics, August 2023
600 large companies report that they include Taxonomy KPIs in their transition plans and financial planning	An analysis conducted by CDP and Clarity AI on a sample of 1700 companies subject to EU Taxonomy Regulation found that around 600 companies referenced EU Taxonomy KPIs as part of their financial planning and transition plans. **Source:** CDP and Clarity AI (2023), Exploring the EU Taxonomy as a tool for transition planning

<table>
<tr>
<td>6.5% of bonds issued by EU companies are green bonds</td>
<td>Green bonds are a useful tool for corporates to finance the shift of their business model to more sustainable activities. Green bond issuance reached 6.5% of total EU corporate bond issuance in 2023.


Source: Bloomberg, based on data as of January 2024. Includes instruments where the net proceeds of the fixed income instrument will be applied toward green projects or activities that promote climate change mitigation or adaptation, or other environmental sustainability purposes. ‘Sustainability’ and ‘Sustainability Linked’ and ‘Social’ Debt are not included. Note: Data shows yearly issuance of Corp/Gov Green Bonds (Consolidating duplicate bonds)</td>
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<td>€266bn of green bonds issued by EU governments</td>
<td>Based on Eurostat data, in 2022, EU general governments alone issued €266bn of green bonds, compared with €85bn in 2019, equal to 1.7% of EU GDP. According to figures from Bloomberg, over 40% of all use-of-proceeds green bonds with external assurance in the EU are from the public sector and, based on publicly available information, the issuers of over 90% of these bonds refer to the EU Taxonomy in their public reports.[12]
Source: Eurostat, Green and sustainability bonds issued by governments, 2022</td>
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<td>56% of total EU assets disclose under SFDR Articles 8 or 9</td>
<td>The SFDR has significantly increased the level of transparency related to the integration of sustainability considerations and objectives in investment products. Funds disclosing under Article 8 and Article 9 are reported to now account for 56% of total EU assets. 10% of funds reporting under Article 8 have set a carbon reduction objective, as of October 2023. This trend reflects an increase in net-zero commitments by investors for their financial products.
Source: Morningstar (2023), SFDR Article 8 and Article 9 Funds: Q3 2023 in Review</td>
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<td>US$120bn in investment funds track EU climate benchmarks</td>
<td>Investment funds that track the EU climate transition benchmarks and EU Paris-aligned benchmarks are reported to have grown considerably and are currently valued at US$120bn.
Source: Morningstar, September 2023, EU Taxonomy, SFDR, BMR Data for EU Platform on Sustainable Finance.</td>
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</table>

12 Bloomberg New Energy Finance, May 2023, Sustainable Debt Tool

9–10% of SMEs in the EU have raised green or sustainability-linked loans from banks	Forthcoming European Commission research conducted with over 4,000 SME respondents shows that, over the last two years, 9–10% of SMEs have obtained a green or sustainability-linked loan from a bank. **Source:** Internal report commissioned by DG GROW to Oxford Research, Synthesia and Trinomics. Results cited in this Compendium are preliminary, 2023.

List of market practices

Market practices are available in a separate Annex document accessible here.

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	2.2	Green Bond: Internal certifications and external verification: use of SPOs and data quality
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	2.5	Securitisation
	2.6	Sustainability guarantee products
3. Investors	3.1	Investor practices on net-zero transition target-setting at entity-level
	3.2	Use of the Taxonomy to assess the sustainability performance of individual unlisted investments
	3.3	Use of the Taxonomy to assess the sustainability performance of infrastructure fund of fund investments
	3.4	Aggregation and reporting of Principal Adverse Impacts at investor entity-level
	3.5	Origination of Taxonomy and PAI reporting data
	3.6	Taxonomy reporting for an infrastructure fund-of-funds
	3.7	Use of the Taxonomy to screen a global equity fund
	3.8	Use of the Taxonomy and the SFDR to track and drive the sustainability performance of direct real estate investments
	3.9	Use of the Taxonomy and SFDR to assess client sustainability preferences in insurance-based investment products and investment funds
4.Insurers	4.1	Reporting: 2022 Taxonomy report with a focus on the Underwriting KPI (eligibility)
	4.2	Product: State of use of Taxonomy in the development of non-life green insurance products

5.Auditors & Consultants	5.1	From limited assurance to reasonable assurance in a phased approach
	5.2	From a 'NFRD-check' to reasonable assurance
	5.3	Assurance: multi-sectoral and energy
	5.4	Set up of processes for assurance of activities classification and reporting
	5.5	Overcome hurdles with the help of consultants: climate risk assessment
	5.6	Reasonable assurance of gradual alignment of green bonds with the EUGBS
6. SMEs	6.1	Results from survey
7.Public sector	7.1	General synthesis of questionnaire feedback for all public sector categories
	7.2	Taxonomy-alignment of green bond—Supranational Central Europe
	7.3	Taxonomy-alignment of green bond—Supranational Northern Europe
	7.4	Taxonomy-alignment of green bond—Sovereign Eastern Europe
	7.5	Taxonomy-alignment of green bond—Sovereign Western Europe
	7.6	Taxonomy-alignment of green bond—Government Regional Germany
	7.7	Taxonomy-alignment of green bond—Government Local Sweden
	7.8	Taxonomy-alignment of green bond—Government Development Bank France
	7.9	Taxonomy-alignment of green bond—Government Agency Spain
8. Benchmarks	8.1	The EU climate benchmark landscape: an overview
	8.2	Paris-aligned fixed income solutions
	8.3	Introducing the 'cash PAB'

Market observations: corporates

Observations from the Corporate stakeholder group combine the results of a survey of 31 selected European companies across eight sectors and 11 EU countries with contributions from EU business associations, and from members and observers of the EU Platform on Sustainable Finance. Companies are starting to integrate EU sustainable finance regulations into: (i) strategy and business models; (ii) sustainable finance frameworks and transactions; (iii) disclosures; and (iv) supply chains.

Business strategy, transition planning and target setting

Within its scope of analysis, the PSF corporate stakeholder group found that eight of those companies have started to set specific targets related to EU Taxonomy KPIs, such as turnover and capex, which can provide strategic guidance for transition planning at both business and activity levels. The energy sector is particularly active in that respect. The market practices demonstrate that activity-based capex plans can notably complement entity-level transition strategies, confirming the relevance and usefulness of science-based economic activity-level criteria. A recent analysis conducted by CDP and Clarity AI on a sample of 1,700 companies subject to NFRD reporting on the EU Taxonomy found that around 600 companies referenced the EU Taxonomy KPIs as part of their financial planning and transition plans.[13]

13 CDP and Clarity AI (2023), Exploring the EU Taxonomy as a tool for transition planning

Box 1: Combining entity-level corporate transition plans with Taxonomy capex plans

The example of an EU-based utility company illustrates how the EU Taxonomy framework and capex plans can inform an entity-level transition strategy. In November 2021, the company brought forward its decarbonisation target from 2050 to 2040. The company's decarbonisation roadmap, covering all its direct and indirect emissions, was certified by the Science Based Targets initiative (SBTi) and is consistent with limiting global warming to no more than 1.5°C, as per the Paris Agreement goal. Moreover, the company has set a target of aligning 80% of its capex with EU Taxonomy criteria over the 2023–25 period.

Its validated commitments for 2030 and 2040 require the company to:

- eliminate its direct GHG emissions (Scope 1) from power generation by 2040, from 365 gCO_2e/kWh in its 2017 base year, and with a mid-term target of 80% by 2030 (72 gCO_2e/kWh);
- eliminate direct GHG emissions from power generation and indirect GHG emissions (Scope 3) from fuel and energy-related activities, covering all sold electricity by 2040, from 332 gCO_2e/kWh in 2017, and with a mid-term target of a 78% reduction by 2030 (73 gCO_2e/kWh); and
- eliminate absolute indirect GHG emissions (Scope 3) from the use of sold products by 2040, from 25.3 $mtCO_2e$ in 2017, and with a mid-term target of 55% by 2030 (11.4 $mtCO_2e$).

To access the financing necessary to support the transformation of its business, the company has drawn up a sustainability-linked framework that sets out its strategy, targets and how it will measure progress. Its 2023–25 plan sets out how financial transactions will support its roll-out of a sustainable business model (i.e., how its capex is aligned with the Sustainable Development Goals (SDGs) and the EU Taxonomy). The company has selected the following five KPIs, which are core, relevant and material to its business and enable it to measure its sustainability improvements:

- KPI #1: Scope 1 GHG emissions intensity relating to power generation (gCO_2eq/kWh);
- KPI #2: Scope 1 and 3 GHG emissions intensity relating to integrated power (gCO_2eq/kWh);
- KPI #3: Absolute Scope 3 GHG emissions relating to gas retail ($mtCO_2eq$);
- KPI #4: Renewable installed capacity (%); and
- KPI #5: Proportion of capex aligned with the EU Taxonomy (%).

From a regulatory standpoint, the five selected KPIs contribute to the climate change mitigation objective, as defined in the EU Taxonomy Regulation.

Finance and transactions

Sustainable bonds and loans, in both green and sustainability-linked formats, are important instruments for financing the transition of corporate business models. Early evidence suggests that the market is beginning to adopt the EU Taxonomy and the EU GBS to back up claims of sustainability performance and improve comparability. Their use is expected, over time, to provide credibility and transparency to debt issuance. The market practices also highlight some early examples of companies establishing sustainability-linked approaches to financing, with KPIs tied to EU Taxonomy criteria.

Overall, the companies surveyed found it challenging to clearly identify a definitive economic financial advantage arising from the issuance of sustainable debt instruments. However, they acknowledged that using the EU Taxonomy enables them to access a broader and more diverse pool of investors, while also deepening market engagement.

The market practices reveal that the EU Taxonomy and the EU GBS play an important role in providing assurance, transparency and credibility to both issuers and financiers. A growing number of companies and banks are referring to the Taxonomy or GBS when structuring sustainable debt instruments and products, with significant heterogeneity continuing in terms of how those references are made, from simply drawing parallels with economic activities identified as sustainable by the EU Taxonomy, to measuring and reporting alignment, or setting related targets. This is expected to increase in the coming years, as the volume of EU Taxonomy reporting data increases and as the EU GBS becomes operational.

The market practices suggest an appetite and need for green and sustainability-linked bond and loan products from banks for companies, while also acknowledging that the credibility and transparency of such products remain a challenge, as in many cases the products do not specify an annual trajectory towards sustainability performance targets. Sustainability-linked loans and bonds, in particular, are less standardised and mature and in some cases lack transparency. This impedes the tracking of sustainability performance and progress overtime. An analysis by Sweden-based bank SEB of 191 sustainability-linked bonds found that issuers were not on track to meet around a third of the KPIs within their bonds:[14] regular reporting is therefore essential to preserve market integrity.

14 SEB Group (2023), The Green Bond—Your insight into sustainable finance, September 2023

Box 2: Using the EU Taxonomy to structure corporate sustainable debt instruments

The market practice surveyed companies within the auto, chemicals, communications, energy, forestry, real estate, service and transport sectors, and found 16 frameworks covering different types of instruments (e.g., green bonds and loans or sustainability-linked bonds and loans), with most using use-of-proceeds instruments. Reference to and use of the EU Taxonomy usually depended on the structure and approach of the financial instrument.

For use-of-proceeds approaches (e.g., green bonds), references to the EU Taxonomy technical screening criteria are typically made in the section related to the selected projects' eligibility criteria.

For sustainability-linked approaches (e.g., sustainability-linked bonds), reference to the EU Taxonomy is typically made for: (i) KPIs tied to EU Taxonomy metrics and targets (e.g., the proportion of capex aligned with the EU Taxonomy, or the proportion of revenues aligned with the EU Taxonomy); and/or (ii) in respect to selected KPIs that measure the company's sustainability performance relating to EU Taxonomy objectives.

The market practices feature some early examples of companies establishing a sustainability-linked financing approach with KPIs tied to EU Taxonomy alignment, in line with the EU Commission recommendation on facilitating finance for the transition to a sustainable economy. For instance, one of the companies introduced a new KPI in 2023 in its sustainability-linked financing framework, namely 'Proportion of capex aligned to the EU Taxonomy (%)'. The company's sustainability performance target (SPT) is to achieve 80% in the 2023–25 period. Another company introduced a new KPI to its sustainability-linked financing framework, namely 'Revenue aligned with EU Taxonomy climate mitigation criteria, as a share of total revenues'. The company's SPT is to achieve 50% by 2025.

Reporting and assuring disclosures to monitor progress

As of 2023, reporting on the Taxonomy alignment of companies' activities is nascent, but it is already improving.[15] Despite facing challenges, most companies have started to adapt their practices to comply with the new EU sustainability reporting requirements.

For example, EU companies have taken steps to respond to new data origination requirements. These include:

- establishing dedicated processes and teams across organisations to ensure alignment across the business;
- setting up specific IT solutions;
- involving senior management in EU Taxonomy reporting activities;
- adopting verification processes for Taxonomy alignment data; and
- engaging with companies.

Such steps are key to ensure progress in terms of both data quality and availability.

In August 2023, Morningstar Sustainalytics found, when analysing a sample of more than 800 companies which reported Taxonomy data, that companies in the utilities sector reported 69% of capex alignment, followed by around 26% for the real estate sector and 16% for industrials.[16] On turnover, the utilities sector also has the highest average revenue alignment (33%), followed by real estate (30%) and industrials (14%).[17] Those sectors also tend to show higher eligibility, which is consistent with the current coverage of economic activities by the Climate Delegated Act. The analysis also shows that a non-negligible proportion of companies still report zero alignment, with a substantial dispersion of reported Taxonomy data within sectors.

As part of a fact-finding exercise conducted in 2023,[18] ESMA found that almost all selected issuers active in the four main sectors covered by the Climate Delegated Act disclosed the required Taxonomy alignment KPIs for the 2022 financial year. ESMA found that 70% of issuers used the mandatory templates appropriately, although further improvements are still needed in the use of those templates, notably to ensure that the mandatory qualitative information is sufficient regarding the assessment of the compliance of companies with transparency requirements in relation to the nature of their activities. ESMA also noted positive practices in relation to the provision of explanations on the nature of activities and compliance tests, as well as in relation to the inclusion of clear links with companies' sustainability strategies.

15 Here referring to large companies in scope of the CSRD.
16 All figures are the average of values and include companies which reported zero value.
17 All figures are the average of values and include companies which reported zero value.
18 ESMA (2023), Results of a fact-finding exercise on corporate reporting practices under the Taxonomy Regulation

Overall, studies show that companies are taking a cautious approach to reporting, due to operational complexities and varying interpretations (e.g., of the DNSH criteria) and issues related to data origination and updating of internal information systems.

Verification and assurance

The market practices suggest that verification processes remain scarce, and early efforts differ across some member states.[19] Among the EU companies analysed as part of the stocktaking exercise, 12 have received limited assurance in their external audit of Taxonomy disclosures, with none receiving reasonable assurances from external auditors.

Consultants observe that companies are gradually familiarising themselves with the EU Taxonomy framework and its application, transitioning from general sustainability-related commitments and declarations to specific, measurable and financially defined KPIs. This represents a shift in mindset for many companies. The auditors also observe that clients often engage them in assurance processes earlier than previously, to align their approaches and understand how to prepare the data in an auditable manner.

Finally, consultants and auditors have observed that for some clients, sustainability reporting remains predominantly a compliance exercise, and they expect that the initial costs of setting up new data collection processes will be recovered by future savings or other advantages when the market reacts to differences in sustainability performance across different companies (e.g., through improved access to finance for sustainable activities).

19 It is worth noting that only a few member states mandate limited assurance on Taxonomy reporting (e.g., Spain).

Box 3: Verifying the alignment of corporate activities with the EU Taxonomy

This market practice refers to the creation of a repository of evidence used in the verification exercises that a company undertakes to align its activities with the EU Taxonomy. The qualitative information collected describes compliance with the requirements of the substantial contribution, DNSH and minimum safeguards criteria for each eligible activity.

The methodology developed makes it possible to systematise and streamline the process of collecting evidence and verifying Taxonomy alignment for various activities. It involves the company taking the following steps:

- The process starts with the monthly identification and classification of all the company's new activities, according to the description of the activity.
- Then, on a quarterly basis, the company carries out consolidation and evaluation exercises to assess the alignment of these activities in terms of revenue, capex and opex.
- The exercises are verified by an external entity, with the company using relevant templates to standardise the necessary evidence.
- The document compiling the evidence for each financial year becomes part of the company's inventory of evidence, facilitating this task from year to year and making the process comparable.

In addition, the company has developed a methodology in which any new business opportunity is analysed to determine: (1) if it is suitable for the company to invest resources in it; and (2) if the opportunity meets Taxonomy-related criteria set by the company. The result of systematising and standardising the process of collecting and reviewing the Taxonomy alignment of the company's activities suggests three benefits:

1. It facilitates the collection of evidence and simplifies the data that needs to be reviewed annually.
2. It makes it possible to assess in advance whether the asset will be Taxonomy-aligned or not, which can influence the investment decision.
3. It facilitates the identification of equivalent standards in other jurisdictions and provides evidence to the auditor.

In this particular case, the company's efforts are well rewarded, as shown by the fact that 74% of the company's debt is in instruments that refer to levels of compliance with the EU Taxonomy.

Market observations: credit institutions

Observations from the Credit institutions stakeholder group combine the contributions of eight banks domiciled in the EU that have shared their experience across various activities of their business, and contributions from members and observers of the EU PSF.

Business strategy, transition planning and target setting

Credit institutions play a central role in supporting the real economy's transition by financing large companies, SMEs and households across the EU.

Evidence suggests that banks have started to use elements of the EU Taxonomy and the Pillar 3 Implementing Technical Standards (ITS) of the Capital Requirements Regulation, as part of their lending strategies. They are also using them to facilitate clients' assessment and engagement in relation to managing their own climate transition risks and achieving their sustainability commitments.

The EU sustainable finance framework provides a common denominator for banks and business clients to engage on decarbonisation and the transition of business activities. The market practices show, for example, that EU Taxonomy capex plans associated with the ESRS E.1.1 transition plan disclosure requirements provide a useful tool for banks to assess their clients' transition readiness: they provide both a baseline and forward-looking targets to assess client and businesses' transition preparedness. This also supports the development of finance offerings and solutions from banks that target climate or environmental objectives through sustainability labelled or even non-labelled financing products and services.

Box 4: A bank's pathway towards net zero

Leading global banks have committed to the Net-Zero Banking Alliance (NZBA), pledging to finance climate action to transition the real economy to net zero GHG emissions by 2050. The practices of six European credit institutions show how the EU sustainable finance framework and the EU Taxonomy can be used as a reference framework to benchmark and support banks in helping carbon-intensive sectors to transition, as well as to guide the banks' own transition finance strategies.

The first step for banks to deliver on their entity-level net-zero targets requires that they assess their clients' transition plans. To do so, the six banks have developed dedicated assessment tools to identify, track and record these plans. These tools are intended to enhance alignment between the client's transition plan and the bank's own transition pathway towards net zero. As observed from the market practices, some of the tools that have been developed include:

1. **ESRS E1–1 transition surveys** to evaluate clients' transition plans. This data-driven approach enables banks to align their offerings with clients' needs, and to increase the likelihood of success of the clients' net-zero transition;
2. **tier-based scoring** to categorise and score clients based on their transition plans. This approach offers a structured framework to evaluate varying degrees of transition preparedness among clients and can provide a valuable risk management tool. The approach takes into account factors beyond CO_2 emissions; it includes metrics related to the use of renewable energy, capex over the next five years, and alignment with the EU Taxonomy; and
3. **incentives and financing options** based on clients' EU Taxonomy eligibility. Taxonomy eligibility signals that this sector or company has the potential to align with the bank's net-zero commitments and deserves financing support due to its strategic positioning.

Finance and transactions

Credit institutions have also started to integrate the EU Taxonomy as part of their ESG risk management and credit decision-making processes. In some instances, alignment with the Taxonomy technical screening criteria can be used to provide better pricing conditions or access to finance, offering an incentive to clients. The market practices demonstrate the use of the EU Taxonomy across banking activities to:

- identify and originate labelled and unlabelled green, sustainable and sustainability-linked loans;
- incentivise good sustainability practices among clients;
- distribute loans to investors via securitisations; and
- issue green bonds as part of funding programmes.

The market practices collected show how the EU Taxonomy has been integrated into credit institutions' green loan origination processes. They provide three examples where banks have complemented their loan origination framework with EU Taxonomy criteria to help identify environmentally sustainable loans. These are:

1. green loan origination thresholds based on the EU Taxonomy technical screening criteria (TSC): The origination of green loans can be based on specific thresholds using the EU Taxonomy's TSC as a baseline or as exclusion criteria;
2. green loan incentives based on EU Taxonomy alignment: The EU Taxonomy can be used to develop a set of loan incentives to support and attract clients and projects totally or partially aligned to the EU Taxonomy, increasing the volume of EU Taxonomy-aligned exposures and therefore increasing the bank's GAR; and
3. monitoring progress on sustainable lending: Applying specific elements of the EU Taxonomy framework to assess whether transactions can be earmarked as sustainable in internal loan systems.

Reporting and assuring disclosures to monitor progress

A study from PwC highlights the variety of KPIs reported so far by credit institutions at the entity level. This indicates a lack of standardisation in methodologies used to report the green asset ratio. This is partly because the study focused on Taxonomy eligibility reporting in 2022, and mandatory reporting of Taxonomy alignment data by non-financial companies is still very recent. A significant amount of EU Taxonomy data collected by banks is based on estimates, notably for their retail exposures, and can therefore only be reported on a voluntary basis (separately from the GAR). Differences in methodologies from one data provider and bank to another can also affect the quality and comparability of reporting.

Box 5: EU Taxonomy reporting challenges for banks on mortgages

The market practices describe specific challenges associated with banks' experiences using the EU Taxonomy for assessing real estate credit provisions, which impact EU Taxonomy reporting and GAR compilation. These challenges include:[20]

- **Data collection and verification:** a majority of the banks' Taxonomy-eligible assets comprises lending to households. This means that banks need to conduct their own Taxonomy alignment assessment for those exposures, whereas Taxonomy-alignment KPIs for companies that fall under the CSRD are available from external vendors. The data required to perform Taxonomy assessment for retail exposures has, for the most part, not been collected from bank customers yet and is not automatically collected at present.
- **Inconsistencies with international standards:** issuers outside of the European Economic Area and the UK are often not able to provide specific documentation to substantiate alignment of investment vehicles with all applicable DNSH criteria, which often relate to specific EU directives. Assessing the interoperability of market standards (e.g., the Equator Principles) with EU directives and EU Taxonomy criteria could help resolve inconsistencies for non-EU exposures.
- **Criteria interpretation and DNSH assessment:** there are specific challenges relating to performing and verifying the DNSH criteria for activities 7.1 (construction of new buildings) and 7.7 (acquisition and ownership of buildings) set out in the EU Taxonomy Regulation Climate Delegated Act. In the case of mortgage lending, where the exposure is to a large number of buildings, alignment at the individual building level is seen as a possible solution. For new building construction, information on construction and demolition waste, and on building components and materials, is currently unavailable. In future, the expectation is that this information will be included in the loan contract, or that it will be more easily obtained from an external certifier.

20 See also PSF Usability Report, October 2022

Market observations: investors

Observations from the Investors stakeholder group combine the contributions of seven investors and external investor-led initiatives.

Business strategy, transition planning and target setting

Investors are starting to use the EU Taxonomy and other EU standards and tools to complement their net-zero target-setting strategies in the assessment of investee companies' alignment with the Taxonomy and their net-zero transition strategies, as well as to support shareholder engagement. Early evidence shows that investors are making use of the EU framework's tools, including the EU Taxonomy, to support investment decisions.

At this early stage of implementation, investors are using the EU sustainable finance framework mainly to complement voluntary industry guidance on target-setting based on various approaches and benchmarks (e.g., the SBTi, Climate Action 100+ and those from private providers). It is expected that the entry into force of climate transition plan disclosure requirements as part of CSRD ESRS E1.1 and the CSDDD[21] will help investors improve their assessment of companies' transition strategies through increased transparency and standardisation. Investors also expect to increasingly leverage the EU Taxonomy to support more robust, comparable target-setting for climate solutions across asset classes, using equivalent frameworks in other geographies to assess non-EU based investees.[22]

Shareholder engagement is an important component of investors' net-zero strategies. The market practices also demonstrate how the EU sustainable finance framework can support engagement efforts. For example, it can provide granularity and transparency to assess in a comparable manner the robustness of EU Taxonomy capex plans of issuers in high-impact sectors. The CSRD provides further metrics that are useful for assessing companies' transition strategies and sustainability impacts. Ensuring that the role of shareholder engagement is effectively recognised, along with appropriate oversight mechanisms and transparency tools, is an important priority as part of the EU sustainable finance framework. In this regard, investors see merits in reinforcing the Shareholder Rights Directive.

Finally, investors note that the sequencing and complexity of EU policy developments can pose implementation challenges, with many investors focusing their efforts on the interpretation of reporting requirements and preparation of regulatory disclosures, while

21 Subject to adoption
22 IIGCC (November 2023)—IIGCC Climate Solutions Guidance

waiting for investee companies at EU and international level to begin reporting sustainability metrics. Many investors are therefore only in the early stages of using the framework for more strategic purposes. Improvements in corporate reporting should support further uptake, as should the clarification from the European Commission that the use of estimates to assess the Taxonomy alignment of investee companies that either do not report yet or are out of regulation scope is allowed.

Finance and transactions

The EU sustainable finance framework is increasingly being used to both structure and assess the sustainability performance of investment products. This has largely been driven by regulatory reporting requirements under the SFDR. The PAI indicators and the EU climate benchmarks are leading the way, with widespread consideration and adoption across a wide range of investment products that qualify under either Articles 8 or 9 of the SFDR. However, interpretation challenges remain, leading to heterogeneity in the way certain sustainability indicators, including PAIs, are used and reported by investors.

According to a Morningstar study published in October 2023, funds disclosing under Articles 8 and 9 of the SFDR now account for 56% of total EU fund assets.[23] The vast majority of these funds (53% of total assets) are classified under Article 8 (promoting environmental or social characteristics), despite significant outflows since 2022. Article 9 funds (with a sustainable investment objective), although smaller in size (accounting for 3.4% of total fund assets) continue to attract new capital from end investors.

Consideration of PAI indicators is increasingly widespread within these funds. Most Article 8 funds consider at least seven mandatory PAI indicators, and most Article 9 funds consider at least 11.[24] MSCI notes in a study released in July 2023 that those PAIs tend to be more focused on 'involvement-type' PAIs, which show a company's exposure to a given economic activity. For example, 80% of funds considered exposure of companies to the fossil fuel sector and 93% considered exposure to controversial weapons.[25] How exactly these indicators are considered in the investment process is less clear, and substantial variation in practice is likely, given that the SFDR does not prescribe how this should be done.[26]

There is also increasing evidence of investors setting targets to reduce the GHG emissions of their investment products, at times leveraging the EU sustainable finance framework to do so.

- Morningstar found that Article 8 products are increasingly setting carbon reduction objectives. While in October 2022 only 1% of Article 8 products had done so, by September 2023 this had increased to 10%.[27] This trend may reflect the implementa-

23 Morningstar (2023), SFDR Article 8 and Article 9 Funds: Q3 2023 in Review
24 Ibid.
25 MSCI (2023), Funds and the State of European Sustainable Finance
26 Additional clarity on PAI calculation methodologies is expected as part of the current review of the SFDR RTS—see ESAs Joint Consultation Paper on the review of SFDR Delegated Regulation regarding PAI and financial product disclosures (2023) and JC 2023 55—Final Report SFDR Delegated Regulation amending RTS (europa.eu)
27 Morningstar (2023), SFDR Article 8 and Article 9 Funds: Q3 2023 in Review

tion of entity-level net-zero commitments by investors within their financial products. The ESA's Joint Consultation Paper on the Review of SFDR Delegated Regulation, regarding PAI and financial product disclosures, contains additional requirements to further standardise reporting on GHG emissions reduction for financial products.

- Assets invested against the Paris-aligned and climate transition benchmarks now represent US$120bn in assets, the majority of which are securities issued by European and global large cap corporates.[28] Most of those assets invested against EU climate benchmarks (79%) are still classified under Article 8, in spite of the Commission's clarification in April 2023 that financial products that passively replicate climate transition and Paris benchmarks can be considered sustainable investments and therefore be classified under Article 9.

Box 6: Using the EU Taxonomy for investment products

The market practices provide some early examples of investors applying the EU Taxonomy and PAI indicators to products and processes across a range of asset classes. They show investors:

- assessing the sustainability performance of existing assets in a global equity fund;
- assessing the environmental sustainability of assets within a real estate portfolio; and
- strengthening due diligence processes for infrastructure fund-of-fund investments.

These examples reflect both the challenges with implementation and interpretation of the requirements (particularly with regards to the DNSH and minimum safeguards criteria), but also the opportunities and potential benefits of using the EU framework and tools strategically. Throughout these market practices, the EU Taxonomy and PAI indicators are seen to facilitate consistency in the way investors evaluate sustainability performance across a range of assets and activities.

The use of the EU Taxonomy at the financial product level remains limited, primarily due to limited disclosures by underlying companies. According to a Morningstar study of Article 8 and 9 funds in 2023, only 28% of Article 9 funds report a target of EU Taxonomy-alignment above 0% and less than 10% of Article 8 funds commit to invest a portion of their assets into EU Taxonomy-aligned assets.[29] It attributes this to data availability challenges and the fact that investee companies have only recently started to report on Taxonomy alignment. These figures are expected to increase as companies start disclosing their Taxonomy alignment KPIs under Article 8 of the Taxonomy Regulation Disclosures Delegated Act.

28 Morningstar (2023), SFDR, BMR Data prepared for EU Platform on Sustainable Finance.
29 Morningstar (2023), SFDR Article 8 and Article 9 Funds: Q3 2023 in Review

Reporting and assuring disclosures to monitor progress

Despite the various challenges related to data availability and the interpretation of EU sustainable finance regulation, investors are progressively adapting their practices to respond to EU sustainability reporting requirements. The collection of robust, reliable and comparable data remains a key challenge for investors who largely rely on data providers. A lack of interoperability between EU regulation and that in other jurisdictions also results in limited coverage for investors offering investment products which are invested in markets beyond the EU. For certain asset classes such as alternatives, in the absence of centralised data management systems to handle EU Taxonomy-related information, many financial institutions have set up manual processes in-house to collate the data they need. Some investors have created detailed data collection templates and shared them with respective local asset or ESG managers who perform initial investment screening and data collection. Some issuers of green bonds have developed dedicated questionnaires as a basis of assessment of the eligibility/alignment of green bond activities.

Reporting of investment funds (PAI)

Since June 2023, financial undertakings have been required to disclose entity-level PAI statements on a comply-or-explain basis under Article 4 of SFDR (on a mandatory basis for financial market participants over 500 employees). High levels of variation in PAI reporting were observed, with financial undertakings disclosing PAI indicators with different scopes, asset classes, data sources and methodologies, due to variations in how financial institutions interpret the legislation.[30] There are also different interpretations among investors regarding the meaning of the "consideration" of PAIs under Article 7 of SFDR (and related requirements for the integration of client sustainability preferences under MIFID/IDD).

This makes comparability of the reported data across investors' activities very challenging. In future, the implementation of CSRD ESRS reporting, starting in 2024 for first reporters, should help increase consistency in financial market participants' PAI reporting. The SFDR assessment launched by the European Commission, alongside the revision of the SFDR regulatory technical standards (as proposed by the European supervisory authorities in 2023) would also bring further clarity on methodologies for the calculation of the PAI metrics and support increased comparability over time. Finally, financial institutions have also highlighted inconsistencies between certain PAI indicators and the Taxonomy's DNSH criteria and note that further consistency between frameworks in the near term is important to resolve this.[31]

30 The ESAs have issued several Q&As, in November 2022, confirming the scope of the PAI disclosure; see Q&A IV.23, IV24, and IV25.

31 The Platform notes that it has previously pointed out such inconsistencies and provided specific recommendations to ensure consistency and coherence. See the Platform´s reports on SFDR and the Data and Usability (October 2023) that can be found on the Platform´s page.

Data availability

Engagement between different market actors in the sustainable finance value chain is emerging as a key practice for facilitating the collection and verification of data. For instance, in private market investments made outside the EU where Taxonomy data are sparse, investors have been actively engaging with companies, asset managers and data providers to achieve a consensus on the interpretation of certain criteria and data needed. Overall, investors rely principally on external ESG data providers to collect data from investees and conduct EU Taxonomy assessments of investee companies.

Engaging ESG data providers and consultants

Due to the current scarcity of publicly reported data, many of the EU Taxonomy and PAI datasets available in the market remain largely based on estimates. Financial institutions have highlighted important variations in the data provided across external providers, including variations in EU Taxonomy-aligned data publicly reported by companies.

The verification and assurance of Taxonomy data is becoming particularly important to ensure that Taxonomy reporting can adequately fulfil its role in tracking progress on sustainability performance. Investors have taken steps to adopt formal quality check procedures, conducting ESG control activities at both local asset management and investment company levels, as well as actively engaging with external consultants and audit firms to encourage alignment of data estimation methodologies.

Finally, investors welcome the EU legislative proposal on ESG ratings. This is expected to enhance the transparency, comparability and governance of ESG rating providers and their methodologies—which could also support necessary improvements for "raw" metrics such as Taxonomy and SFDR PAIs, reflecting their important role in the sustainable finance value chain.

Some of the challenges noted above in terms of interpretation issues, and the quality, availability and comparability of data, have meant that in their first years of implementation, new SFDR, MIFID and IDD requirements with regards to sustainability preferences may have not helped improve comparability as much as end-investors could have expected. In some cases, heterogeneity in the way SFDR pre-contractual annexes were filled in may have created confusion for end-users, as highlighted by a study from Weefin which reviewed a sample of SFDR pre-contractual disclosures and noted that the level of detail often did not match the effective level of ESG ambition.[32] Similarly, 2II investing conducted a study which found that SFDR had significantly improved transparency, but also observing that 27% of all analysed environmental Article 8 and 9 funds were associated with environmental impact claims which were not sufficiently substantiated.[33] Those studies highlight the importance of addressing current challenges to allow for sufficient comparability, and confidence from end-investors, which will ultimately support the channelling of flows into sustainable investments.

32 Sustainable finance barometer—ESG practices & impact of asset managers, Weefin, June 2023, WeeFin

33 2ii Investing, August 2023, Market review of environmental impact claims of retail investment funds in Europe—2DII (2degrees-investing.org)

Market observations: insurers

Observations from the Insurers stakeholder group combine the contributions of two large insurers as underwriters, as well as external insurer-led initiatives. Investment-related practices are combined in the market observations from investors.

Business strategy, insurance solutions

The EU Taxonomy Regulation considers that underwriting non-life insurance and reinsurance activities for climate-related perils has the potential to provide adaptation solutions and to prevent adverse impacts of climate change. In other words, the EU Taxonomy considers how the insurance company and, more specifically, its products and services are helping policyholders adapt to climate change risks, to prevent or protect against climate-related perils.

The current scope of application of the EU Taxonomy to insurance products and services is limited to the climate change adaptation criteria. This limits the ability to draw parallels between insurers' net-zero targets and commitments, and the EU Taxonomy.

Early observations nevertheless show that insurers have started to make references to the EU Taxonomy's climate and environmental objectives when developing new green non-life insurance solutions. Such practices remain nascent, as the EU Taxonomy does not formally consider substantial contribution of insurance practices to its environmental objectives beyond climate adaptation, as noted above. The EU Taxonomy technical screening criteria can provide useful incentives for insurers as they progressively transform their activities to deal with the challenges posed by climate adaptation, including by encouraging policyholders to develop preventive actions, or by offering risk management support to their clients. The Taxonomy is seen as a useful tool to facilitate understanding among various stakeholders, and potentially allow for the comparability of insurance solutions.

Box 7: Developing green non-life insurance products

In this market practice, an insurer's green business programme uses a definition of a green offer and the concept of shades of green, both developed by the insurance company, to help assess the materiality of the environmental benefits of a particular green business product or service. It describes a tailor-made framework to support entities within the insurance company to develop green business offers.

Green business is defined as a property and casualty insurance coverage or service that contributes to at least one of the following four objectives:

- the mitigation of climate change by reducing greenhouse gas (GHG) emissions (such as insuring low-emission energy infrastructure or vehicles).
- adaptation to the consequences of climate change (such as insuring resilient buildings).
- the transition to a circular economy, such as by extending the lifetime of devices, and thus limiting the use of new raw materials (for example, by promoting the use of second-hand spare parts).
- the limitation of biodiversity loss and pollution (such as through pollution prevention or mangrove or coral reef conservation), helping to protect nature and its ability to store carbon.

Within these objectives, the insurer has defined three shades of green. The aim is to differentiate between types of activities, namely client incentives, claims treatment and the insured asset. These shades provide guidance and transparency to assess the materiality of a green business offer.

- Shade 1 is for offers that encourage environmentally sustainable behaviour (e.g., through rewards or information sharing).
- Shade 2 is for actions that encourage environmentally sustainable claims management (e.g., replacement of accidentally damaged goods with more energy efficient or reconditioned devices).
- Shade 3 is for offers that provide insurance for environmentally sustainable assets or activities (e.g., low-emission vehicles or solar panels) or environmentally friendly clients and/or activities.

Reporting and assuring disclosures to monitor progress

Insurers have started to report on eligibility, for their underwriting KPI, with a significant level of heterogeneity, including in certain cases among insurance companies of relatively similar size and business mix. Out of 38 insurance companies that were identified to have reported their underwriting ratio eligibility this year (covering FY 2022), the percentages of eligibility ranged from 5% to 100%, with an average of 51%.[34] There has been significant interest within industry groups as insurers prepare for the first EU Taxonomy alignment reporting cycle in 2024. Insurers also note that important interpretation issues remain around the EU Taxonomy criteria for adaptation and the underwriting KPI. These may contribute to a lack of comparability of Taxonomy-alignment KPIs. Insurers note that data collection is expected to remain a key challenge for the coming reporting cycle and should improve over time.

34 Clarity AI, November 2023, EU Taxonomy data prepared for EU Platform on Sustainable Finance.

Market observations: public sector

Green bonds with the use of their proceeds linked to the EU Taxonomy are core instruments of the EU sustainable finance framework. The observations of the public sector stakeholder group distil the responses of 32 out of 34 surveyed supranational and EU public sector issuers of green use-of-proceeds bonds with assurance that mention the EU Taxonomy or the EU GBS in their framework and/or other public documents. The respondents cover around 90% of total green bond issuance with assurance in their sector and over 40% of the total of these bonds issued by all EU issuers together.[35]

Business strategy, transition planning and target setting

Most EU public sector entities are not subject to EU sustainable finance disclosure requirements for their financing activities. The survey confirmed that adoption of the EU Taxonomy for classification and reporting is mainly driven by best practice and increasing investor requests for EU Taxonomy-related information, i.e., is mainly driven by market factors.

The use of the EU Taxonomy at entity level is still work in progress. There is no definitive conclusion in sight for the time being, with the exception of pure-play entities. While central governments are not currently leveraging the EU Taxonomy for the totality of their activities, some of them are—like other public sector categories gradually extending its use in the context of their green use-of-proceeds bonds.

Green bond markets are forward-looking and typically react more quickly to new official investment guidelines, with valued knock-on effects in less responsive product segments, e.g., loans. In addition, by using the Taxonomy to demonstrate to investors how their capital is being used, issuers of green bonds are incentivised to promote the application of the EU Taxonomy among the final recipients of the funds and report progress in Taxonomy alignment as soon as it materialises. Green bonds are therefore a powerful instrument for monitoring progress in this area, both in terms of the extension of green bond eligibility and of actual Taxonomy alignment.

In this context, the decision to gradually align green bonds with the EU Taxonomy creates a particularly solid first step towards the broader classification and reporting of the remaining activities of the issuer, establishing the conditions for a more precise market assessment of the overall sustainability at entity-level of the entity's busi-

35 The observations in this section do not capture views from outside this perimeter of research. Debt management offices and other issuers who are not issuing green bonds at this moment, possibly for reasons unrelated to the EU Taxonomy (e.g., low funding needs), may equally have tried to work with the EU Taxonomy and may have developed their own methods.

ness development strategy, transition planning and target setting, as well as enabling market monitoring of actual implementation over time. The survey demonstrates there is evidence that voluntary approaches to sustainability disclosures in the green bond market provide food-for-thought and factual reference for broader application towards sustainability disclosures at entity level.

Overall, the survey suggests that the public sector plays a key role in the wider use of the EU Taxonomy, by advising the final recipient of the funds on its gradual application and by reporting feedback to the PSF on viable solutions in critical areas. At the same time, public sector green use-of-proceeds bonds play an important role in gradually extending the availability of comparable information in the market. They thus provide issuers with a platform for constructive dialogue with stakeholders: exposures to public sector issuers represent an important component of assets held by banks, insurance companies, pension funds and asset managers.

Finance and transactions

Public sector issuers play an important role in the promotion and development of high-quality sustainable debt markets, given their scale, influence and role as enablers or accelerators of green private sector activities, either by co-financing or promoting such activities. The volume of green use-of-proceeds issuance by public sector issuers that make reference to the EU Taxonomy in their public reports has grown substantially in the past five years.

Total stock of green bond issuance by outreach respondents

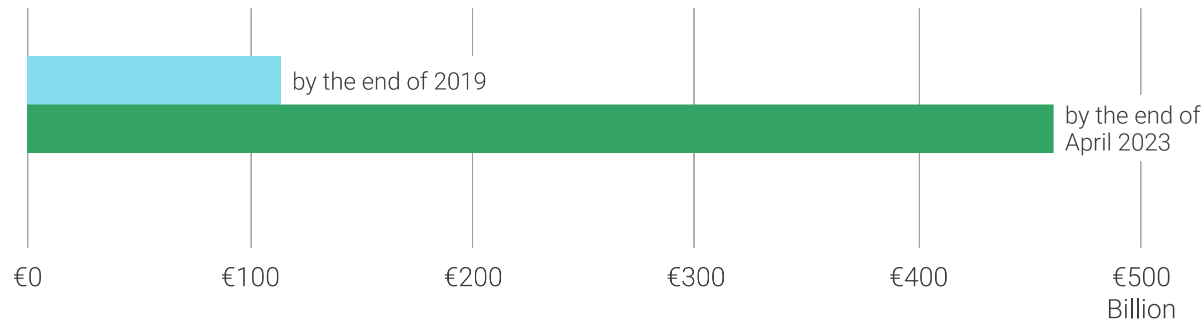

Chart 1: Total stock of green bonds issuance by outreach respondents
Source: PSF public sector outreach survey results (see Annex for more information)

Survey results suggest that public issuers are gradually aligning the classification and reporting (in some cases even the eligibility and selection) of their bond allocations with the EU Taxonomy on a voluntary basis. Frequently observed approaches to gradual Taxonomy alignment at this stage include a combination of substantial contribution assessment of the use of proceeds with a gradual approach to DNSH and minimum safeguards criteria: here, implementation is deemed to require more time, given lack of data and poor data quality. The use of auditable proxies is seen as a useful intermediate step to help issuers implement first and then improve, particularly given that assurance standards are still under development.

Public sector issuers note that market scrutiny of EU Taxonomy alignment and more efficient pricing of alternative investment opportunities can create an incentive to transition activities faster. They recognise that the EU Taxonomy can be a tool for business opportunity and strategy rather than used for mere regulatory compliance, and they encourage issuers' proactive operationalisation of the EU Taxonomy in their activities. They also note that a review of certain EU Taxonomy criteria with a view to structure and scope, particularly in the context of public expenditures, could help enlarge the subset of economic activities in scope of the EU Taxonomy.

Finally, public sector issuers also note that challenges remain to accelerate the use of the EU Taxonomy, notably due to the exclusion of exposures to central governments and supranational entities from banks' green asset ratio calculations.

Box 8: Example of a multilateral development bank gradually operationalising the EU Taxonomy for green lending and bonds

The multilateral development bank has set an internal operational plan to gradually align:

- its green lending tracking methodology with the EU Taxonomy; and
- its green bonds framework with the EU Taxonomy and the EU GBS.

It has introduced innovative operational solutions, including proxies to overcome data unavailability and usability issues relating to the EU Taxonomy. It has thus been able to:

- build a competitive edge in the market by using the EU Taxonomy to substantiate its sustainability commitments as part of its green use-of-proceeds bond programme;
- enhance protection against reputational and legal risks, using the EU Taxonomy to establish a solid, science-based framework for the definition of bond eligibilities and dialogue with investees and investors;
- obtain reasonable assurance on its green bond framework, including allocation and impact reports; and
- initiate strategic reflections on how to define best practice in non-financial disclosures applied to its broader loan portfolio.

Reporting and assuring disclosures to monitor progress

The availability and quality of data is a key obstacle in the application of the EU Taxonomy by the public sector, in particular, for the DNSH and minimum safeguards criteria. Some public sector entities have started to develop internal EU Taxonomy classification and reporting strategies to collect and disclose information on a voluntary basis. Some issuers have taken a gradual approach to EU Taxonomy implementation, in particular with regard to DNSH and minimum safeguards criteria, with the use of proxies when formal compliance is not possible immediately. The establishment of assurance standards will be key for ex-ante determination of facts that can be shared without legal and reputational risks, as well as for ex-post verification required to deter greenwashing.

Market observations: consultants and auditors

Observations from the Consultants and auditors stakeholder group combine the result of selected contributions from members and observers of the EU Platform on Sustainable Finance.

Reporting and assuring disclosures to monitor progress

Consultants observe that their clients are gradually familiarising themselves with the EU Taxonomy and its application, transitioning from general sustainability-related commitments and declarations to specific, measurable and financially-defined KPIs. That is a mindset shift for many companies. Companies have started to use the EU Taxonomy and capex KPIs for decision-making processes, complementing voluntary and market-led sustainability frameworks.

Most advanced companies seek advice to map their investments against the EU sustainable finance framework, including for strategic target-setting and alignment with EU policy objectives. Moreover, clients seeking strategic guidance for future green investments and business transition strategies are also gradually applying the EU Taxonomy.

Consultants also note that initial training and early engagement across business units and locations are key to support implementation of the EU sustainable finance framework. Development of concise, standardised and traceable internal processes and controls help in obtaining quality information and assurance in a cost-efficient manner. Auditors note that clients have started to engage them in assurance processes to align approaches and understand how to prepare the data in an auditable manner.

Finally, both consultants and auditors observe that for some clients, sustainability reporting is more than a compliance exercise. They expect that the initial costs of setting up new data collection processes could potentially be recovered by future savings or other advantages as the market starts to reward sustainable and transitioning businesses (e.g., through improved access to finance for more sustainable companies).

Box 9: Practical example of moving from limited to reasonable assurance of Taxonomy disclosures

While there is no wider and voluntary best practice for EU Taxonomy assurance yet, several market practices highlight how market participants, consultants and auditors can work together to facilitate assurance readiness in general and reasonable assurance readiness (noting that only a few Member States mandate limited assurance on Taxonomy reporting (e.g., Spain)). Obtaining reasonable assurance on Taxonomy disclosures and KPIs (eligible and aligned capex, opex and turnover) is an important step to increase credibility of the disclosures and track progress. Given how recent Taxonomy reporting is, both financial and non-financial sector companies are in the process of building relevant internal control processes and gradually approaching reasonable assurance readiness. Elements of the process include:

- Transparency about methodologies and assumptions: auditors who have already had experience with EU Taxonomy assurance highlight the need for market participants to thoroughly document the EU Taxonomy assessment process, develop comprehensive working papers which can later be revisited and reviewed by an auditor, and be transparent about assumptions and interpretations used during the assessment, thus increasing credibility of the reporting and readiness for assurance;
- Engagement with consultants and auditors at an early stage of EU Taxonomy assessment: consultants can help build appropriate processes and internal controls to assess Taxonomy eligibility and alignment, and auditors can help to test market participants' approaches, review assumptions used for assessment of technical screening criteria, DNSH criteria and minimum safeguards to eliminate potential errors ahead of the reporting period;
- Meaningful use of or investment in IT systems and automation: assurance is complicated and time-consuming if processes are organised and data is collected manually. Investment in data collection and automation can not only simplify reporting, but also enhance a company's assurance readiness;
- Establishment of proper governance and accountability: sustainability-related data within a company should be treated with the same diligence as financial data. Sustainability reporting in many companies has often been initially developed by non-financial functions. However, the introduction of Taxonomy reporting has brought the financial and sustainability teams closer together. In some cases, sustainability reporting (including Taxonomy disclosures) has been transferred to the CFO office, thus ensuring an equal level of control of all types of corporate disclosure.

Market observations: SMEs

Observations from the SME stakeholder group combine the results of a survey of 2,142 SMEs conducted on behalf of the PSF, with observations from two studies commissioned by the European Commission.[36]

Europe's 23m SMEs are the backbone of the European economy. They employ around 83m people, account for about half of Europe's GDP and play a key role in adding value in every sector of the economy.[37] They are estimated to have a significant environmental footprint and to be responsible for 60–70% of industrial pollution and waste in the EU.[38] In all regards, SMEs are central stakeholders to help achieve EU sustainability objectives.[39]

Results from the PSF SME Survey accompanying this Compendium suggest that a significant majority of the surveyed companies (58%) have already invested in sustainable projects, with variations across sectors: 69% of manufacturing companies, 51% of services firms and 54% of trading companies have done so, with investments increasing with the size of the SME.[40] The European Commission confirms this trend, finding that 35% of European SMEs had invested in sustainability projects and practices in 2021.[41]

Internal vs external source of sustainable finance

However, studies and surveys find that the majority of SMEs' green finance practices are self-financed. Of the 1,232 SMEs that had made sustainability investments in the PSF SME survey, only 35% say they have made use of external financing.

While the proportion of finance going to SMEs to date is still insufficient to meet the objectives of the EU Green Deal, bank financing is by far the dominant external source of financing for SMEs. Of the 35% above mentioned that have made use of external financing, the majority have obtained a loan from their bank; 23% of those loans have benefited from a promotional element. Indeed, SMEs already benefit from lending programmes, grants and subsidies from national, European or international institutions that facilitate

36 The European Commission studies include internal reports commissioned by DG FISMA to Ramboll and the Frankfurt School, and from DG GROW to Oxford Research, Synthesia and Trinomics. At the time of writing in late 2023, the latter had not yet been finalised and results cited in this Compendium are preliminary.

37 European Commission (March 2022), SMEs, resource efficiency and green markets

38 OECD (2018), Environmental Policy Toolkit for SME Greening in EU Eastern Partnership Countries

39 Noting that 93.5% of SMEs are micro enterprises. Source: EC, SME Performance Review, 2022, 2023

40 PSF SME survey: The questionnaire, which was published using the EUSurvey tool, received 2,142 responses from 25 EU countries. The translations of the questionnaire into the respective languages were done by the artificial intelligence integrated within the survey tool.
Despite the extensive coverage across countries, the distribution is not representative. Most responses came from Germany (approximately 60%) and Romania (approximately 25%), which means these countries are over-represented. The largest number of respondents were medium SMEs (based on official EU definitions) from the manufacturing sector.

41 European Commission (2023), Annual Report on European SMEs 2022/2023

access to sustainable financing. Such loans are often linked to environmental performance indicators, such as energy efficiency, resource savings or waste reduction.

In general, microenterprises use significantly less external financing.

SME green and sustainability-linked lending

Forthcoming EU Commission research finds that, over the last two years, 9–10% of SMEs have obtained a green or sustainability-linked loan from a bank. One-quarter of small and medium-sized unlisted SMEs have accessed sustainable loans, while only 4.4% of micro-SMEs have done so. This is shown in Table 1.[42]

Table 1: SME green and sustainability-linked lending, by size.

	Green loan	Sustainability-linked loan	Total
Listed SMEs	36.3%	43.4%	79.7%
Unlisted SMEs	2.5%	2.7%	5.2%
medium	9.3%	15.1%	24.4%
small	13.7%	10.4%	24.1%
micro	2.0%	2.4%	4.4%
Total	4.5%	5.1%	9.6%

Note: 4,000 SME respondents participated in the study.
Source: Internal EC study commissioned by DG GROW to Trinomics, Oxford Research and Syntesia (2023, forthcoming)

Most importantly, the study suggests that the share of SMEs that are active in Taxonomy-relevant sectors is twice as great as that for SMEs active in non-eligible Taxonomy activities (see Figure X). There is a mismatch, however, between the share of Taxonomy-eligible SMEs in a bank portfolio—which the interviewees in the study estimate as ranging from 30% to 70% of total portfolios—and the share of sustainable loans that banks provide to SMEs, which is generally less than 5–6% of SME lending portfolios.[43]

42 Internal EC study commissioned by DG GROW to Trinomics, Oxford Research and Syntesia (2023, forthcoming).
43 Some differentiation is expected as, regardless of the green agenda, not all SMEs would meet bank's loan origination/risk criteria.

Chart 2: Share of EU SMEs that obtained sustainable finance over the last two years among unlisted SMEs, by Taxonomy eligibility and type of product.
Source: Internal EC study commissioned by DG GROW to Trinomics, Oxford Research and Syntesia (2023, forthcoming)

Challenges for SMEs in accessing sustainable loans from banks

The DG GROW study[44] finds that most SMEs have limited access to sustainable and green loans from banks. The reasons for this include:

- the excessively high minimum threshold for sustainable loans (often around €5m–€10m). Among the banks interviewed for the study, a quarter do not offer sustainable lending to SMEs below a certain loan size;
- a lack of awareness among SMEs for such products. The vast majority of SMEs are not aware of the existence of these kinds of products and banks do not always or proactively seek to raise such awareness with their clients;
- the lack of a harmonised and common green or sustainable loan definition, which increases challenges for banks to originate such products and to monitor progress with their clients. There is currently no clear common approach or strategy among SME borrowers and lenders in the EU, which further complicates banks' assessments of their clients and hinders SMEs' access to sustainable loans accordingly;
- the lack of sustainability-related data reported by non-listed SMEs. Most SMEs currently report little or no sustainability data. With the notable exception of listed SMEs that will start reporting in 2029, SMEs are outside regulatory disclosure obligations (i.e., are not in scope of the CSRD). Disclosures by non-listed SMEs will remain voluntary.[45]

Beyond financing challenges, it is worth highlighting that the EU will not reach net zero without the full involvement of SMEs. SMEs need to start taking measures to transition their economic activities towards net zero, irrespective of the mandatory nature of the EU corporate reporting requirements (including for listed SMEs). General expectations on SMEs to contribute to the EU sustainability transition and environmental objectives are expected to increase over time. The absence of proportionate reporting by SMEs as well as the lack of proactive measures and efforts from banks may hinder SMEs' access to sustainable finance.

44 Internal EC study commissioned by DG GROW to Trinomics, Oxford Research and Syntesia (2023, forthcoming).
45 An opt-out will be possible for listed SMEs during a transitional period, exempting them from the application of the directive until 2028.

Benefits and challenges associated with the EU Taxonomy

SMEs should benefit from using the EU sustainable finance framework, including the EU Taxonomy.

By adopting the Taxonomy on a voluntary basis, SMEs can benefit from reductions in costs and improved access to debt financing: access to concessional public support schemes, consisting of grants, guarantees, direct financing or discount rates, can reduce the financial costs of investment projects that are to some extent in line with the Taxonomy criteria.

Moreover, Taxonomy disclosures can contribute, together with other sustainability information disclosures, to increasing the management's focus on sustainability and transition aspects of the business, raise awareness about green finance (issuing a green bond or raising a green loan) and thus improve companies' access to private capital and lending opportunities.

Finally, the sustainability reporting requirements for large companies and banks indirectly affect non-listed SMEs. The EU Taxonomy Regulation and the CSRD intensify the data needs and collection processes from large corporates and banks, leading some of them to seek information from their SME counterparts and clients. It is crucial that SMEs should understand and be able to use the Taxonomy to meet banks and clients' demands, on a voluntary basis.

The use of the EU Taxonomy by SMEs however presents several practical challenges. Building on the 2022 PSF recommendations, DG FISMA's report evaluates the potential mechanisms and challenges faced by SMEs in demonstrating Taxonomy climate change mitigation-alignment.[46] These challenges include:

- The position that SMEs hold in the overall supply chain. SMEs individually often only cover a portion of the supply chain and can find it difficult to identify their eligibility under the Taxonomy. The study finds that relying on NACE codes only complicates the process.
- The DNSH criteria and the many references to EU legislation are not easy to understand for SMEs. SMEs should be able to navigate and understand Taxonomy criteria in the simplest and most proportionate way possible. Specifically, for those DNSH criteria that are based on existing legislation, SMEs should be able to understand easily whether they adhere to and comply with such legislation at jurisdiction level.
- The interpretation of Taxonomy criteria. Some criteria include ambiguous wording (such as "where feasible" or "key components"). This can pose challenges for SMEs to assess their alignment with the Taxonomy.
- The costs and lack of resources associated with conducting Taxonomy assessments and reporting. SMEs have limited technical and legal resources compared with larger companies, as they only need to disclose information to a limited number of business partners. This is confirmed by the study from DG GROW, which highlights the level of costs and resources required to understand Taxonomy requirements and collect, prepare, process and report the necessary information.[47]

46 Internal research commissioned by DG FISMA to Ramboll and Frankfurt School.

47 Internal EC study commissioned by DG GROW to Trinomics, Oxford Research and Syntesia (2023, forthcoming).

Voluntary use of a framework inspired by the EU Taxonomy by SMEs should be simple, practical and proportionate

The European Commission is paying special and explicit attention to enhancing access to sustainable finance for SMEs. The SME relief package released in September 2023 and the guidance on transition finance encourage large companies and financial intermediaries to apply the principle of proportionality when engaging with SMEs and to exercise restraint when requesting information from SME value chain partners, suppliers and customers.

The European Commission takes a similar proportionate approach across EU legislative acts establishing EU funding instruments, most notably Regulation (EU) 2021/523 establishing the InvestEU Programme, Regulation (EU) 2021/241 establishing the Recovery and Resilience Facility, and the associated technical guidance.

These regulations have adapted or simplified the EU Taxonomy criteria to fit the specific context that such funding instruments operate in, including, in the case of InvestEU, a simplified approach to financing aimed at SMEs.

How the InvestEU Programme and the Recovery and Resilience Facility make use of the EU Taxonomy for SME finance[48]

The regulation establishing the InvestEU Programme includes 1) a climate and environmental tracking system which monitors the contribution of the InvestEU Fund to the achievement of the EU's climate targe, [49] and 2) a sustainability proofing mechanism, which assesses whether investment projects have an environmental, climate or social impact. Both were developed using, where appropriate, the criteria established in the EU Taxonomy Regulation for determining whether an economic activity is environmentally sustainable, including the DNSH principle. In addition, the InvestEU Regulation states that guidance should include adequate provisions for undue administrative burdens, and projects below a certain size should be excluded from the sustainability proofing. As a result, the sustainability proofing guidance contains a specific section with a simplified sustainability proofing approach that can be applied for intermediated debt products aimed at SMEs. A similar approach was taken for the InvestEU Climate and Environment Climate Tracking Guidance, with its Annex 4 specifically developed for tracking climate and environmental sustainability finance provided mostly to SMEs via intermediated financing portfolios of banks, guarantee institutions and fund managers. Several funding instruments use this guidance. An example of this is the Sustainability Guarantee Product, described in Box X below.

The regulation establishing the Recovery and Resilience Facility (RRF) states that the Facility should support activities that fully respect the Taxonomy Regulation's DNSH principle, and that the Commission should provide technical guidance on how DNSH criteria should apply in the context of the RRF. The technical guidance that the Commis-

48 The following paragraphs showcase how InvestEU and the RRF integrate the EU Taxonomy and do not intend to showcase how these frameworks should be used as an alternative to the Taxonomy in the context of the EU Taxonomy Regulation.

49 European Commission (2021), Commission Notice on the InvestEU Programme climate and environmental tracking guidance

sion subsequently developed describes how member states should design and assess measures for compliance with the DNSH criteria. This guidance is not specific to SMEs but provides a step-by-step guide and high-level principles for the DNSH assessment. It recognises the significance of compliance with existing EU legislation in showing absence of harm, such as through environmental impact assessments, but concludes that legal compliance may not always be sufficient in demonstrating compliance. The guidance sets out a checklist for the assessment (annex I), a list of supporting evidence that can be used in the assessment (annex II), an exclusion list for the most harmful activities (annex III), and examples of positive DNSH assessments that member states can use as a basis (annex IV).

When it comes to financial instruments, the RRF relies on the InvestEU sustainability proofing mechanism, combined with the RRF exclusion list, given that the latter is more stringent than exclusions set out in the annex of the InvestEU Regulation.

Conclusion

While SMEs already benefit from access to sustainable finance via promotional banks or government programmes, access from sources of private finance remains limited due to various challenges on both the supply and demand sides. The studies conducted by the EU PSF and the EU Commission over recent months confirm numerous challenges associated with the use by SMEs of the EU sustainable finance framework and offer recommendations for improvement.

Building on all the above, the extensive studies mentioned and regulatory precedents, the PSF will develop a simplified and voluntary approach, inspired by the EU Taxonomy, to apply to and be used by SMEs. SMEs should be able to make use of the sustainable finance framework to support their own transition, fulfil direct and indirect reporting obligations, and improve their access to green finance from banks and investors, in line with the European Commission's commitments made in the SME Relief Package. Overwhelming evidence from the studies and surveys encourage a coordinated development and coherent application of voluntary sustainability standards for SMEs across the EU.

Accordingly, banks and investors should further raise awareness about the EU sustainable finance framework and, in particular, the EU Taxonomy with their SME clients. They should make use of the tools provided by the framework, including public incentive measures, report their Taxonomy-aligned SME exposures in the green asset and investment ratios (GAR and GIR) and progressively meet demand for SME green lending.

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Annex: Market practices from stakeholder groups

Market practices are available in a separate Annex document accessible here.