Commission de Surveillance
du Secteur Financier

Taxonomy Regulation Disclosures by Issuers

Results of a focused examination on corporate reporting practices

December 2023

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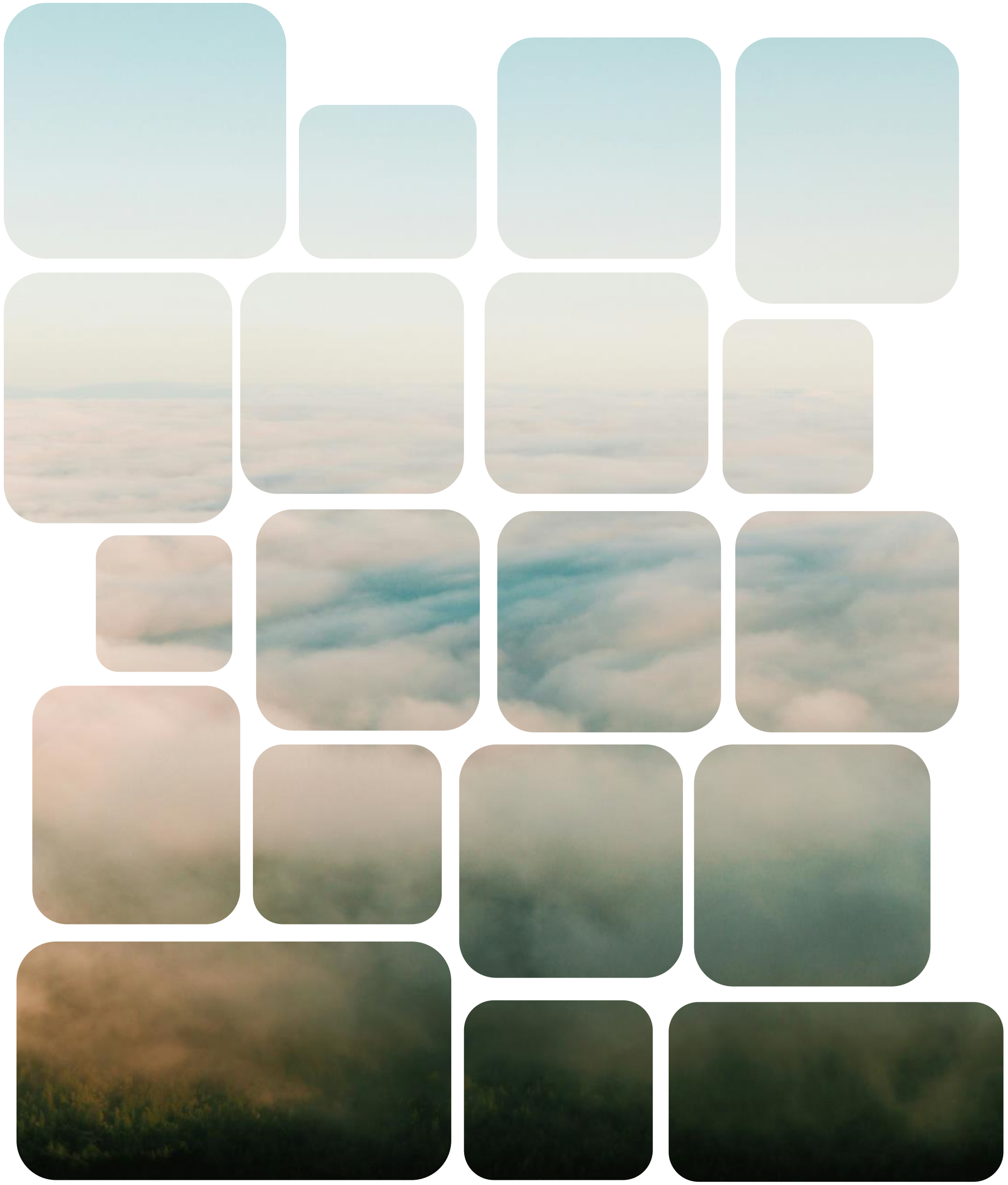


Background

2023 marked a major step for the reporting under Article 8 of the Taxonomy Regulation. Indeed, in 2023, for the first time, non-financial issuers are required to disclose not only the taxonomy eligibility, but also the alignment of their economic activities for the financial year 2022 with the first two environmental objectives set out in the Taxonomy Regulation : climate change mitigation and climate change adaptation (including activities covered by the Complementary Climate Delegated Act on fossils gas and nuclear energy)

The information to be disclosed as well as the timing for the disclosure are specified in the Disclosures Delegated Act (DDA).

Objective

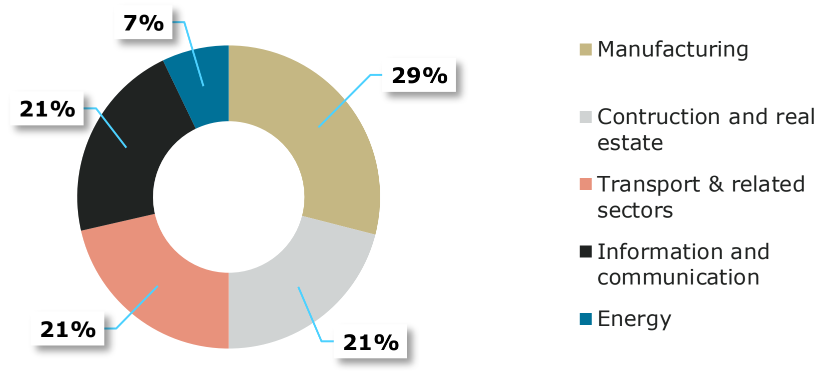
In 2023, the CSSF has examined the Taxonomy reporting to evaluate the quality of the disclosures provided by non-financial issuers under the new requirements of the Taxonomy Regulation. This report includes the summary of the main findings of this review.

Scope and methodology

The CSSF has therefore carried out a focused examination of the information disclosed under Article 8 of the Taxonomy Regulation as from 1 January 2023 for a selection of non-financial issuers under its supervision having economic activities eligible under the Taxonomy Regulation.

The figure hereafter outlines the sectors of issuers selected for the purpose of this report:

Sectors of activity in the sample



Regarding quantitative information, the CSSF has assessed:

- the use and completeness of the templates required by Annex II of the DDA,
- the adequate reporting of the different Key Performance Indicators (KPIs), and
- the avoidance of double counting for activities contributing to both climate objectives (mitigation and adaptation).

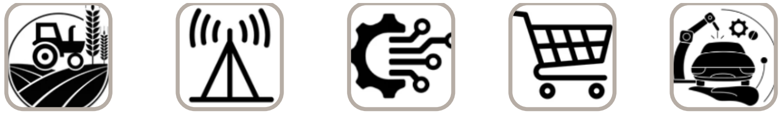
For qualitative information, the accounting policy and the assessment of compliance with Annex I of the DDA were examined, as well as the existence of references to other parts of the financial or non-financial statements. Finally, the disclosure of additional voluntary information was also analysed.

When reviewing the reports prepared by issuers, the CSSF undertook a more in-depth analysis of the areas where more clarity was deemed necessary or where incorrect application had been identified, and further action was taken by the CSSF accordingly.

Main findings on the assessment of eligible and aligned economic activities

The CSSF notes that among all the non-financial issuers under its supervision subject to the reporting requirements under the Non-Financial Reporting Directive (NFRD) and Article 8 of the Taxonomy Regulation, **46%** have identified economic activities that are to be considered taxonomy-eligible.

Issuers in the below industries did not report any taxonomy-eligible activities for the climate objectives for 2022, i.e. their activities don't qualify as activities that can make a substantial contribution to climate change mitigation and climate change adaptation:



Agricultural producers | Tele-communication | Industrial services | e-commerce & retail | Automotive

The fact that some or all activities may not yet be included in the list provided by the Taxonomy does not necessarily mean that they are unsustainable. As of today, the EU Taxonomy is still evolving and the criteria may not have been developed yet. Therefore, the activities are simply not eligible for the time being.

> The evaluation of the eligibility of each sector/industry is likely to undergo changes as a result of the European Commission's work, and it will be important for issuers to put in place regulatory watch procedures as regards future developments.

The share of taxonomy-eligible activities is likely to increase with the introduction of the non-climate environmental objectives, for which issuers will also have to consider the eligibility of their economic activities as from 2024 (for Taxonomy reporting 2023).

Assessing the eligibility of issuers' business of the economic activities defined in the Climate Delegated Act (CDA) may be challenging for specific activities as little guidance exists.

For example, one reviewed issuer incorrectly reported an activity as eligible through an internal assessment by analogy to other taxonomy-eligible activities, although it cannot yet be considered as such by the Taxonomy Regulation. Even though the issuer considers that its activity significantly contributes to one of the environmental objectives, an assessment by analogy is not permitted. Indeed, comparability of Taxonomy reporting between issuers would be affected and criteria for not doing significant harm may not be adapted.

> For the purpose of identifying taxonomy-eligible activities, the European Commission released the EU Taxonomy Compass, an online tool which aims at making the contents of the Taxonomy Regulation more easily accessible for a variety of users.

Another issuer confused the assessment of eligible and aligned activities. Whereas its main business should be considered as eligible, the issuer only disclosed as eligible the part of its business which was taxonomy-aligned.

The CSSF draws the attention of issuers to the FAQs on EU Taxonomy, and notably to FAQ 3 of the Taxonomy-Eligibility reporting (part 2) FAQ document, in order to assist them in assessing the eligibility of their activities, and to the stakeholder request mechanism set up by the Commission when this assessment is not straightforward.

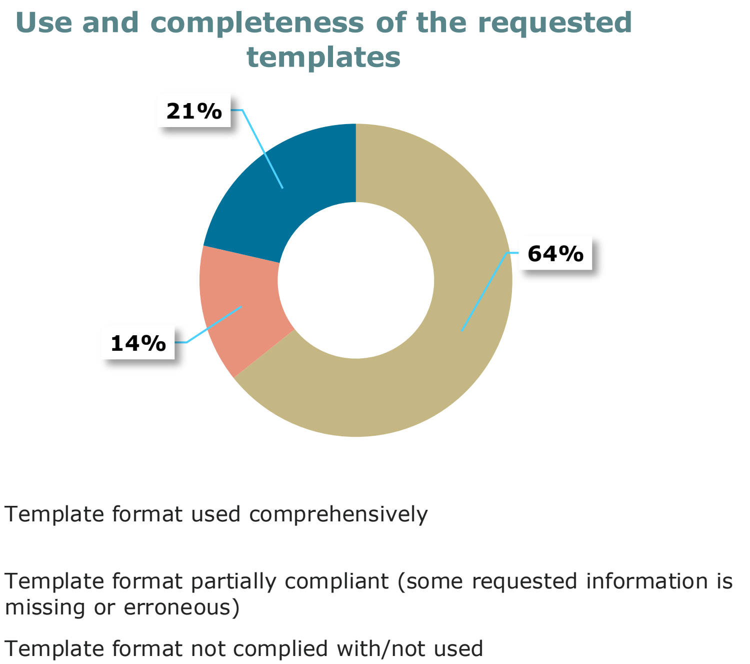
Main findings on reporting of quantitative information

Use of mandatory templates

All but one of the issuers reviewed disclosed the quantitative information regarding the KPIs in tables as required by Article 2 of the DDA. However, the CSSF noted that several issuers took liberties with the templates and/or filled them in incorrectly, thus potentially misguiding users' understanding of the KPIs.

The main departures identified concerned:

- Incomplete templates (rows and/ or columns missing or merged),
- Missing information regarding Do No Significant Harm (DNSH) criteria ("n/a" instead of "Yes"),
- DNSH columns filled in where the DNSH criteria do not apply ("Yes" instead of "n/a"),
- Section totals omitted.



The CSSF reminds issuers that, independently of the level of eligibility and alignment of the respective economic activities, they shall use the templates set out in the DDA without any modification.

The CSSF also draws the attention of issuers to the revised version of the DDA, which includes amendments to the mandatory templates.

KPIs - reporting & calculation

The table below summarises the rounded average proportion of taxonomy-eligible activities which the reviewed issuers have reported as aligned or not for each of the 3 KPIs, i.e. Turnover, CapEx and OpEx:

Sectors	Turnover		
	A.1. Aligned	A.2. Not aligned	B. Not eligible
Manufacturing	10%	65%	25%
Construction & real estate	10%	33%	57%
Transport & related sectors (with fleet)	< 1%	90%	10%
Transport & related sectors (freight forwarder)	5%	< 1%	95%
Information & communication	5%	< 1%	95%
Energy	20%	< 1%	80%

Sectors	CapEx		
	A.1. Aligned	A.2. Not aligned	B. Not eligible
Manufacturing	5%	50%	45%
Construction & real estate	10%	33%	57%
Transport & related sectors (with fleet)	< 1%	90%	10%
Transport & related sectors (freight forwarder)	< 1%	10%	90%
Information & communication	< 1%	10%	90%
Energy	33%	< 1%	66%

Sectors	OpEx		
	A.1. Aligned	A.2. Not aligned	B. Not eligible
Manufacturing	10%	75%	15%
Construction & real estate	10%	33%	57%
Transport & related sectors (with fleet)	< 1%	90%	10%
Transport & related sectors (freight forwarder)	< 1%	10%	90%
Information & communication	< 1%	< 1%	98%
Energy	15%	< 1%	85%

The difference observed between eligibility and alignment shows that the concerned issuers have potentially considerable room to adapt their activities, technologies, or processes to reach higher Taxonomy alignment rates.

Some of the issuers reviewed have encountered difficulties when calculating KPIs:

- CapEx: some components of the Total CapEx (denominator) as defined in Annex 1 of the DDA were sometimes missing.

The denominator of the CapEx KPI shall cover the additions to tangible and intangible assets during the financial year, including those resulting from business combinations, and additions to right-of-use assets.

- OpEx: a few issuers misunderstood the definition of Operating Expenditure in accordance with the DDA and considered instead their total operating expenses as the denominator of the OpEx KPI.

The denominator of the OpEx KPI shall cover direct non-capitalised costs that relate to research and development, building renovation measures, short-term lease, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of assets of property, plant and equipment by the undertaking or third party to whom activities are outsourced that are necessary to ensure the continued and effective functioning of such assets.

Main findings on reporting of qualitative information

Annex I Section 1.2 of the DDA requires non-financial issuers to provide qualitative information which accompanies the KPIs.

Accounting policy

The CSSF noted that most issuers provided to some extent satisfying disclosures accompanying the KPIs. Some issuers however provided only partial or no explanation at all.

For those issuers for whom the information on how turnover, CapEx and OpEx were determined and allocated to the numerator was incomplete or missing, the CSSF requested additional information to better understand how the data in relation to the KPIs would comply with the Taxonomy regulation.

Furthermore, the CSSF noted that not all issuers included references to the related line items in the financial statements. Where references were provided, the reconciliation was mostly straightforward.

> The CSSF reminds issuers that the disclosures about the basis of determination of KPIs should be tailored to their respective businesses and situations.
>
> References to the related line items in the financial statements are key for an understanding of the determination of the KPIs.

Assessment of compliance

The CSSF was able to identify certain good practices among the disclosures reviewed. In general, issuers provided qualitative information to support the assessment of compliance with the Taxonomy Regulation. Most issuers provided a description of the nature of the taxonomy-eligible and aligned economic activities.

Furthermore, when assessing the alignment of their activities, almost all issuers provided specific information on the technical screening criteria (TSC) for substantial contribution and DNSH which their activities complied with or not.

The type of assessment conducted regarding the compliance with the criteria of Minimum Safeguards was sometimes described, although not always enough elaborated.

Explanations on how issuers avoided any double counting in the allocation in the numerator of KPIs across economic activities were not homogeneous. Most issuers did not provide any explanation at all but some provided a detailed or partial explanation.

> The CSSF reminds issuers of the requirement to include an explanation on assessment of compliance with the Taxonomy Regulation and the TSC included in the DDA.
>
> The CSSF also recommends issuers, when providing a description of the nature of the taxonomy-eligible and aligned economic activities, to complement such descriptions with information on the taxonomy non-eligible economic activities in order for the reader to better understand which activities are concerned and the reason why they are non-eligible.

Contextual information

The CSSF noted that contextual information relevant for an understanding of the nature of the KPIs was disclosed to a certain extent. As such, for the turnover KPI, issuers should, amongst others, provide information about the amounts related to taxonomy-aligned activities pursued for own internal consumption.

Information on CapEx plans has been addressed by issuers to a minor extent.

Although all but one issuer reviewed disclosed quantitative information on the OpEx KPI, accompanying qualitative information which should be provided to explain and further contextualise the OpEx KPI has not been satisfyingly addressed by issuers in their reports.

The CSSF reminds issuers that the DDA requires to provide contextual information to accompany the KPIs disclosed. This explanation shall notably include:

- a quantitative breakdown of KPIs,
- a qualitative explanation of key elements of change, and
- key information about the CapEx plan if any.

The CSSF expects issuers to significantly improve contextual information essential to gain a better understanding of the KPIs reported.

Main findings on voluntary reporting

The DDA does not preclude voluntary disclosures of undertakings' activities. On the contrary, all undertakings subject to the reporting obligation are encouraged to voluntarily report any relevant additional information where they consider that this is relevant for investors to gain a better understanding of the taxonomy-eligibility and alignment of the entity's activities.

Nevertheless, and as a general principle for all undertakings, voluntary disclosures are not part of the mandatory disclosures under Article 8 of the Taxonomy Regulation and entities should always explain the reasons for making such disclosures.

When publishing voluntary information on KPIs, specifically if a CapEx or OpEx measure is not calculated in strict compliance with the definition provided in the Taxonomy Regulation, it should be considered as an APM and should be treated in accordance with ESMA APM Guidelines.

In the context of the focused examination, the CSSF has not reviewed the voluntary reporting by entities not subject to any mandatory Taxonomy reporting requirement but has assessed the voluntary information provided by issuers with eligible activities. **21%** of the issuers examined provided voluntary information. Such information has been provided mainly in the templates for KPIs by filling in substantial contribution and DNSH criteria for activities listed under A.2 Taxonomy-eligible but not environmentally sustainable activities (i.e., not taxonomy-aligned activities).

When the information consisted of comparatives or additional information provided in the templates, it was easily identifiable. In addition, the basis for the disclosures and the methods of preparation have been presented by all issuers providing voluntary information.

Moreover, some issuers disclosed potential taxonomy-aligned activities with respect to the remaining four environment objectives.

However, the CSSF noted the following issues in the voluntary information disclosed:

- The method of preparation was not in conformity with the regulation (e.g.: assessment by analogy);
- Almost all issuers failed to explain how and to what extend the voluntary information differed from the mandatory disclosures – the information was either boilerplate or not entity-specific;
- Some issuers mixed-up their voluntary and mandatory reporting which obscured the information disclosed.

When assessing and possibly voluntarily disclosing an activity's future eligibility or alignment, issuers should avoid disclosures which may lead to any suspicion or risk of greenwashing. This information should at least be clearly separated from the compulsory disclosure.

Closing remarks

Platform on Sustainable Finance

The Platform on Sustainable Finance advises the European Commission on the implementation and usability of the EU Taxonomy and on the technical screening criteria for the EU Taxonomy.

The CSSF draws the attention of issuers to the recently launched stakeholder request mechanism, where issuers are provided the opportunity to notify the Platform on Sustainable Finance about activities they believe should be covered by the EU Taxonomy.

2024 Priorities

The CSSF reiterates that ESMA has set the disclosures to be reported by issuers relating to Article 8 of the Taxonomy Regulation as its first priority when it comes to non-financial statements disclosure requirements. As highlighted by ESMA, it should be of significant merit to improve the disclosures on the compliance assessment with the substantial contribution as well as the DNSH criteria.

Furthermore, issuers should consider providing disclosures about their CapEx plans which would enable investors to understand issuers' efforts to expand their taxonomy-aligned activities.

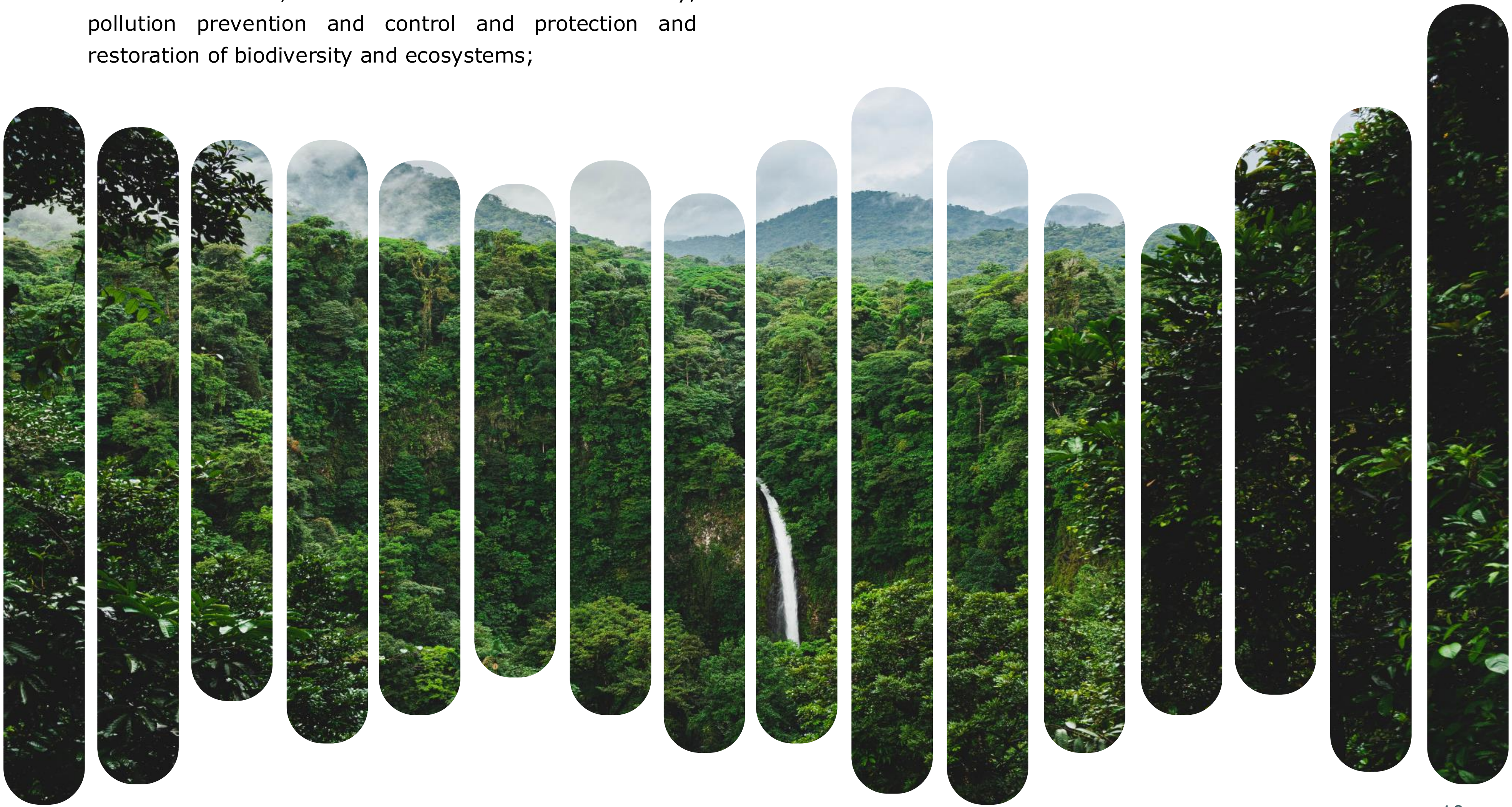
The CSSF will continue to challenge issuers on the issues identified in this report and will thoroughly assess how they comply with the requirements set in this regulation. The CSSF is aware that this regulation is complex and that a certain learning and adaptation period is therefore expected.

Updated Taxonomy Regulation

On 27 June 2023, the European Commission adopted:

- The Environmental Delegated Act, regarding criteria for economic activities making a substantial contribution to one or more of the non-climate environmental objectives, namely: sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and protection and restoration of biodiversity and ecosystems;
- Amendments to the DDA;
- Amendments to the CDA.

This updated regulation will be applicable as from 2024 (for Taxonomy reporting 2023).



Commission de Surveillance du Secteur Financier
283, route d'Arlon
L-2991 Luxembourg (+352) 26 25 1-1
direction@cssf.lu
www.cssf.lu